The International Budget Project

Joel Friedman

A Guide to Tax Work for NGOs

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Acronyms

CAA	Children's Action Alliance
CAFOD	Catholic Agency for Overseas Development
CBA	Centre for Budget Advocacy (in ISODEC)
CBPP	Center on Budget and Policy Priorities
CRS	Catholic Relief Services
CTJ	Citizens for Tax Justice
EITI	Extractive Industries Transparency Initiative
GDP	Gross domestic product
HIPC	Highly Indebted Poor Countries
IAG	International Advisory Group (of the EITI)
IBP	International Budget Project
IFI	International financial institutions
IMF	International Monetary Fund
IPF	Institute for Public Finance
ISODEC	Integrated Social Development Centre
NGO	Non-governmental organization
OECD	Organisation for Economic Co-operation and Development
PFMC	Public Finance Monitoring Center
PSC	Production-sharing contract
PWYP	Publish What You Pay
RWI	Revenue Watch Institute
SFAI	State Fiscal Analysis Initiative
SOFAZ	State Oil Fund of the Azerbaijan Republic
TJN	Tax Justice Network
UK	United Kingdom
US	United States
VAT	Value-added tax
WBI	Women's Budget Initiative

Foreword

The International Budget Project (IBP) is pleased to release *A Guide to Tax Work for NGOs*, as we believe there are exciting and important opportunities for civil society to influence revenue policy in countries around the world. Tax work is a logical next step for civil society engagement with the budget, building on the successes that civil society groups have had on the expenditure side of the budget.

The idea of producing a guide to tax work was discussed at IBP even before the ink was dry on *A Guide to Budget Work for NGOs*, which was published in 2001. The process of making the guide a reality, however, did not begin in earnest until 2005, with Joel Friedman leading the effort. Joel is a senior fellow at the Center on Budget Policy Priorities (CBPP), specializing in U.S. budget and tax policy, and thus has first-hand experience with the type of "tax work" described in the guide. He has also worked extensively with the IBP on budget transparency and other issues over the years.

While Joel directed the process, he received essential support from two research assistants at CBPP. Without the help of Ruth Carlitz, the first draft of the guide would never have been completed. She provided invaluable support researching and writing sections of virtually every chapter. Similar assistance at the end of the process was provided by Aviva Aron-Dine, whose superb contributions and willingness to dig into any issue ensured that the guide continued to move steadily on the path to completion.

Three other individuals were also closely engaged with preparing this guide, and deserve special thanks. Ian Gary of Oxfam America drafted a detailed manuscript on the extractive industries that served as the basis for Chapter 12, and he provided essential guidance on these issues throughout the process. Albert van Zyl, a Senior Budget Analyst at IBP, did all of the initial legwork on the tax administration chapter and portions of the tax-reform discussion. Debbie Budlender of Community Agency for Social Enquiry offered astute comments on early drafts of the guide and then, with her exceptional editing skills, helped shape the final version of the guide.

CBPP is one of the pioneers in applied budget work, and the IBP has always benefited from its association with CBPP, learning from the experiences and insights of those who work there. This guide is no different. Isaac Shapiro, the former head of IBP, played an important role in conceptualizing and steering the content of the guide. In addition, Martha Coven, Jason Furman, Nick Johnson, Iris Lav, and John Springer played crucial roles at various stages commenting on, editing, and re-writing portions of the guide. At the IBP, Vivek Ramkumar also offered very helpful comments, and Rocio Campos skillfully shepherded the guide through the design and printing phase.

We also benefited from the valuable comments of a number of reviewers and friends of the IBP: Vitus Azeem of ISODEC, Kathleen Barnett of the International Center for Research on Women, John Christensen of the Tax Justice Network, Julie McCarthy of the Revenue Watch Institute, Carlos Monge of Grupo Propuesta Ciudadana, Richard Murphy of Tax Research LLP; Katarina Ott of the Institute of Public Finance, and Henry Parham of Publish What You Pay.

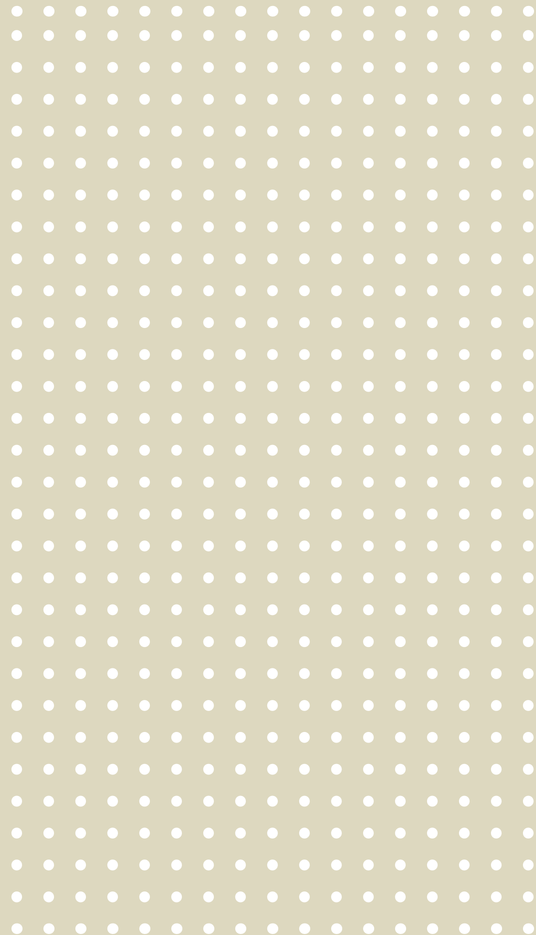
Finally, the guide would not have been possible without the intellectual and financial support of the Ford Foundation, the Open Society Institute, and the William and Flora Hewlett Foundation. These foundations provide support to IBP not only for this guide, but also for our other efforts to bolster budget transparency and expand the influence of civil society in the budget process.

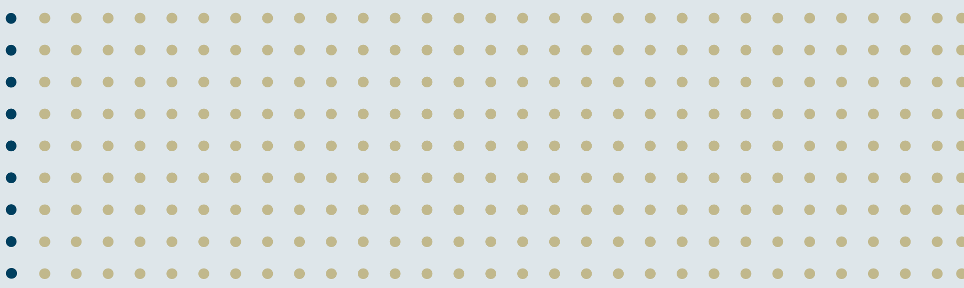
The IBP is constantly inspired by the innovative budget work being carried out by civil society groups around the world. We hope that this guide will aid these groups in their future endeavors, strengthen their ability to influence tax policy, and ultimately help them ensure that government is more responsive and accountable to the needs of its citizens, particularly the disadvantaged.

Warren Krafchik
Director, International Budget Project
October 2006

PART ONE

Introduction to Civil Society Revenue Work





1 Introduction

The budget is one of the most important public documents produced by a government, expressing its priorities and commitments. It is the place where a government proposes how much revenue it plans to raise and how it plans to use these funds to meet the nation's competing needs, from bolstering security to improving health care to alleviating poverty. Given its wide-ranging implications for a nation's citizens, the budget should be the subject of widespread scrutiny and debate.

Over the past decade, civil society groups and researchers have become increasingly involved in assessing and influencing the budgets of their countries. Among developing and transitional countries, this type of "applied budget work" first took root in middle-income countries, such as Brazil, Croatia, India, Israel, Mexico, Poland, Russia, and South Africa in the 1990s. At the end of that decade, a second wave of civil society budget organizations emerged in low-income countries in Africa (Burkina Faso, Malawi, Uganda, Zambia), South and Central America (Bolivia, Ecuador, Honduras, Nicaragua, Peru), South Asia (Indonesia, Nepal), and Central Asia (Azerbaijan, Georgia, Kazakhstan).

This work has been shown to have a real impact, improving governance and reducing poverty in several countries. In Mexico, for example, the FUNDAR Center for Research and Analysis and a coalition of Mexican organizations undertook a successful campaign that resulted in both a substantial increase in federal funding targeted at reducing maternal mortality and a more equitable regional distribution of this funding. Another example is the Uganda Debt Network, which has contributed to efforts to eliminate corruption in the flow of government resources by building an effective community network to monitor whether funds intended for hospitals and schools are actually delivered. (In-depth case studies of six established budget groups are presented on the International Budget Project's website, http://www.internationalbudget.org/.)

Civil society groups around the globe have successfully overcome barriers to engaging in budget expenditure work over the past decade. Such success stories can be replicated in tax policy as more civil society groups take up tax work.

What This Guide Offers

In 2001, the International Budget Project published *A Guide to Budget Work for NGOs* to assist non-governmental organizations (NGOs) seeking information on how to assess and improve government budgets in their countries (Shapiro, 2001). Although the guide looked at the budget as a whole, its main focus was on expenditure programs.

A Guide to Tax Work for NGOs is intended to help demystify revenue policy issues and give civil society budget groups the tools they need to influence revenue policy in the same way that they have been able to influence expenditure policy. Groups that are knowledgeable about both sides of the budget—expenditure *and* revenues—will ultimately be more effective.

The main audience for the guide is civil society groups that focus on, or want to focus on, applied budget analysis. This would include groups that do not consider themselves to be "budget organizations" but that plan to use budget work as a way to strengthen their advocacy on the issues that are their primary focus.

The guide discusses revenue issues, and especially taxes such as the value-added tax and personal income tax. It provides a basic description of different tax types, discusses some of the key debates, gives examples from a range of countries, and provides ideas for revenue-related projects that groups might want to undertake.

The guide does not attempt to cover all the revenue issues that are important in developing and transitional countries. For instance, it focuses only on national-level taxes, not on local-level taxes. Nevertheless, it provides an introduction that we hope will build interest and confidence among civil society groups considering engaging in revenue work.

The guide is divided into four parts:

Part I—Introduction to Civil Society Revenue Work

Chapter 2 explains why civil society budget groups should engage with revenue issues. *Chapter 3* introduces budget groups to the major types of taxes. *Chapter 4* reviews the different stages of the budget process, examining issues and information related to revenues during each stage and pointing out where opportunities for civil society revenue work may exist. *Chapter 5* provides an overview of fairness and equity issues in tax policy and highlights the importance of tax administration.

Part II—Examples of Civil Society Revenue Projects

Chapter 6 presents examples of the types of revenue work that budget groups have undertaken to date. *Chapter 7* suggests some initial revenue-related projects that groups could undertake as they develop expertise in revenue issues. *Chapter 8* presents more advanced projects, such as analyzing tax proposals or assessing the distribution of the tax burden. This chapter also includes a toolkit of basic revenue-analysis techniques.

Part III—Selected Revenue Policy Issues and Civil Society Budget Work

Chapter 9 examines the personal income tax and the value-added tax in detail. *Chapter 10* summarizes some of the key issues related to tax administration. *Chapter 11* examines some tax policy issues currently facing many developing and transitional economies. *Chapter 12* outlines revenue and budget issues surrounding the extractive industries and describes current efforts to monitor oil revenues.

Part IV—Additional Resources and Bibliography

This final part of the guide includes two sections: one provides Internet links to the resources offered by many of the organizations discussed in the guide, and the other provides a bibliography of the materials used in developing this guide.

2 Why Civil Society Groups Should Get Involved in Tax Policy

Tax policy has a substantial impact on many of the core concerns of civil society groups, from ensuring the availability of funds for important social programs to narrowing the gap between rich and poor. In many countries, tax debates are dominated by businesses and wealthy individuals, who often do not have the same concerns as civil society groups. Civil society groups can help broaden the debate and bring a new focus on fairness and the needs of the disadvantaged to the discussion of tax policy.

Decisions on revenue issues are some of the most important that a government makes. Tax debates are sometimes perceived as technical, but at times they become heated and even volatile, leading to mass mobilizations. For instance, the imposition of a poll tax in the United Kingdom in 1990 led to riots and ultimately the demise of the administration of then-British Prime Minister Margaret Thatcher. In Bolivia in 2003, violent protests erupted when the government attempted to meet International Monetary Fund targets for deficit reduction by imposing a tax increase that was perceived as unfair (Shultz, 2005). Even in situations that are less extreme, it is vital that civil society be in a position to offer its perspective on tax policies so that that it can influence these policies and the impact they have on all citizens.

This chapter outlines ways in which working on taxes can advance the core concerns of civil society groups.

Reasons for Civil Society to Work on Tax Issues

- Ensure adequate sources of funding for important anti-poverty programs.
- Improve the distribution of income and wealth.
- Promote economic growth that can benefit all citizens.
- Enhance government transparency and accountability.

Ensuring Funding for Important Programs

Civil society groups choose to get involved in tax issues for the same reasons they become involved in the budget. No government program or policy can succeed without funds to implement or enforce it. Moreover, without taxes and other revenue flowing into its treasury, a government cannot commit to funding a program in the first place. Indeed, the first step in formulating a budget is typically determining the so-called "fiscal envelope"—the amount of money the government can afford to spend. Public expenditures in most countries are funded primarily by the taxes and fees levied by government, although in some countries, governments also finance expenditures through grants from foreign donors or loans from international financial institutions.

Knowing how the tax system works allows groups to engage in debates on the taxes and other sources of revenue needed to fund crucial government activities. Civil society groups can examine government revenue policies and assess their implications for the country's ability to maintain commitments to needed health, education, and welfare programs, as well as their impact on the country's overall fiscal position.

As part of their efforts to improve the integrity and transparency of budgets, for instance, groups can assess whether the government's revenue projections are realistic: whether the revenues assumed in the budget will in fact materialize. Political leaders can be tempted to inflate revenue figures so that a budget appears both to meet wide-ranging expenditure demands and to be fiscally responsible. But if actual revenues then fall short of projections, the government will have to cut expenditures, particularly if the country is already deeply in debt and has little flexibility to borrow more.

Under these circumstances, promised investments in social programs may be the first to be cut, as governments devote scarce resources to other commitments they view as more binding (such as debt service payments, civil service salaries, or pensions). Unfortunately, expenditures that target the poor are often the easiest to sacrifice, because the poor tend to be unorganized and politically weak. Civil society groups may find they can more easily defend these programs if they also engage with tax issues and work to ensure revenue adequacy. Moreover, if civil society groups are advocating new expenditure policies that require substantial funding, they can strengthen their case by proposing specific taxes or other revenue sources to pay for them.

Improving the Distribution of Income and Wealth

Tax policy influences the distribution of income and wealth in a country. Different groups face different tax liabilities under a country's tax code. Knowing how the tax burden is borne by these different groups—rich or poor, male or female, urban or rural, employers or workers—can help civil society advocate new, fairer tax policies.

Who bears the burden of a tax often depends on the tax base—for instance, whether a tax is levied on the income a person earns, or the goods and services a person consumes. Because poor people must spend a large share of their income simply to purchase basic necessities, taxing consumption can impose a heavier burden on the poor than the well-off. In contrast, income taxes are often structured in such a way that the tax burden rises as income rises. They tend to impose a heavier burden on those with the greatest ability to pay the tax and so have the potential to reduce income inequality.

How a tax is administered can also influence the distribution of income because it affects which groups of people actually bear the burden of taxation. Many countries have difficulty ensuring that people pay the taxes they owe. In some countries, taxpayers can bribe tax collectors in order to avoid paying taxes. Wealthy individuals and businesses tend to benefit the most from weak tax administration, since they owe the most in taxes and are better able to structure their affairs (or pay bribes) to evade the tax net. If the wealthy escape taxation, then other taxpayers, including lower-income people, bear more of the burden and the potential for reducing inequality through the tax system is reduced.

Finally, the levels of revenues collected and how these revenues are used also affect the distribution of income and wealth. As noted, consumption taxes often impose heavier burdens on the poor. But if a consumption tax is increased in order to fund a poverty-reducing expenditure program, such as primary education or health care, the overall effect can be to improve equity in the country. On the other hand, moderate-income households that seem to benefit from a tax cut may actually lose if the reduction in revenues necessitates cuts in expenditure programs.

Civil society groups can ensure that crucial equity issues are part of tax debates. Civil society participation is especially crucial since those outside government with the most influence on tax policies—typically businesses and the wealthy—are often concerned only with how a particular tax policy proposal will affect them directly, giving little attention to the proposal's broader impact on society.

Promoting Economic Growth That Benefits All

Economists continue to debate how to promote economic growth and what role tax policy can play. Tax policies can have an impact on a country's economy by influencing incentives to work, save, and invest. But economies are also heavily influenced by factors other than tax policies, including the regulatory environment, corruption, and commodity prices set in global markets.

Economists can provide insight into the impact of different tax policies on economic decisions, and research has given rise to certain "best practices" for tax design. At the same time, no single set of tax policies works everywhere because each country's circumstances are unique. Nor do the results of economic studies conducted in developed countries necessarily hold in developing countries.

Civil society groups can play an important role in evaluating tax proposals, assessing whether they are likely to achieve their stated goals and otherwise being skeptical of claimed benefits. For example, businesses may exaggerate the potential economic gains of certain tax breaks—such as tax incentives designed to encourage investment. Civil society groups can help provide a more realistic assessment of these proposals.

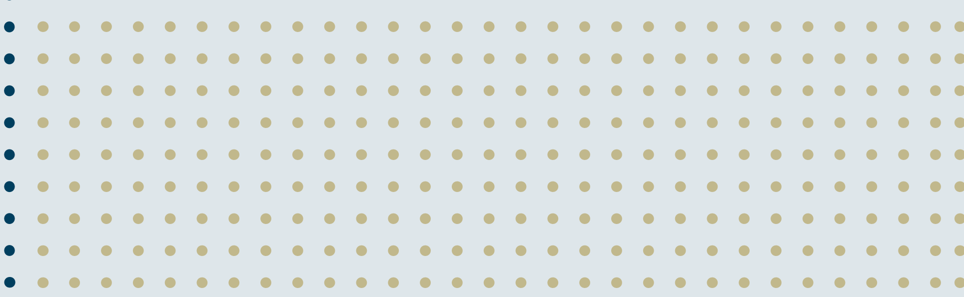
In addition, civil society groups can help ensure that the benefits of growth are shared widely throughout society, and that equity concerns are taken as seriously as economic concerns. The most "efficient" tax system—that is, the one that is theoretically most conducive to economic growth—will not necessarily promote a fair distribution of income and wealth. As a result, tax decisions are often portrayed as conflicts between equity and efficiency. In reality, most tax systems are far from optimal in terms of either efficiency or equity. Civil society groups can therefore look for opportunities to further both goals—for instance by strengthening the country's tax administration. When the goals of equity and efficiency conflict, then civil society groups should insist that revenue policies strike an appropriate balance between them.

Enhancing Government Transparency and Accountability

All of the issues covered in this chapter—ensuring funding for poverty-reducing programs, improving the distribution of wealth and income, and promoting the type of economic growth that benefits all citizens—are directly related to a broader concern shared by civil society groups: the desire to improve government transparency and accountability, so that budgets are responsive to the needs of the country and its citizens.

Currently, many countries lack a process through which governments and their citizens engage over tax policy. Relevant information is often not available in a timely manner, and there may be few official avenues for influencing tax policies. The problem may reflect weaknesses in the budget process generally. But it also may arise because tax issues are technical or complicated, making it easier for the government to sidestep debate and conceal the true implications of tax policies.

By educating the public about tax issues and promoting transparency in tax policy, civil society groups can overcome these barriers. Vigorous, open debate on tax policies is ultimately an essential ingredient for the development of a country's "fiscal social contract," whereby citizens are willing to pay taxes because they are confident that the tax system is fair and is raising revenue for valued programs and services (Moore and Schneider, 2004).



3 Major Types of Tax Revenue

Governments fund their activities in a range of ways. The main components of government revenue are typically consumption taxes, income taxes, and a range of non-tax revenues, including grants from donors (see box). The exact mix of revenue sources reflects economic, historical, and political factors specific to each country.

This chapter provides a brief overview of the different types of revenue that governments rely upon to fund their activities. More detailed discussions of the value-added tax, the personal income tax, tax administration issues, and revenues from extractive industries are presented in Part III of this guide.

Main Components of Government Revenue

Tax Revenue:

- Consumption taxes
  - o Value-added tax, sales taxes, excise taxes
  - o Trade taxes
- Income taxes
  - o Taxes on personal and business income
  - o Social security and payroll taxes
- Wealth taxes

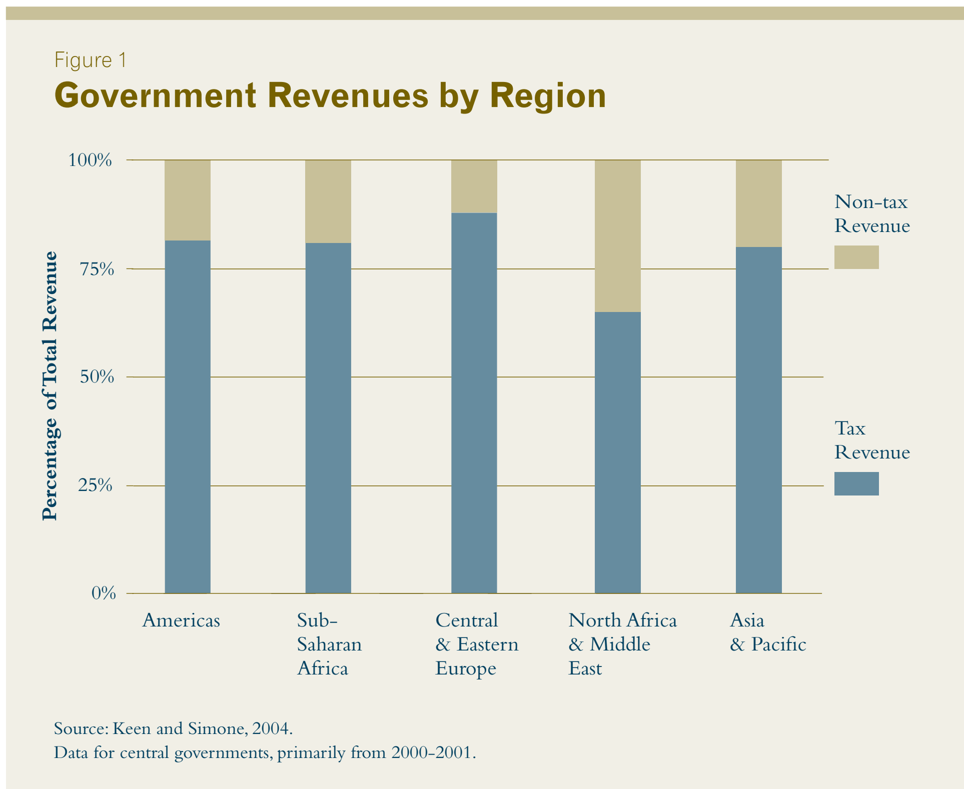
Non-Tax Revenue:

- Grants from donors
- Income from public enterprises
- Income from natural-resource extraction
- Administrative fees and charges
- Fines and penalties

Tax and Non-Tax Revenues

This guide focuses primarily on tax revenues. A tax is a compulsory transfer from individuals and businesses to the government. It is not paid in return for any specific government service. Nevertheless, tax-paying citizens are still likely to expect government to provide certain services or benefits using the tax money it collects. (Sometimes, this linkage is even more direct; for instance, countries may link an individual's level of retirement benefits to the payroll taxes he or she has paid.)

In addition to taxes, there is a range of non-tax revenue sources. These can include grants from international institutions and foreign governments and user fees for government services. In countries where natural resources (oil, minerals, timber, etc.) play a dominant role in the econ-



omy and where the government owns those resources, governments often receive substantial non-tax revenue from transactions related to extractive industries.

Some non-tax revenues—such as foreign aid or oil revenues—do not come directly out of citizens' pockets. Citizens may thus be less concerned about how these funds are raised and allocated. But citizens should be concerned about all revenue that government raises, since all of these funds have the potential to contribute to society's well-being.

Most countries derive more revenue from tax than non-tax sources. Data from the International Monetary Fund (IMF) indicate that, on average, tax revenue represents more than three-quarters of total revenue. Non-tax revenue can be a significant source of revenue in particular countries, however, such as those that are heavily dependent on foreign assistance or on revenue from extractive industries. Figure 1 shows that the region that includes the oil-rich Middle East derives a significantly larger share of revenue from non-tax sources than other regions.

Some sources of non-tax revenue can impose a heavy burden on certain groups, including the poor, even when they do not account for a significant proportion of total revenue. This can be the case, for instance, when governments charge fees for

health care, education, or other services. This guide does not focus in detail on non-tax revenues other than the discussion of the extractive industries in Chapter 12. Some of the tools presented in Part II for analyzing tax revenue can, however, also be applied in analysis of non-tax revenue.

In comparing revenue levels across countries, the standard way to measure them is as a share of the economy (gross domestic product, or GDP). Table 1 shows that developed countries generally raise more revenue relative to the size of their economies than developing countries. Some people believe that developing countries should push for higher levels of revenue in order to expand the level of services. Others argue that it is neither feasible nor appropriate to increase revenues given the depth of poverty in many developing countries.

Table 1

Amount and Sources of Government Revenue

	(Percent of GDP)		
	Total Revenue	**Tax Revenue**	**Non-Tax Revenue**
Low-income countries	18.0	14.9	3.1
Lower-middle–income countries	22.0	16.0	6.1
Upper-middle–income countries	25.6	21.0	4.6
High-income countries	32.8	27.5	5.3

Source: Keen and Simone, 2004.
Data for central governments, primarily from 2000-2001.

Major Tax Types

Every tax is characterized by a tax base and a tax rate. Typical tax bases include consumption, income, and wealth.

Consumption Taxes

Value-added taxes, general sales taxes, and excise taxes are all types of consumption taxes—that is, taxes based on the consumption of goods and services. Goods can also be taxed when they cross country borders. Such "trade taxes" or "tariffs" are common in developing countries, in part because they are more easily administered than many other taxes. Environmental or pollution taxes also can take the form of consumption taxes or excise taxes (see box on next page).

Environmental Taxes

Environmental taxes are an example of how taxes can be used to put a price on activities that are considered harmful for society as a whole. For instance, a manufacturing plant may emit pollutants that have high environmental and health costs, but that impose little or no monetary cost on the manufacturer. In such a case, a government can levy a tax on the manufacturer to reflect the cost to society of the effects of the pollution. Many economists believe that such taxes enhance economic efficiency by inducing businesses and individuals to take into account the social costs of their decisions.

Some countries have imposed environmental taxes directly on the emission of pollutants. While emissions taxes are more common in developed than developing countries, China has implemented taxes on air and water pollutants, as have several Eastern European countries. In most cases, the primary goal of emissions taxes is not to raise revenue but to reduce emissions, and countries with emissions taxes have often dedicated the limited revenue these taxes raise for environmental programs.

Emissions taxes can be challenging to administer because measuring companies' emissions output can be difficult. An excise tax on fuels such as gasoline or natural gas is another kind of environmental tax; it is much easier to implement, though it may not be as efficient as an emissions tax in targeting pollutants. Excise taxes are much more common than emissions taxes and are typically more significant sources of revenue.

Consumption taxes are generally levied on goods and services when they are sold. Consumers bear the burden of consumption taxes, but they typically are not the ones who actually pay the tax to the government. Instead, businesses are responsible for collecting the tax when a transaction occurs, and they then remit the receipts to the government. For this reason, consumption taxes are known as "indirect" taxes: taxes under which consumers do not pay the tax directly but rather indirectly through businesses.

Consumption taxes can impose a heavy burden on the poor because the poor spend a larger share of their income than those who are better off, who are able to save more of their income. Any funds that are saved (i.e., not consumed) are not subject to a consumption tax. As a result, consumption taxes are levied on a smaller share of the income of well-off households than low-income households.

Some countries attempt to address equity concerns regarding consumption taxes by exempting certain basic necessities, such as food items or health care, from taxation. It is sometimes difficult, however, to target such tax relief effectively. Further,

exempting large numbers of items from taxation reduces the revenue raised by the tax, which may force the government to apply higher tax rates to the remaining taxable items to generate needed revenues.

Equity concerns surrounding consumption taxes may be mitigated to some extent if the expenditure programs these taxes fund have a positive impact on the poor. For example, in Ethiopia, IMF economists found that even though the country's shift to a value-added tax increased tax burdens for the poor, the change had the potential to benefit the poor if the revenue raised were devoted to primary education and health programs (Munoz and Cho, 2003).

The value-added tax (VAT), which is the most prevalent type of consumption tax, is discussed in further detail in Chapter 9. In many countries, the VAT has taken the place of a general sales tax. While both the VAT and the general sales tax are levied on the consumption of goods and services, they are administered very differently. The VAT is imposed at every step of the production process, while the sales tax is imposed only when the consumer buys the finished product. By collecting taxes at multiple stages of the production process, the VAT makes it harder for some people to avoid paying their taxes.

Income Taxes

Income taxes are levied on individuals and businesses. Income taxes are known as "direct" taxes, since the person (or business) who owes the tax is directly responsible for paying it to the government.

The personal income tax is imposed on income earned through work. It can also be levied on income from investments. Earnings from work can also be subject to "payroll taxes" or "social security taxes." (Often these taxes are used to finance social insurance programs, such as unemployment, health care, or retirement benefits, rather than becoming part of general government revenue.) Most income taxes levied on businesses are imposed on their profits; that is, the tax only applies to income after expenses have been deducted from receipts.

Income taxes can be structured so that they impose a larger burden on the well-off than on the poor. For instance, income taxes often have a graduated rate structure, meaning that higher tax rates are imposed on higher levels of income. Further, most income taxes are designed to exclude from taxation people or businesses with incomes below a certain level.

However, special exemptions or deductions are also provided to *wealthy* individuals and businesses. Sometimes these exemptions have the stated goal of encouraging certain activities (such as investing in a particular sector of the economy). Sometimes they are introduced simply because these powerful groups were able to influence the political process. All these special exemptions and deductions require higher tax rates on everyone else to raise the same level of revenue. Further, such exemptions and deductions can make a graduated income tax less equitable than it appears. Equity may also be undermined if wealthy individuals and businesses are able to evade the tax.

The personal income tax is discussed in further detail in Chapter 9.

Wealth Taxes

Taxes can also be imposed on wealth. Wealth taxes are normally levied on individuals' "net worth," which is their assets (such as investments, house, and other property) minus their liabilities (such as a mortgage or other debt). Wealth taxes are considered to be direct taxes.

In some countries, wealth taxation takes the form of a "transfer tax," which is a tax on wealth when it is transferred from one person to another. Gift taxes and inheritance taxes are two types of transfer taxes. Taxes on property such as land are also wealth taxes and are a common source of revenue for local governments.

Wealth tends to be more highly concentrated than income or consumption. Thus, taxes on wealth are generally viewed as targeting those who are the most well-off. In some cases, however, the tax can be shifted to those who have lower incomes. For instance, a landowner could shift the burden of a property tax on to his or her tenants by increasing their rent by the amount of the tax.

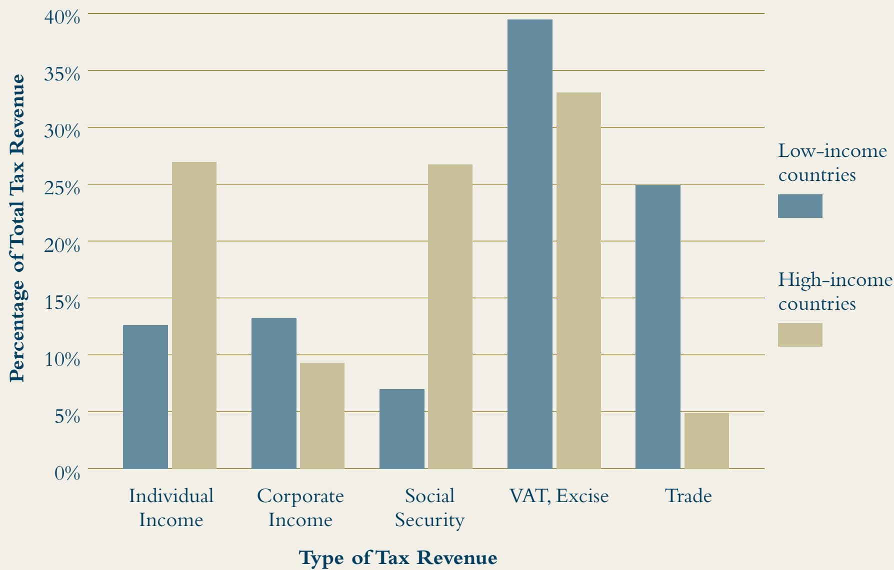
The Tax Mix

In general, a country does not want to be overly reliant on a single source of revenue. However, it also does not want to have to administer too many different types of taxes. Further, different tax types must fit together in a coherent manner to avoid creating loopholes that can generate unintended opportunities for tax avoidance.

Internationally, the VAT is the most common tax and represents the largest source of tax revenue in most countries.

Figure 2

Contribution of Major Tax Types to Total Tax Revenue



Source: Keen and Simone, 2004.
Data for central governments, primarily from 2000-2001.

Beyond this general pattern, as shown in Figure 2, the individual income tax tends to be a more significant source of tax revenue in high-income countries than in low-income countries. Low-income countries rely to a greater extent on consumption taxes than income taxes.

High-income countries tend to collect more revenue from social security taxes than low-income countries. These taxes are then used to fund the more extensive social insurance programs provided in these countries. Some Eastern European countries also rely heavily on social security taxes. Finally, trade taxes play a much larger role in low-income countries than in richer countries.

Because consumption taxes generally impose a greater burden on the poor than do income taxes, a tax system that relies more heavily on consumption taxes is likely to impose a greater relative tax burden on the poor. An income tax can only be an effective redistributive tool if it contributes a significant share of the country's total revenue and can be effectively administered.

Borrowing and Other Sources of Government Financing

All of the money the government spends must come from somewhere. In general, the money comes from five sources: (1) tax revenues, (2) non-tax revenues, (3) borrowing, (4) asset sales, and (5) printing money. When expenditure exceeds tax and non-tax revenues, the government is said to be running a deficit; when revenue exceeds expenditure, it is said to be running a surplus.

Expenditures and tax and non-tax revenues are commonly referred to as "above-the-line" transactions. In contrast, borrowing and asset sales are considered to be "below-the-line" transactions or "means of financing." (Printing money generally does not show up in the fiscal accounts, but it has important implications for economies.) The distinction between these two types of transactions is important because the net sum of "above-the-line" transactions is a standard measure of a country's fiscal position and a central indicator of a country's economic health.

Governments most commonly finance deficits by borrowing. A government can borrow by issuing bonds or by taking out loans and can borrow from either domestic or foreign sources. "Official lending" from the World Bank and the IMF is an important component of foreign borrowing in most developing countries.

Another source of financing is the sale of government assets, such as land or government-owned businesses. The sale or transfer of public assets to the private sector is often referred to as "privatization." When the asset is sold, the government receives the proceeds from the sale. Although some governments classify these proceeds as revenue, the IMF recommends classifying them as "below the line" financing.

Proceeds from the sale of a government asset are typically realized only one time, while revenues are collected each year. Thus privatization proceeds would not be appropriate for

"Earmarked" Revenues

Most revenue that government collects is available to fund all types of government expenditure. The budget formulation and enactment process then determines how these funds are allocated across different expenditure programs.

Some revenues, called "earmarked" or "hypothecated," are devoted solely to particular expenditure categories. For example, taxes on fuel can be set aside specifically for road construction. Earmarking can increase government's ability to collect taxes, because citizens may be more willing to pay a tax when they know what the funds will be used

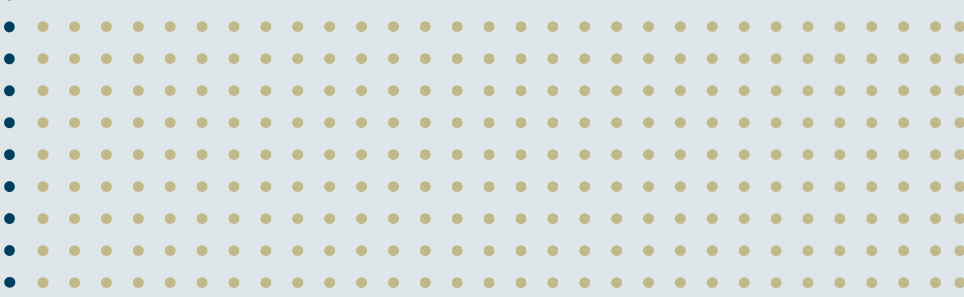
funding an ongoing government expenditure program in the way that a steady stream of revenue would be. Privatization proceeds are better suited for paying off debt or financing one-time investments. Further, proponents of privatization usually emphasize the proceeds from the sale, but often ignore the decrease in revenue that can result when, for example, a state-owned enterprise is sold and no longer generates user fees for government.

In contrast, debt relief, even though it is a "below-the-line" transaction, typically provides an ongoing boost to government finances. Countries pay interest on their debt. In countries with large amounts of debt, these interest payments can consume a considerable share of the budget, crowding out other expenditure priorities. In response to concerns about unsustainable levels of foreign debt and its pernicious effects, in 1996 the World Bank and the IMF introduced the Initiative for Heavily Indebted Poor Countries (HIPC). The initiative sought to cancel some of the debt of these poor countries in order to reduce the interest payments these countries were required to make and create room in their budgets for other expenditures. HIPC countries are required to use these freed-up funds to pursue economic and social reforms. Some countries, such as Uganda, have set up "virtual funds" to channel the interest savings to poverty reduction efforts. Despite these debt relief efforts, many HIPC countries still struggle with high levels of debt.

Finally, governments can also finance deficits by printing money, or they can run down reserves of foreign currency. When countries resort to printing money to pay for goods and services, it leads to inflation. Inflation in essence imposes a hidden "inflation tax" because it reduces the purchasing power of existing assets. Moreover, as inflation pushes up the prices of the goods and services the government purchases, it will need to print even more money, resulting in still higher inflation rates. Although there is little evidence that low and moderate rates of inflation are economically harmful, high rates of inflation can be very damaging, and so relying on more than very modest inflationary-finance can be dangerous.

for. Earmarking can also represent an important means of safeguarding revenue to fund poverty-reduction initiatives. For instance, Ghana currently allocates one-fifth of its VAT revenues to the Ghana Education Trust Fund, which supports public education.

Earmarking can be difficult to implement if a country lacks well-developed budget planning and public expenditure management systems that allow funds to be tracked. Another concern about earmarking is whether the revenue stream is sufficient to cover the expenditure program being funded. A third concern is that earmarking can limit the possibilities for re-prioritizing expenditures if the country's priorities shift over time.



4 Revenues in the Budget Process

The budget process consists of several different stages, each of which offers different opportunities for civil society to influence policy. These stages will be familiar to civil society groups that have worked on expenditure issues, and they are described in *A Guide to Budget Work for NGOs*.

Each country's budget process has its own unique features, reflecting the organization of the executive, the powers of the legislature, and the independence and effectiveness of oversight institutions. The opportunities for civil society to participate in the budget process and influence the content of the budget also vary widely, although some opportunities exist in nearly every country. Many of the approaches civil society groups use to influence the expenditure side of the budget may also prove valuable for engaging with revenue issues.

This chapter explains how revenues are treated during the different phases of the budget process. Each section discusses what information about revenues may be provided and what opportunities for civil society engagement exist at a given stage of the cycle.

Civil Society Can Be Involved at Each Stage of the Budget Process

- Issue policy analyses to influence the executive's positions on tax policy prior to the release of the budget.
- Testify before the legislature on the likely impact of the executive's revenue proposals.
- Compare revenue forecasts with actual collections to assess the accuracy of the projections.
- Bring public attention to year-end reports and audit reports dealing with revenues.

Formulation Stage

The formulation stage is when the executive prepares the budget. During this stage, the executive undertakes two crucial revenue-related activities. Both are directly linked to establishing the "fiscal envelope," the total amount of money the government will have available to spend.

The first activity is determining which revenue policies will be included in the budget. While these may include significant changes to the existing tax system, they typically involve more modest changes, such as adjusting for the effects of inflation. For example, the tax threshold—that is, the income level at which a person begins to pay income taxes—should be adjusted regularly to take into account the effects of inflation, which erodes the value of money each year. If the tax threshold was previously 10,000 shillings and inflation was 10 percent over the year, the tax threshold should be increased to 11,000 shillings to maintain it at the same level in inflation-adjusted terms. In some countries, these thresholds are indexed to inflation, so the adjustment occurs automatically. In other countries, such adjustments are not automatic, and then it is up to government to decide each year whether the threshold should be adjusted to compensate for the effects of inflation on income and prices.

The second activity is projecting the level of revenues that would be generated under existing laws and the executive's new proposals. Such projections are based in part on information about the economy and assumptions about its future course, such as expected economic growth, inflation, and unemployment levels. These assumptions are generated by macroeconomic forecasting techniques that differ greatly across countries. According to a study by IMF economists, governments typically do not make much information about these techniques available to the public (Kyobe and Danninger, 2005).

Some imprecision in revenue forecasts is to be expected, and forecasting is especially difficult when the economy is volatile or suffers an unexpected external shock, such as an increase in oil prices. But revenue forecasts that are consistently incorrect—whether because of technical shortcomings or political interference—can severely impede the implementation and management of expenditure programs. Overly optimistic revenue forecasts can leave important programs underfunded when projected revenues never materialize. Overly pessimistic revenue forecasts can be harmful as well, leading government to cut programs or reject new initiatives unnecessarily on budgetary grounds.

Much of the formulation stage is typically conducted by the executive behind closed doors. However, many countries release a pre-budget statement, which gives legislators and non-governmental organizations an opportunity to comment on the broad outlines of the executive's plans for the coming year.

Opportunities for Civil Society During the Formulation Stage

Even if the formulation process is relatively closed and little information is provided to the public, it may still be clear what revenue issues are under discussion. Civil

society groups can then seek to influence the executive's position on these issues prior to the release of the budget, either by attempting to meet with the appropriate public officials or by issuing analyses. They can also attempt to influence the policy-making process by releasing reports about principles or broad directions the budget and revenue policies should follow.

In countries that issue a pre-budget statement, civil society groups should take advantage of the opportunity to respond to the policy priorities it presents, including the revenue proposals.

Civil society organizations can also push for more transparency in the budget formulation process. They can, for example, encourage the release of pre-budget statements when they are not provided and call for greater openness in the preparation of macroeconomic assumptions and revenue forecasts.

Legislative Stage

The legislative (or enactment) stage begins with the presentation of the budget to the legislature and the public. Often, this is when the budget gets the most public attention and is covered most vigorously by the press.

Coverage of the budget at this stage is facilitated by the substantial amount of information that typically accompanies it. For instance, the budget may include historical data on actual revenue collections as well as projections for revenues in the current year, the budget year, and future years. (It may also contain such information for each specific source of revenue, such as income taxes, the value-added tax, and excise taxes.) In addition, the budget may include discussions of the revenue proposals contained in the budget and the budget's macroeconomic assumptions.

During the enactment stage, legislatures review, amend, and adopt the budget. The extent of legislative involvement varies across countries. The variations depend in large part on the nature of the governmental system (parliamentary versus presidential, for instance) and the legislature's powers under the constitution. In some countries, the legislature's power is more limited with regard to revenue issues than expenditure issues. For instance, many legislatures are constrained in their ability to change revenues from the level proposed in the executive's budget.

The results of the Open Budget Questionnaire coordinated by the International Budget Project suggest that in developing and transitional countries, public hearings

held by the legislature are more likely to focus on expenditure issues than on revenue issues or the macroeconomic assumptions that underpin revenue projections.

Opportunities for Civil Society During the Legislative Stage

Usually the legislative stage affords civil society the most opportunities to participate in the budget process. Because of media and public interest in the budget at this point, the views of civil society groups are more likely to receive attention in the media. This creates opportunities to mobilize public opinion.

Civil society may also have the chance to testify before the legislature on a budget's impact. Legislators often lack sources of independent information, and thus can be especially receptive to civil society analyses.

Implementation Stage

During the implementation stage, many governments release reports on expenditures and revenues to show the progress being made toward budget targets. The level of detail provided and the timeliness of the information differ from country to country.

Revenue collections can vary sharply from month to month as a result of seasonal variations in earnings and consumption and rules relating to the remittance of tax payments. Thus, deciphering these "in-year" revenue reports requires an understanding of collection patterns in previous years.

In addition to in-year monitoring reports, the executive frequently submits a supplemental budget to the legislature proposing adjustments to the enacted budget. Revenue policies are rarely adjusted in the middle of the year, however.

Opportunities for Civil Society During the Implementation Stage

Mid-year reviews and in-year monitoring reports provide an opportunity for civil society to assess the integrity of the original budget. Analyses can focus on the accuracy of the original revenue forecasts, explaining the causes of any significant deviations and the extent to which these deviations are affecting expenditure programs.

Monitoring by civil society groups typically depends on the information provided in government reports, especially in the case of revenue. Where relevant information is not available, civil society groups can highlight this shortcoming.

Assessment Stage

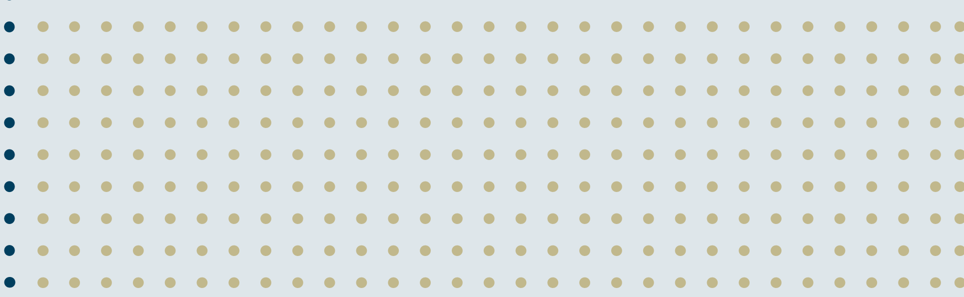
This stage of the budget process includes the issuing of reports assessing the actual outcome for the fiscal year. Such year-end reports are issued by the executive as well as independent auditors.

On the revenue side, year-end reports compare actual revenue collections to the estimates in the originally enacted budget and attempt to explain the differences between the two. Another type of year-end report focuses on the operations of the tax administration and how its budget was spent. Such assessments may examine the allocation of funds within the tax administration (such as whether more resources were devoted to auditing individuals or businesses) or whether the tax administration achieved its desired outcomes (such as higher compliance rates among targeted groups).

The tax administration can also release special, in-depth reports once the detailed revenue data for a year are available (which sometimes can take two or more years). Such detailed reports about revenues paid and who paid them can provide useful insights to inform revenue policy debates. For instance, such reports can quantify the "tax gap"—the difference between the total taxes that should be collected under current law and the total taxes that actually are collected. They may even identify the extent to which different groups of taxpayers are underpaying taxes. Other reports can assess the distribution of the tax burden, showing the amount of taxes paid by different groups of taxpayers. Unfortunately, very few developing countries issue reports on tax gaps or tax burdens.

Opportunities for Civil Society During the Assessment Stage

Many year-end and audit reports go unnoticed by the media and the public. Civil society groups can play an important role simply by highlighting the findings of such reports and by summarizing them in clear and accessible language. Because these reports are issued long after the budget year has ended, civil society groups may also need to explain how the reports' findings are relevant to current budget debates. In some cases, groups may want to raise concerns about delays in issuing these reports, pointing out that such delays undermine the reports' usefulness. Civil society can also encourage the legislature and its committees to review the findings of the reports.



5 Basic Issues in Tax Policy

Most civil society groups are interested in tax policy because of its potential to address poverty and inequality. This chapter discusses some of the key issues that determine whether or not tax policies reduce poverty and improve the distribution of income.

Key Criteria for Evaluating Tax Policies

- Do tax laws and rules treat all people fairly?
- Are taxes designed in a way that ensures that they impose minimal burden on the poor?
- Are targeted tax breaks promoting social goals, or merely rewarding the well-off for actions they would have taken in any case?
- Are taxes raising enough revenue to fund anti-poverty programs?
- Could a badly needed expenditure program be funded by a specific tax increase?
- Is the tax code easy to administer, or is it highly susceptible to evasion?

Taxes and Fairness

When is a tax fair? The answer depends on how one defines "fair." As one commentator put it, "most of us accept as 'fair' this principle: The poor should pay nothing, the middlers something, and the rich the highest percentage" (cited in Slemrod and Bakija, 2004). However such a definition does little to clarify the specifics of tax policy.

Taxes are often characterized as regressive, proportional, or progressive.

- *Regressive*—A tax is regressive if it represents a smaller share of income for higher-income individuals than lower-income ones. So, for example, a tax that imposes the same cost on two taxpayers who have different incomes would be considered regressive. Assume a tax of $2,000 is paid by two taxpayers; one has an income of $20,000 and the other has an income of $100,000. This tax is regressive because it would represent 10 percent of the income of the lower-income taxpayer and only 2 percent of the income of the higher-income taxpayer.

  A tax can be regressive even if lower-income taxpayers pay smaller amounts in taxes than higher-income taxpayers. In the example above, for instance, if the lower-

income person's tax were reduced to $1,000, the tax would still be regressive because it would represent 5 percent of the lower-income person's income, which is more than the 2 percent tax burden faced by the higher-income person.

- *Proportional*—A tax is proportional if it represents the same share of income for all taxpayers. In the example above, the tax would be proportional if it were $10,000 for the higher-income taxpayer and $2,000 for the lower-income taxpayer. It would then represent 10 percent of the income of both taxpayers.

- *Progressive*—A tax is progressive if it requires higher-income people to pay a larger share of their income in tax than lower-income people. In the example, the tax would be progressive if it were designed so that the lower-income taxpayer paid only $1,000 in tax and the higher-income taxpayer paid $20,000. The higher-income taxpayer would then be paying 20 percent of his or her income in tax, while the lower-income taxpayer would be paying only 5 percent.

A progressive tax reduces income inequality. In the example above, the higher-income person earns five times as much as the lower-income person ($100,000/$20,000=5). This income gap narrows once the effects of the progressive tax are taken into account: the higher-income person's after-tax income of $80,000 ($100,000 income less the $20,000 in tax) is about four times the lower-income person's after-tax income of $19,000 ($20,000 income less the $1,000 in tax).

The justification for progressive taxes is found in the "ability-to-pay" principle. This principle states that higher-income people can afford to pay a larger percentage of their income in taxes than lower-income people, because they need only a relatively small percentage of their large income to cover basic expenses.

These examples only look at people who have different incomes. There are also fairness issues surrounding how the tax code treats people who have the same income but differ with respect to other characteristics that affect their ability to pay. For instance, should two people who have the same income pay the same amount of tax if one of them has very high medical bills? To the extent that such health expenditures affect a person's ability to pay taxes, there is a strong argument for lowering the sick person's tax bill. Another equity question is whether a country's tax system reduces or exacerbates existing gender inequalities (see box on next page).

Does The Tax System Treat Men and Women Differently?

A country's tax system can affect women and men differently. This can happen in two ways. First, women and men occupy different social and economic roles, and an identical tax may thus have a differential impact. For instance, a high rate of tax on part-time earners is likely to affect women more than men because women are more likely to work part-time to accommodate family responsibilities.

Second, there may be explicit differences in the way that taxes are imposed on women and men. These differences sometimes favor women. In Pakistan, for instance, the tax code allows working women to shield a greater amount of their income from tax than working men. Other times, however, these differences can penalize women. In South Africa prior to 1994, for example, married women were taxed at higher rates than married men.

Some income tax codes can also result in implicit discrimination against women because of the way they are structured. Under a progressive income tax code, higher incomes are taxed at higher rates. If the tax code treats a married couple as a single unit, then their earnings are combined for tax purposes. This can create a "marriage penalty," when two people pay higher taxes on their combined income after they are married than they paid when they filed their taxes separately as single people. Women are usually affected disproportionately by these penalties because the higher tax is effectively placed on the "second" earner. (Women are more likely to be earning less than their spouses and their earnings are thus usually regarded as "secondary.")

Marriage penalties reflect social attitudes favoring the traditional nuclear family, where the man is the sole earner outside of the home and the woman cares for the children and performs other domestic duties. Such penalties effectively punish two-earner families that do not match this norm.

While some governments may collect tax data that are disaggregated by sex, few publish such data. Nevertheless, even without these data, it is usually possible to draw general conclusions based on available information regarding the relative social and economic positions of women and men.

Who Actually Bears the Burden of a Tax?

The burden of a tax does not necessarily fall on the person or entity that pays the tax to the government. For example, if the government imposes a 10 percent sales tax, prices will rise by 10 percent. Although businesses will collect the taxes and remit them to the government, ultimately consumers will pay the taxes because everything they purchase will be more expensive.

In some cases, while the intention may be to impose a tax on particular taxpayers, they may be able to shift the burden of the tax on to others. For instance, property owners may shift the burden of a property tax on to their tenants by charging higher rent.

The question of who bears the tax burden is particularly important with regard to the corporate income tax. Economists agree that ultimately people bear the burden of all taxes. One might assume that the burden of the tax is, therefore, borne by the corporation's owners (including shareholders). Some believe, however, that at least part of the burden falls on workers or consumers, who end up paying the tax in the form of lower wages or higher prices on goods and services.

The extent to which this shifting occurs depends on economic circumstances: a firm may find it easier to reduce wages when unemployment is high than when unemployment is low. Also, some corporations structure their operations and finances in ways that allow them to avoid taxes in the countries where they are located, thereby effectively shifting the tax burden to the countries' other residents.

Economists generally assume that even if corporations can shift part of their tax costs on to others, owners of capital still pay the majority of those costs. Because owners of capital tend to be among the wealthier members of society, the corporate income tax has the potential to be progressive. Moreover, without a corporate tax, wealthy individuals might be able to avoid income taxes by disguising their personal income as corporate income and their personal expenses as corporate expenses.

A final question to consider in assessing the distribution of tax burdens is how the revenues from a tax are used. While assessing the progressivity or regressivity of a given tax is important, assessing the overall equity of government policies requires looking at both revenue and expenditures. From this wider perspective, a tax that may raise concerns because it places a burden on the poor could be seen as less problematic if, for example, the revenue raised is used to fund effective anti-poverty programs.

Taxes and the Economy

Civil society groups are usually concerned primarily about the impact of taxes on equity. Economists, in contrast, tend to focus more on how a tax affects the economy (often referred to as "efficiency"). Taxes affect the economy by influencing individual behavior, such as decisions about whether (and how much) to work, save, or invest. Taxes tend to encourage people to shift away from taxed activities to untaxed ones, and from more heavily taxed activities to more lightly taxed ones. Taxes also may encourage businesses and workers to operate in the informal sector, as opposed to the formal economy.

It is important, however, not to exaggerate the impact of taxes on the economy. Most research has shown the impact to be relatively modest. Further, how a given tax policy influences the economy will depend on the context—for example, on the size of the country's informal sector, its legal and regulatory environment, the effectiveness of its tax administration, and the level of corruption (Bird and Zolt, 2005).

How Tax Changes Affect Revenues and the Economy

Economic growth expands the tax base and therefore results in an increase in tax revenues. Some people use this linkage between economic growth and revenues as an argument for tax cuts. They argue that high tax rates dampen economic activity and encourage tax evasion. Some argue further that cutting taxes will promote economic growth and increase tax compliance to such an extent that the tax system will generate the same amount of revenue as without the tax cut. In short, the tax cut will pay for itself.

This theory has been rejected by virtually all economists. They find no evidence that tax cuts are able to boost economic growth enough to increase revenues above where they otherwise would have been. Rather, evidence suggests that raising tax rates generally increases revenue collections, while reducing tax rates results in lower tax collections.

Recently, some people have pointed to the strong economic growth and revenue gains experienced in many Eastern European countries as evidence of the power of lower tax rates. But credit for the improvements in these countries' economies also goes to the range of legal, regulatory, and other reforms they have undertaken as part of their drive to join the European Union (see Chapter 11).

Trade-Offs Between Equity and Efficiency

The tax policy goals of equity and economic efficiency are often viewed as being in conflict. But the extent of this conflict is frequently exaggerated. As discussed, the impact of taxes on the economy is more limited than is often portrayed. Further, the effects of a particular tax on economic efficiency are likely to be different than economic theory would predict if work and investment decisions in a country are already distorted by other social and economic factors. In many cases, tax policy is able to promote both equity and efficiency. For instance, as discussed more below, closing tax loopholes and combating other forms of tax evasion can improve both the efficiency and the fairness of the tax system.

In some cases, however, there may be tension between fairness and efficiency. For example, economic theory suggests that the most efficient tax would be one in which all individuals pay the same amount regardless of their circumstances. This system is efficient because a person's tax liability is unaffected by his or her choices, and so the tax system does not influence or "distort" economic decisions. Yet, such a tax would be highly inequitable, placing a much heavier burden on the poor than on those with higher incomes.

Even in less extreme cases, tax policy decisions may require trade-offs between equity and efficiency. For example, economists generally believe that a policy of broadening the tax base and lowering the tax rate enhances the efficiency of the tax system. In contrast, those more concerned with equity may seek to narrow the tax base by exempting goods such as food or health care from taxation as a way to shield lower-income households from tax. In such cases, the goal should be to strike a balance between fairness and efficiency, taking into account both the realistic economic impact of the tax policies and how effective they would be in achieving their social goals (see box on next page).

Taxes and Tax Compliance

The ability of government to promote and enforce compliance with the tax code can have a significant effect on the type of tax policy choices available to a country. Tax policies that cannot be properly administered not only fail to raise the intended revenues, but can also lead to corruption and undermine good governance.

Tax authorities face daunting challenges. They must contend, first, with large numbers of small businesses, many of which fail to register with the government or

Tax Expenditures: Using Tax Policy to Achieve Specific Policy Goals

Tax preferences reduce or eliminate taxation of selected goods or activities in order to make them more attractive or to alleviate burdens on particular groups of taxpayers. Tax preferences can be used to encourage companies to invest in a particular geographic region or sector of the economy or in worker training or high-technology equipment. They can also be used to promote social goals, for instance to encourage higher education or saving for retirement.

The aims of tax preferences are often similar to the aims of subsidies provided through spending programs. For this reason, tax preferences are sometimes referred to as "tax expenditures."

Because tax expenditures shrink the tax base, they reduce revenue collections unless tax rates are increased to compensate. There can also be other problems associated with tax expenditures. First, it may be difficult or impossible to use tax expenditures to provide assistance to individuals or businesses that pay little or no tax. For example, tax breaks will be of little benefit to struggling businesses, because unprofitable businesses do not pay income tax. Similarly, it may be hard to target tax expenditures efficiently. For example, a government might seek to assist the poor by exempting food items from sales tax. But food items are also consumed by higher-income households, and often in larger quantities. Thus, while exempting food items helps the poor, a portion of the tax expenditure's cost would reflect benefits for higher-income households.

A problem also occurs when a tax break that is intended to change behavior instead merely rewards people or businesses for actions they would have taken even without the tax incentive. For example, developing countries frequently offer tax breaks to attract foreign investment. Yet research shows that companies generally base their investment decisions on factors other than tax policy (see Chapter 11). As a result, such tax expenditures reduce revenues but may do little to influence foreign investment.

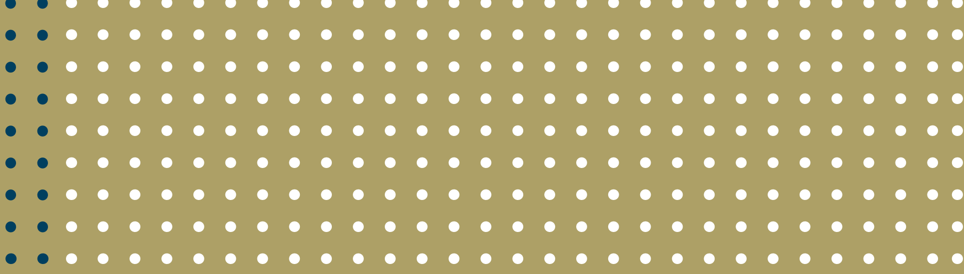
A major concern for civil society groups concerned with transparency and accountability is that tax expenditures typically receive less scrutiny than spending programs. Spending programs tend to be reviewed as part of the regular budget process. In contrast, tax preferences are frequently permanent features of the tax code. They are therefore reviewed only when there is a proposal to change them.

keep extensive records. At the other end of the spectrum, they must also deal with the complex financial affairs of corporations and wealthy individuals, who have the ability to structure their activities in ways that allow them to avoid taxes—for instance, by shifting profits and wealth offshore to "tax-haven" countries. They must

also confront a proliferation of tax-reducing schemes, some of which violate only the spirit of the law, and some of which represent outright illegal tax evasion.

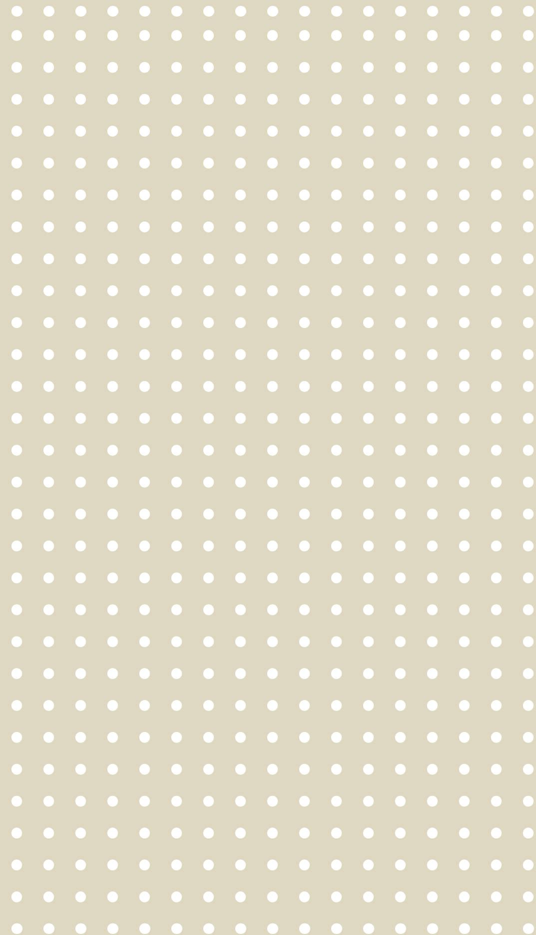
Policies that close tax loopholes, eliminate tax incentives prone to abuse, or otherwise improve compliance with the tax system can promote the twin goals of efficiency and fairness. Tax-avoidance activities necessitate higher tax rates, since they push the burden of funding the government on to a smaller number of compliant taxpayers. Reducing tax evasion broadens the tax base, allowing for lower rates, and also can improve equity—particularly if it eliminates ways in which high-income households and corporations can avoid paying tax.

Tax policy changes that simplify rather than complicate the tax code are more likely to be successfully implemented, in part because they ease administrative and compliance burdens. Policymakers, however, sometimes choose to narrow the tax base and complicate the tax code by providing exemptions and deductions intended to achieve policy or political goals. A key question then is whether tax expenditures are the most effective way of pursuing these policies.



PART TWO

Examples of Civil Society Revenue Projects



6 How Budget Groups Have Approached Revenue Work

This chapter provides examples of how civil society groups have incorporated revenue analysis into their work. The chapter first examines the tax work of groups in the United States that work at the state level. Most of these groups began by focusing on expenditure issues and then added revenue issues when it became evident that these issues were affecting the programs they cared about.

The chapter also reviews how tax work is being adapted in developing and transitional countries. It examines the efforts of civil society groups in Croatia, Ghana, and South Africa, as well as a growing international movement around monitoring the extractive industries and fighting tax evasion.

Examples of Revenue Work by Civil Society

- State-level groups in the United States have successfully pushed for progressive tax reforms and adequate revenue levels.
- Groups in Croatia, Ghana, and South Africa have expanded public understanding of revenue issues and influenced government revenue policies.
- International efforts have been launched to ensure that multinational corporations pay their fair share of revenues, and that information on these payments is made public.

Tax Work in the U.S. States

In 1993, the Washington, D.C.-based Center on Budget and Policy Priorities launched the State Fiscal Analysis Initiative (SFAI) to enhance analysis of state budget and tax policies, with a particular focus on how these policies affect low- and moderate-income people. Many social programs in the United States are largely operated and funded at the state level, but prior to SFAI's formation relatively little civil society budget work was being conducted at the state level.

SFAI now comprises organizations in 28 of the 50 U.S. states as well as one in the District of Columbia. The activities of SFAI groups include research, policy analysis

and development, advocacy, public education, and technical assistance. Below are examples of how SFAI groups in the U.S. states of Alabama, Arizona, and Ohio were able to successfully incorporate revenue issues into their work.

Alabama Arise

In 1988, a group of Alabama activists began to organize a grassroots coalition dedicated to lobbying for low-income people in their state. Since then, the coalition—Alabama Arise—has grown to encompass 140 member organizations from across the state, with a heavy concentration of churches, other religious organizations, and charities. Many of these groups had not traditionally been involved in tax and budget analysis but recognized that hardly anyone in the state was examining how state budget and tax policies affected the poor.

Alabama Arise has worked since its early days to increase awareness about the state's regressive tax system and push for meaningful tax reform that would benefit low-income families. These efforts won Alabama Arise a seat on the governor's tax reform commission in 1991. Over the years, Arise has conducted hundreds of workshops (170 in 2003 alone) to educate its members and others about tax reform. This effort led to the state legislature enacting in 2006 a significant step toward a more progressive tax system. Tax exemptions were substantially increased, with the largest increases going to families with lower incomes.

In order to keep focused on grassroots advocacy, Alabama Arise decided in 1994 to form a separate group, the Arise Citizens' Policy Project (ACPP), to focus on analysis and dissemination of critical research. ACPP conducts both short- and long-term policy research and incorporates a significant amount of public participation in its work. Its research fuels the outreach and advocacy work of the larger coalition.

Alabama Arise has drawn attention to the regressive nature of Alabama's tax system and other issues in "The Alabama Tax & Budget Handbook," a 56-page pamphlet-style publication. The handbook is written in clear, non-academic language and features graphs, charts, and cartoons to illustrate some of its key points.

Arizona Children's Action Alliance

Children's Action Alliance (CAA) was formed in 1988 with a primary focus on issues of child care and child abuse and neglect in Arizona. In the early 1990s, the group's executive director realized that CAA needed a greater understanding of how

programs affecting children were funded. CAA started by analyzing spending issues and then expanded its work to incorporate revenues.

Later in the 1990s, Arizona was cutting taxes, even though most human services programs were already starved for funds. Faced with a significant budget deficit, lawmakers responded by cutting services further, rather than considering tax increases to help close the budget gap. CAA showed that this policy course weakened the state's ability to provide services for children. CAA succeeded in blocking or slowing efforts to cut corporate taxes.

More generally, CAA tries to integrate tax analysis into its work on children's issues by showing how revenues raised or lost by tax policies translate into levels of support for children's programs, as well as how particular state tax policies may affect working families. For instance, CAA releases a "Strengthening Families" bulletin several times a year, examining the effect of the state's fiscal policies (including its tax policies) on Arizona's families and children.

Emergency Campaign to Protect Ohio's Future

A campaign in Ohio shows what can happen when people recognize the connection between tax revenue and vital government services. Early in 2002, as the United States suffered from an economic downturn, members of a non-partisan statewide coalition of more than 100 organizations and individuals called on Ohio to adopt "a fair, progressive, diversified system of taxation that eliminates Ohio's structural deficit and provides stable revenues sufficient to fund government services and invest in Ohio's future."

In pursuit of this and related goals, the group helped establish the Emergency Campaign to Protect Ohio's Future, a coalition of more than 300 Ohio organizations concerned with reducing poverty. Among them were many groups not customarily involved in budget and tax work, such as churches, children's advocacy groups, and senior citizens' groups.

The Emergency Campaign conducted polls revealing that most Ohioans would support raising taxes if the increased revenues were used to maintain essential human services. It shared these findings with state legislators and the media. It also publicized research showing that declining tax revenues were a main cause of the state's budget deficit. The coalition organized a rally at the statehouse to bring public attention to the people who would be affected by budget cuts and to intensify pressure for tax increases. Ultimately, the Emergency Campaign succeeded in blocking many of

the budget cuts proposed in the governor's budget. In addition, the legislature and governor agreed to a temporary increase in the state sales tax, some broadening of the sales tax base, and corporate tax reform.

Tax Work in Developing and Transitional Economies

Croatia's Institute for Public Finance

The Institute for Public Finance (IPF) was founded in 1970 by the University of Zagreb in Croatia as a non-profit academic research institute focusing on public-sector economics. Although part of the university community, IPF researchers have gone beyond academic work. IPF's transition into advocacy was spurred by the director's attendance at an International Budget Project conference, where she saw how rigorous academic research could be used to influence current policy debates. IPF decided to focus on fostering public awareness of the importance of budget transparency, government accountability, and citizen participation.

On the revenue side, IPF has looked at issues that range from the level of progressivity and redistributive effects of the income tax to pollution licenses and a tax on carbon dioxide emissions by corporations. IPF has published a citizen's guide to taxation, which outlines Croatia's tax system in an accessible manner, provides basic information on the role taxes play in the relationship between citizens and the state, and lists benchmarks for assessing a "good" tax system. IPF's website includes additional information about Croatia's tax system, such as links to the country's tax laws and a tax table that summarizes all of the country's taxes on goods and services, individuals, and corporations.

IPF publishes newsletters and sends them free of charge to parliament, ministries, media, and non-governmental organizations. The newsletters are also published on IPF's website, and are available in both Croatian and English. They respond to the introduction of new policy initiatives, reflect on proposals in the government's budget, and comment on economic conditions in the country, in connection with elections or changes of government. Since the publication of the first newsletter, tax issues have been addressed as a natural component of budget analysis. Along with the newsletters, IPF has published a number of books, including the citizen's guide to taxation.

IPF has played an active role in budget and tax debates by developing close relationships with the media and members of parliament. In addition, IPF staff give

lectures and conduct one-day workshops on the importance of budget transparency, government accountability, and citizen participation. By establishing itself as an unbiased and trustworthy source of information, IPF has become influential in domestic policy debates.

Ghana's ISODEC

The Integrated Social Development Centre (ISODEC) in Ghana was created in 1987. It describes its mission as "promoting social justice and fundamental human rights, especially of the poor and those without organized voice and influence." Initially, ISODEC focused on urban health and sanitation as well as basic education. Subsequently, it grew into an organization primarily promoting rural water and sanitation and providing administrative and technical support to local partners of Wateraid, a British non-governmental organization also involved with rural water and sanitation issues.

In 2000 ISODEC began a research and advocacy program called Rights Based Advocacy that aimed to promote alternative, more equitable national development strategies. This program combined policy research and advocacy on a wide range of social and economic rights issues, linking grassroots activities to broader movements.

As part of the Rights Based Advocacy program, ISODEC set up the Centre for Budget Advocacy (CBA) to focus on budget work. The stated mission of CBA is "facilitating the spread of budget activism not only in Ghana but across the African continent and empowering people to engage in budgets principally as a tool for achieving equity and fairness in society, especially for women, children and the poor and underprivileged." CBA conducts research and analysis of the budget and the economy, including examination of the effects of revenue policies on the poor (at both the national and local levels). CBA also conducts training on budget issues for government officials and civil society organizations in Ghana and neighboring countries. CBA has organized public meetings in each of Ghana's ten regions to solicit views from citizens about the budget, to create awareness of the budget as an important development tool, and to foster a budget dialogue among different stakeholders in the country.

Tax work has been a key component of CBA's work since its founding. One of its first activities related to tax policy was the publication of a guide entitled "Taxation in Ghana Made Simple." CBA also began including analysis of the government's revenue proposals in its reviews of the government's annual budget submission. For instance,

in 2005, CBA commented on the reduction in corporate income taxes and shortcomings in tax administration, which compel the country to rely heavily on donor support. CBA has criticized the government for continually reducing the income tax and relying more heavily on regressive consumption taxes. ISODEC is also involved with Ghana's efforts to implement the Extractive Industries Transparency Initiative (see below), serving on a committee the government set up to improve the monitoring and oversight of revenues from the extractive industries.

South Africa's Women's Budget Initiative

The Women's Budget Initiative (WBI) began in South Africa in 1995, soon after the country's first democratic elections.

The WBI started as a collaborative effort between members of parliament and non-governmental policy-oriented research organizations. (The WBI was seen as a non-governmental initiative despite the involvement of legislators in the partnership.) It engaged in research, training, and advocacy focused on the gender impact of government budgets.

In its first year, the WBI examined four areas—housing, education, welfare, and work—as well as the broader issues of public-sector employment and taxation. Researchers from a number of non-governmental organizations and academic institutions conducted the research, as one of the explicit aims of the Initiative was to expand civil society's ability to do budget analysis, especially in organizations working on gender issues. This research was published as a book, with chapters addressing each of the four topics.

The WBI analysis highlighted South Africa's shift from direct to indirect taxation and the gender bias implicit in such a shift. The chapter on taxation also examined other tax types in terms of their impact on women. It recommended that government tax data include gender breakdowns to facilitate more sophisticated analyses of the gender impact of taxation. In the late 1990s, the government followed some of the WBI recommendations and published the number of male and female taxpayers who submit returns.

The WBI expanded its work over the years to encompass all sectors of the budget. In its fifth year, the WBI focused on tax issues, conducting a gender analysis of South Africa's customs and excise taxes and examining gender issues in relation to local government revenue.

In some cases WBI's analyses led to tangible policy results on tax issues. For instance, pressure from the WBI and other groups led the government to remove the VAT on paraffin, which is consumed heavily by the poor.

International Efforts

Movement for Tax Justice

An international movement for "tax justice" has been gaining momentum in recent years. Its main aim is to ensure that multinational corporations pay their fair share in taxes.

The most visible face of this movement is the Tax Justice Network (TJN), an international coalition of non-governmental development organizations, religious groups, trade unions, academics, journalists, economists, financial professionals, and public-interest groups. TJN, headquartered in London, works "for a tax system which is favourable for poor people in developing and developed countries, and finances public goods and taxes public bads such as pollution and unacceptable inequality." Most TJN affiliates are in developed countries, but the number of partners in developing countries is growing.

The Tax Justice Network encourages local campaigns for tax justice. It also promotes discussions of tax-justice issues within multilateral agencies such as the United Nations, the World Bank, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the European Union—places where business interests tend to be influential. TJN publishes briefing papers and a quarterly newsletter and operates an electronic mailing list to facilitate discussion. It also organizes conferences on the harmful effects of international tax avoidance, often in conjunction with the U.K.-based Association for Accountancy and Business Affairs.

Monitoring Extractive Industries

A number of research and advocacy groups have started monitoring the extractive industries in recent years. In a 1999 report, Global Witness exposed the role of the oil and banking industries in facilitating the misuse and theft of oil revenues in Angola, one of the world's poorest countries despite its vast oil wealth. The report concluded that this plundering could occur in large part because crucial informa-

tion about oil revenues was not made public, and it called on the oil companies to publish their revenue payments to the Angolan government.

The problems identified in Angola also plague other resource-rich countries. To address this issue, Global Witness, Catholic Agency for Overseas Development (CAFOD), Oxfam, Save the Children UK, Transparency International UK, and George Soros, chairman of the Open Society Institute, launched in 2002 the "Publish What You Pay" campaign, calling for the mandatory disclosure of payments from extractive industries to host governments. The major governmental response to this civil society initiative has been the Extractive Industries Transparency Initiative, led by the U.K.'s Department for International Development. Civil society's involvement in these two efforts has expanded rapidly, helping to bolster transparency in resource-rich countries and to reform international reporting standards. These various activities are discussed in Chapter 12, "Revenues from Extractive Industries."

7 Where to Start: Building a Knowledge Base

This chapter explores potential projects that civil society groups can undertake as part of the process of developing expertise in revenue issues. The main goal of these projects is to expand budget and tax literacy, both within the group and among a wider audience of media, policymakers, and other non-governmental organizations.

Initial Projects to Build Civil Society Expertise in Revenue Issues

- Issue a revenue guide for non-experts that provides background information on the country's revenue system.
- Press the government to make more revenue information publicly available.
- Conduct introductory trainings on current revenue issues for other groups, legislators, and journalists.

Revenue Guide

The original *Guide to Budget Work for NGOs* noted that preparing a budget guide is a useful initial project that both develops the organization's capacity and produces a valuable product. The same can be said of a revenue guide.

A revenue guide serves as a background document for people who are not tax experts, providing them with basic information about the country's revenue system in a clear and accessible manner. The guide could be a relatively short and simple pamphlet or a longer document that covers a broader range of issues. It could include sections that:

- **Describe all major revenue sources.** The guide should document all of the major tax and non-tax revenue sources. It should provide basic information about all the major taxes, including the tax base, exceptions to the base, and tax rates. In the case of an income tax, for example, it would show the size of the standard exemption and other deductions and credits (clarifying which taxpayers are eligible for them) and then show the tax

Croatian Revenue Guide

The Institute for Public Finance (IPF) in Croatia published a budget guide in 2000 and a revenue guide in 2002. Both are visually attractive, with colorful, easy-to-read formats and cartoon-like characters in the margins that create a user-friendly feel.

The revenue guide begins with a general discussion that defines taxation, explains why it is important, and outlines the characteristics of a "good" tax. The guide then examines how taxation in Croatia has changed over time and how it compares to taxation in some of Croatia's neighbors. The guide also discusses the general tax law in Croatia and how the tax collection process works, including the rights and obligations of taxpayers. Each of these introductory sections is only a few pages long, filled with simple graphs and charts.

The bulk of the guide examines each of Croatia's revenue sources, such as the income tax, the value-added tax, social security contributions, the profit tax, and various excise taxes. It also has separate chapters on customs duties and taxes levied at the local level. For each tax type, the guide explains what is being taxed, who pays the tax, and what the tax rates are, as well as any recent changes in the tax. The guide includes examples that show step-by-step how certain taxes are calculated.

The guide concludes with a brief chapter on the tax administration as well as a listing of regional and local tax administration offices. At the back is a glossary of key terms. The booklet is about 100 pages long.

In order to enhance the usefulness of the guide, IPF staff held a series of day-long seminars based on the guide for representatives of trade unions, local communities, and media in several parts of Croatia.

rates that apply to taxable income. For non-tax revenues, the guide should explain the source of funds and give readers a sense of their volatility. The guide could investigate biases in the tax code, for example, whether it treats men and women differently given their positions in the labor market and social living patterns (see box on page 31).

- **Present data on revenue collections from all sources.** The guide should include data on the amount of revenue raised by each major source of tax and non-tax revenue to give the reader a sense of their relative importance. Historical data that show actual collections are usually the safest to use, because they are not subject to estimating errors. Projections may, however, be preferable if recently adopted policy changes have significantly altered the mix of taxes in the country. It also can be useful to show the changing composition of total revenues over time.

- **Highlight earmarked revenues.** The guide should clarify which, if any, revenues are dedicated to specific expenditure programs. It should indicate whether the earmarked revenues cover the programs' full costs.

- **Describe the budget process as it relates to revenues.** The guide could include a discussion of the budget process, highlighting aspects of the process that are unique to the revenue side of the budget. Such a discussion could list the key dates in the budget process and the different types of reports relating to revenues that are released by the government during the year.

- **Provide historical context.** Explaining when each tax was first established and why and how it has changed over time can help readers understand the context for a particular tax. Also helpful would be background information on past tax reforms and how they were shaped by economic, fiscal, and political circumstances.

- **Describe the tax administration.** This discussion could examine taxpayers' obligations, such as when taxes are due and who must pay them, as well as withholding and other mechanisms by which businesses pay taxes on behalf of individuals. It could also describe the organizational structure of the government's tax administration and the size of its budget and identify some of the problems it faces.

- **Define terminology.** A glossary would be a handy reference for readers unfamiliar with terms often used in tax debates, such as progressive and regressive taxes and average and marginal tax rates.

Revenue Information and Transparency

Ensuring the availability of revenue information is an essential component of civil society groups' efforts to expand transparency and participation in the budget process.

The International Budget Project developed the Open Budget Questionnaire as a tool for civil society organizations to evaluate public access to budget information as well as the opportunities to engage in budget debates. The questions attempt to gauge country adherence to best practices laid out by the OECD and the IMF, with an emphasis on budget information provided to the public.

The questionnaire focuses on the expenditure side of the budget, but a number of questions address revenue issues (see box on the following page for a discussion of best practices for revenue transparency). Chapter 4, "Revenues in the Budget Process," discusses some of the key revenue-related reports—such as pre-budget statements, in-year monitoring reports, and year-end reports—that are released during the different phases of the budget process.

In advocating for greater transparency and more information, civil society groups are likely to find a range of allies beyond just other civil society groups. For instance, the media typically supports expanding the amount of information made available to the public. Similarly, some business groups may join efforts to press for greater transparency, on the grounds that it will help stamp out corruption and cronyism.

Training

Many civil society budget groups have conducted budget trainings for other civil society organizations, legislators, and members of the media. Similar trainings could be provided on the subject of revenues. Trainings can help stimulate interest in revenue issues and convince attendees that these are issues they can understand and engage with. Trainings can also provide opportunities for budget groups to work with other organizations and learn about their specific interests, or form part of specific advocacy efforts or campaigns.

Budget groups could initially offer introductory courses. These could provide background on revenue issues (such as an overview of the country's tax system or of proposed changes to the tax code) and explain the connection between tax policies and relevant expenditure issues. For instance, a training for education groups could make the case that tax cuts deprive the government of revenues that could be used to fund schools and other education initiatives.

At a somewhat more involved level, groups might use trainings to help create a coalition to advocate for a particular policy. Such a course would aim to ensure potential coalition members understand the full implications of the policy issues being debated. Finally, groups with significant capacity for revenue issues could conduct training courses on specific analytical techniques, such as analyzing tax burdens. The audience for such advanced courses would be like-minded organizations and individuals interested in ongoing and in-depth revenue work.

Civil Society Should Advance Best Practices for Revenue Transparency

There are widely accepted "best practices" for the type of information on both revenues and expenditures that governments should release in a regular and timely manner (OECD, 2001). The International Budget Project's Open Budget Questionnaire assesses the openness of a country's budget process by examining its adherence to these standards. In the case of revenue information, these best practices include the following:

- The budget should provide information on actual revenue during the past year and should provide an updated forecast for the current year.
- The budget should include medium-term revenue projections, extending at least two years beyond the budget year.
- The budget should contain detailed commentary on each source of revenue; revenues dedicated to specific expenditure programs and user charges should be accounted for separately.
- The budget should include a discussion of "tax expenditures," which are the revenue losses associated with preferential tax treatment for specific activities.
- The government should issue a pre-budget report discussing its economic and fiscal-policy objectives over the medium term, as well as specific intentions for the forthcoming budget. This report should highlight the total level of revenue, among other budget aggregates.
- The government should also issue monthly reports on actual revenue collections, a mid-year report that assesses the macroeconomic forecast and revenue collections to date, and a year-end report that compares projected revenues with actual collections, explaining any divergences.

Responses to the Open Budget Questionnaire show that documents related to the executive's budget are routinely released to the public and typically contain significant amounts of information on at least the past year, the current year, and the budget year. In contrast, far fewer countries adhere to best practices when it comes to issuing public in-year monitoring reports and year-end assessment reports. Finally, most countries fail to produce citizens' budgets or other information that can make the budget (and the policies it embodies) more understandable to the public and the legislature and thereby facilitate broader discourse on the budget. (For more information, see http://www.openbudgetindex.org.)

Other Introductory Revenue-Related Projects

Many other possibilities exist for revenue-related projects. Which ones are most suitable for a particular group would depend on the situation within the country, the main concerns of civil society, and the information that is available. Below are some possibilities.

- **Highlight findings of government or academic reports,** including relevant reports by international financial institutions. Government and academic reports are often written in a way that makes them inaccessible to a broad audience, or that obscures their key findings. Civil society groups could make these reports more accessible by presenting their conclusions and data in plain language and with user-friendly graphics. Groups could also, of course, add their own comments on the findings. Groups could do the same with regular government reports that monitor revenue collections.

- **Examine government revenues over time.** Sometimes, budget documents focus only on the budget year and preceding year and provide no historical context. If data on actual revenue collections are available in documents other than the current budget, it can be helpful to pull them together in one place and analyze the trends over time.

  An additional project would be to track the differences between the revenue projections in the budget and actual revenue collections over time. This could, for instance, show if there is a consistent bias of under- or over-estimating revenues. It may be quite difficult, however, to pinpoint the reasons for the differences. If actual revenue collections are consistently below projections, the differences could result from poor modeling of revenues, overly optimistic macroeconomic assumptions, underperformance by the tax administration, enactment of tax policies that were different than those assumed in the budget, or a combination of these and other factors.

- **Raise new issues in tax debates.** Too often, debates over tax proposals are dominated by the groups that stand to benefit directly if the proposals are enacted. Civil society groups can broaden these debates by raising questions about fairness and revenue adequacy, for instance, that are not being asked (see box). Even when it is impossible to provide definitive answers to these questions, groups could highlight relevant research and experiences in other countries that shed light on these issues.

Essential Questions That Should Be Asked as Part of Revenue Debates

The interest of civil society groups in pro-poor government policies and transparent decision-making processes ensures that these groups will bring an important perspective to revenue debates. They will raise key questions, including:

- Are government policies raising an appropriate level of revenue, particularly given the need to reduce poverty, address the country's other unmet needs, and pay for existing promises without large budget deficits?
- How do revenue policies, when combined with expenditure policies, affect the distribution of income and wealth in the country?
- Who would benefit the most from particular tax proposals, and who would bear the burden?
- Is there evidence that a proposed tax change will achieve its desired economic or social goal?
- Are revenues being raised in way that does not distort economic decisions?
- Could a badly needed expenditure program be funded by a specific tax increase?
- Are government revenue policies designed to comply with conditions imposed by international financial institutions?
- Does the country's tax system facilitate tax evasion and encourage the use of tax shelters?
- Does the country's tax administration system have the capacity to implement a proposed tax change?

8 Analyzing Revenue Policies in More Detail

This chapter explores potential projects for civil society budget groups that involve analyzing tax issues and taking positions on tax policies. In addition to the generic projects presented in this chapter, there are likely to be country-specific tax issues that may be even more relevant for civil society groups looking to engage with tax issues in their particular countries.

Ideally, of course, groups would enter the debate while tax changes are under discussion rather than after the decision to implement new policies has been made. Whether this is possible depends on the extent to which government decision-making processes are transparent and information is made available during the earlier stages of the decision-making process. Groups also need to be alert to signs that tax policy changes might be in the offing. Where it is not possible to engage prior to the decision being made, it is still worthwhile to critique the policy and point out its likely impact, but there is less chance of bringing about immediate policy change.

More Potential Revenue Projects for Civil Society Budget Groups

- Assess the credibility of the revenue projections in the executive's budget.
- Examine the distribution of the tax burden, including possible gender bias and whether corporations are paying their fair share.
- Develop a list of principles to guide future tax policy debates.

Analyzing the Executive's Budget

Assessing revenues in the budget involves many of the same techniques as assessing expenditure programs.

The first step is to examine the level of revenues in the budget in light of expenditure demands for the coming year. A particularly important issue is whether the executive's revenue estimates for the year are credible. Over-

or under-stating the amount of revenue that will be collected can have deleterious effects on both the budget debate and implementation of the budget once it is enacted. Whether the executive's revenue estimates are realistic may depend on whether the underlying economic assumptions, including projected rates of economic growth and inflation, are reasonable.

In addition to assessing projected revenue levels, groups may also be interested in examining trends, determining the composition of revenue, and identifying broader policy implications. Different techniques are presented in detail in the supplement at the end of this chapter and are summarized below.

- **Revenues as a share of the economy.** The ratio of revenues to the size of the economy, or gross domestic product, offers the best measure of whether revenues (and thus government) are growing or shrinking over time relative to the economy. Tax revenues as a share of the economy gives an indication of the extent to which government draws on its citizens to support the public sector.

- **Year-to-year changes in revenues.** Unusually fast or slow growth rates in year-to-year revenue are typically a sign of changes in the economy (for instance, weakness in the economy would normally reduce revenue growth) or changes in tax policy. It is important to adjust for inflation and population growth when assessing the growth rate of revenues.

- **Different revenue sources as a share of total revenues.** Examining different revenue sources as shares of total revenue can give a rough indication of the shifting burden of taxation. For instance, if a growing share of total revenue is coming from a progressive individual income tax, while the share coming from regressive trade taxes is shrinking, the revenue system overall is probably becoming more progressive.

- **Revenues, expenditures, and deficits.** Examination of overall fiscal policy entails questions such as: Is the deficit rising or falling? If there is a deficit, is it primarily the result of below-average revenues or higher-than-average expenditures? What are the policies driving these trends? In some countries, policies are influenced by "fiscal targets," which can specify the level of revenues or expenditures or the deficit as a share of the economy; such targets may be part of structural adjustment packages required by international financial institutions in exchange for loans and other assistance.

- **Policy trade-offs.** A revenue analysis should begin by clarifying whether the budget's revenue proposals would cause revenues to rise or fall. It should then determine how this change would affect the rest of the budget. For instance, are revenue reductions being used to justify expenditure reductions? If the proposals would affect the level of expenditures, the next step would be to determine the specific areas of the budget in which spending would rise or fall.

Examining the Distribution of the Tax Burden

Civil society budget groups are often concerned with whether a country's tax burden is distributed equitably. An answer to that question ideally would draw on enormous amounts of detailed data about individual taxpayers, their incomes, their consumption patterns, and the taxes that they pay. Such information, however, can be gathered only by tax administrations and statistical agencies, which may conduct household surveys of income and expenditure. If such detailed data are not available—which is often the case in developing countries—civil society groups can still contribute to the debate on equity. They might, for example:

- **Examine the tax system's impact on a typical family.** A civil society group could examine the impact of the tax system on typical families in different categories—for instance, a single-parent household, a multi-generational household, a household with only one earner, and one with multiple earners. If median income data are available for a range of years, the analysis could examine changes in the tax burdens of these typical households over time by applying the tax laws in effect for each of those years (see, for example, Friedman and Shapiro, 2006).

- **Examine the tax system's impact on low-income households.** A group could compare the impact of the tax system on households with lower incomes, such as half of the median income or lower, with the impact on higher-income households. The analysis could highlight the income level at which households begin to pay the income tax—the so-called "tax entry" point—and where that point is relative to the poverty line (see, for example, Levitis and Johnson, 2006). The analysis could also address the burden imposed on low-income households by other taxes. If a country's income tax does not apply until a household's income exceeds a relatively high level, many may believe that low-income households face little or no tax burden. This belief is likely to be mistaken, however, since consumption taxes, such as the VAT and excise taxes, may significantly affect low-income households.

For a true assessment of the impact of a country's revenue system on low-income households, it may also be important to expand the analysis to include user fees. A civil society group might want to extend this analysis to the local level, where there are often many additional fees and taxes.

- **Examine whether the tax system treats men and women differently.** Groups may wish to scrutinize their countries' tax codes for evidence of explicit gender bias (when the tax rules explicitly distinguish between men and women) and implicit gender bias (when the tax rules have systematically different effects on men and women because of their different positions and roles in society). For instance, some personal income tax codes penalize lower-earning spouses, who are typically women. More generally, a regressive tax code can implicitly discriminate against women if they make up a majority of the poor. Tax administrations and statistical agencies often collect sex-disaggregated data but then do not release the data to the public. Groups would want to pressure these agencies to release any such data.

- **Examine taxes paid by corporations.** Civil society groups in the United States and the United Kingdom have undertaken analyses of corporate taxes, relying on the published financial statements these corporations provide to shareholders. These analyses compare the actual share of corporate profits paid in taxes to the statutory tax rate and other benchmarks, highlighting the extent to which corporations are able to reduce their tax burden by taking advantage of existing tax breaks and other tax-sheltering schemes. (See box on next page.)

- **Examine whether particular tax breaks achieve desired equity or other policy goals.** Policymakers may include provisions in the tax code that are intended to benefit low-income families. For instance, income tax deductions or credits may try to target subsidies to certain activities (such as health or education expenditures), or a value-added tax system may provide tax relief for certain basic goods and services. A possible project would be to examine such subsidies to see how effectively they help low-income households. The analysis could look at the design of the tax breaks (for example, are they useful only to families that have income tax liability?) and/or examine data on consumption patterns to see which types of households are the most likely to purchase the subsidized goods.

Civil Society Efforts in the U.K. and U.S. to Assess Corporate Taxes

In "Mind the Tax Gap," the Tax Justice Network (TJN) examined the taxes paid by the 50 largest U.K. companies between 2000 and 2004 (Murphy, 2006). Using these companies' public accounts, TJN assessed what it termed the "expectations gap"—the difference between the taxes paid by these corporations and the amount that the public would expect them to pay based on the statutory corporate tax rate. The report found that all 50 corporations paid lower taxes than would have been expected, and that the rate of tax actually paid by these companies fell over the period.

In general, the lower-than-expected taxes reflected the effects of a range of available tax breaks, as well as corporations' reliance on tax havens. The report estimated that if these and other corporations had paid the tax "that was reasonably expected of them," corporate tax revenues would have been about 28 percent higher, an amount that would have covered one-third of the annual cost of meeting the United Nation's Millennium Development Goals.

In the United States, the non-governmental group Citizens for Tax Justice (CTJ) has prepared numerous studies examining the taxes paid by corporations. In one analysis, CTJ assessed the financial reports of 275 corporations between 2001 and 2003 (McIntyre and Nguyen, 2004). It found that 82 of these companies, or nearly one-third, paid no tax or received a refund in at least one of three years covered by the study. This was the case even though these companies were profitable in those years and even though the study encompassed giant companies such as AT&T, Boeing, and General Electric. The CTJ report highlights that these companies report higher profits to their shareholders than to the Internal Revenue Service, sheltering nearly half of their profits from the tax collector. Much of this sheltering occurs as a result of tax breaks that have been explicitly enacted into law, such as a generous depreciation allowance, but some also reflects the use of offshore tax havens.

CTJ released its first analyses of corporate tax payments in the mid-1980s. Those reports showed that some major corporations were taxed at lower rates than the average American worker. The reports helped build support for the tax reforms adopted in 1986, which by closing many corporate loopholes were able to generate higher levels of corporate revenues even though they also reduced the statutory tax rate.

Whether corporations pay or evade taxes is an important part of how they affect the communities in which they operate. As such, corporate tax policies should be considered along with social and environmental policies as an issue of corporate responsibility. To bolster corporate responsibility in the tax area, civil society groups can call on corporations to report on their tax policies and tax payments in a more transparent manner (Beloe, et. al., 2006).

Other Possible Studies

Below are further projects that could be of interest to civil society groups.

- **Develop principles to guide a tax policy debate.** Proposals to change tax policy are often prompted by the need to meet some policy goal, such as stimulating the economy when it is in recession, reducing the deficit, meeting the requirements of trade agreements, or rationalizing the tax system to maximize long-term growth prospects. Unfortunately, the resulting debates often lose sight of these initial goals. For instance, deficit-reducing proposals may end up including deficit-increasing tax cuts on the grounds that they would increase long-run growth. Civil society groups can improve the quality of the debate by laying out clear principles for assessing policy proposals based on available economic research, the groups' own values, and experiences in other countries.

- **Analyze the effectiveness of the tax administration.** The quality of tax administration in a country can have a major impact on the government's ability to collect sufficient revenues and adopt new tax policies. Chapter 10 presents potential indicators that a study could use to assess the effectiveness of the tax administration. Such a study could also go a step further and propose improvements in the operations of the tax administration, or describe improvements adopted by other countries.

- **Identify existing tax expenditures.** Although a civil society group would not likely be in a position to estimate the revenue losses from tax expenditures, it may be able to compile a list of major tax expenditures. (This could require partnering with a tax lawyer or accountant.) By highlighting the existence of these subsidies, such a list could promote improved oversight and prompt discussions about the policy rationale for the provisions. It could also help pressure government to provide more information.

- **Assess the way revenue forecasting is done.** Many countries have no formal rules guiding their revenue forecasting process, and there is little coordination among the governmental and non-governmental actors involved. Further, revenue estimates are sometimes based on simplistic forecasting models and may then incorporate adjustments intended more to accommodate political goals than to overcome weaknesses in the model. Therefore, finding out more about the revenue forecasting process could allow a group to highlight a key weakness in the budget process.

- **Examine non-tax revenues.** All countries have some non-tax revenues, ranging from donor assistance to user fees. In many developing countries these sources account for a significant proportion of the budget. Often, however, the government provides even less information about these sources than about tax revenue. User fees are particularly important, as they can have a significant impact on low-income households. They can also have gender implications. For instance, where user fees are imposed for schooling, families may be more willing to pay these fees for their sons than their daughters.

- **Compare the country's tax system with that of its neighbors.** Such an analysis could be of particular interest if countries in a given region are trying to harmonize their tax systems as they move toward greater economic integration. It would also be of interest in the opposite circumstance—when neighboring countries are competing against each other for foreign investment by lowering their tax rates, which can make it difficult for a country to generate needed revenues. An analysis showing that a country's tax burden is comparable to those of its neighbors could help counter efforts to enact revenue-reducing tax cuts.

- **Examine local revenues.** Local governments typically impose a range of different taxes and fees. While each of these might be small in itself, the amounts add up for poor families. Further, the taxes and fees may vary from one local government to another. In countries moving toward further decentralization, charges imposed by local government will become ever more important.

  In addition to looking at the direct impact of these charges on poor households, a group investigating local revenue should ideally investigate how revenue is shared between national and sub-national levels of government. Without equitable sharing, local governments in predominantly poor areas will struggle to provide the necessary services. An examination of this issue would need to look at whether there is formula for determining how nationally raised revenue is distributed between the national and sub-national levels and among the different sub-national governments. Countries such as India and South Africa have established commissions to recommend how this division should be done; in these countries, civil society groups can try to influence these bodies.

- **Highlight revenue issues related to a particular aspect of the economy.** If a sector of the economy has a significant impact on revenues—for instance, the extractive industries or a large informal sector—it may be useful to investigate this in more detail (see, for example, Ott, 2002).

- **Investigate different ways of paying for expenditure proposals that will require significant funds.** Civil society budget work sometimes involves proposing changes on the expenditure side of the budget that would require substantial additional funds. A major expenditure proposal is likely to be taken more seriously by decision-makers if it is accompanied by viable options to raise the needed revenue. Civil society groups could use household survey data or other means to simulate various tax policies that could raise the necessary funds. The analysis would need to discuss how the proposed tax and expenditure changes together would affect the distribution of income. For instance, in South Africa many civil society groups favor creation of a basic income grant for every individual in the country to address widespread poverty. Supporters have done simulations to explore options for changing various taxes in ways that would cover the cost of the basic income grant without imposing such a large burden on the poor that it undoes the benefits of the grant.

Supplement: Toolkit for Basic Revenue Analysis Techniques

This supplement presents the methods of revenue analysis outlined in Chapter 8 and applies them to a fictional budget.

The supplement describes how to:

- examine aggregate budget figures (revenues, expenditure, deficits, and debt) and macroeconomic assumptions (gross domestic product—or GDP—and inflation);
- assess aggregate budget figures as a share of GDP;
- develop an index to adjust GDP and budget figures for the effects of inflation and analyze inflation-adjusted (or "real") rates of growth for GDP and revenue; and
- assess the components of revenue as percentage shares of total revenues, by their year-to-year growth, and as shares of GDP.

Background: Understanding What Information Is in the Budget

The information provided in this fictional budget is presented in terms of "fiscal years," which are yearly accounting periods used by the government. Fiscal years may be different from calendar years. For instance, a country's fiscal year might run from July 1 through June 30 rather than January 1 through December 31. The legislature typically receives the budget at least one month, and frequently three or more months, before the new fiscal year starts.

The budget document in this exercise includes information for seven fiscal years. The aggregate budget figures presented in Table 1 are: revenue, expenditure, deficit (or surplus), public debt, gross domestic product (GDP), and the rate of inflation. These aggregates are measured in billions of dollars, except for inflation, which is shown as an annual percentage change.

Table 1

Budget Aggregates

(in billions of dollars, except when otherwise noted)

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Revenue	14.1	14.7	17.4	19.1	23.3	28.1	32.9
Expenditure	16.9	19.0	21.6	24.9	27.8	30.6	33.3
Deficit/Surplus	-2.8	-4.3	-4.2	-5.8	-4.5	-2.0	-0.4
Debt	24.2	28.5	32.7	38.5	43.0	45.0	45.4
GDP	50.0	54.1	60.2	66.8	75.4	85.3	96.8
Inflation (rate)	8.6%	8.7%	9.6%	10.2%	9.4%	8.6%	7.2%

The first three years in Table 1 (Years 1-3) are historical data. They reflect the actual amounts of revenue collected and funds spent in the year. Year 4 is referred to as the "current year" because it reflects data for the fiscal year that is underway when the budget for the upcoming fiscal year is submitted to the legislature. Data for the current year reflect a mix of actual figures, based on what has actually occurred to date in the fiscal year, and projections for the remaining months of the fiscal year.

The budget then presents estimates for the forthcoming fiscal year—called the "budget year" (Year 5)—plus two additional years (Years 6 and 7). Providing three years of budget estimates is consistent with a medium-term expenditure framework. The figures for Years 5 through 7 are projections, reflecting estimates of the impact of the executive's policy proposals.

Aggregate government revenue appears in the first row. The next row shows aggregate government expenditure. The third row is the deficit or surplus in each year, or the difference between revenue and expenditure for the year. When expenditures exceed revenues, this figure is negative, and the country is said to be running a deficit. If revenues exceed expenditures, the country is said to be running a surplus.

Revenue – Expenditure = Deficit/Surplus

Revenue < Expenditure → Deficit
Revenue > Expenditure → Surplus

The budget is in deficit in each of the seven years presented in the budget document. The debt is the cumulative amount that government has borrowed from the public as of the end of the previous year to finance its deficits.[1] In Year 1, the debt of $24.2 billion indicates that the country had been running deficits in the years prior to those covered in the budget. To calculate debt for a given year, the deficit for that year is added to the debt from the previous year.

$$\text{Debt}_Y = \text{Debt}_{Y-1} + \text{Deficit}_Y$$

So, for example, debt in Year 4 was calculated by adding the deficit in Year 4 ($5.8 billion) to the debt in Year 3 ($32.7 billion), for a total of $38.5 billion.

The last two rows of Table 1 provide information about the macroeconomic assumptions (assumptions regarding the state of economy as a whole) underlying the budget. One row shows GDP, the standard measure of the total output of the economy. The other row shows the rate of inflation that occurred each year, or that is projected to occur in the future. The table indicates that the country has been experiencing significant inflation and is expected to continue experiencing inflation in the future.

Assessment

With this basic aggregate data, it is possible to gain some understanding of the proposed budget. For instance, the deficit is expected to shrink over the three-year budget period, falling from $5.8 billion in the current year (Year 4) to $0.4 billion by Year 7. This decline comes after several years of rising deficits, which increased from $2.8 billion in Year 1 to $5.8 billion in Year 4. A key issue therefore is what policies are being pursued to achieve this deficit reduction.

All of the other aggregate budget figures—revenues, expenditures, and debt—are rising over the budget period. Revenues are projected to rise from $19.1 billion in Year 4 to $32.9 billion in Year 7. Spending is estimated to grow from $24.9 billion in Year 4 to $33.3 billion in Year 7.

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[1]This fictional budget assumes that the deficit is financed entirely by borrowing. Governments can finance deficits by means other than borrowing. For instance, they can raise funds by selling public assets to the private sector. (See box on pages 20-21.)

These figures will have more meaning if they are examined as a share of GDP and are adjusted to remove the distorting effects of inflation, as explained in the next two sections.

Relating Budget Aggregates to the Size of the Economy

Looking at revenue—particularly tax revenue—as a share of GDP gives a sense of the extent to which government draws resources from its citizens. This can be a particularly useful measure when examined over time. A growing economy should generate greater resources. If overall revenue, or revenue from a particular tax, grows in absolute terms but falls as a share of the economy, the government may not be able to fund the expanded services that are required by an expanding economy. To measure a budget figure relative to the overall size of the economy, one divides the budget figure in a given year by GDP in that year.

Share of GDP = Budget Figure ÷ Gross Domestic Product

Converting budget figures into shares of GDP provides a useful way to look at trends over time, particularly when there is no information in the budget regarding inflation. (Calculating shares of GDP implicitly adjusts for inflation, as explained in the box on page 68.) The relationship of the budget to GDP can also be used to compare the budgets of different countries.

Using the data from Table 1, we calculate shares of GDP (shown as percentages) for each of the budget aggregates in Table 2.

Table 2

Budget Aggregates, Shares of GDP

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Revenue	28.2%	27.2%	28.9%	28.6%	30.9%	32.9%	34.0%
Expenditure	33.8	35.1	35.9	37.3	36.9	35.9	34.4
Deficit/Surplus	–5.6	–7.9	–7.0	–8.7	–6.0	–2.3	–0.4
Debt	48.4	52.7	54.3	57.6	57.0	52.8	46.9

Assessment

Converting the budget figures into shares of GDP helps to clarify the picture that emerged from looking at the figures themselves:

- The deficit in the budget is projected to fall significantly, from 8.7 percent of GDP in Year 4 to 0.4 percent in Year 7.

- Although the decline in the deficit was evident in Table 1, the impact of this shrinking deficit on the debt was not clear, since Table 1 shows the debt continuing to rise. When the debt is shown as a share of GDP (as in Table 2), however, it becomes clear that the debt declines sharply, from 57.6 percent of GDP in Year 4 to 46.9 percent of GDP in Year 7.

- Revenue as a share of GDP, which had been relatively flat during the historical years (hovering around 28 percent of GDP), rises rapidly over the budget period, reaching 34.0 percent of GDP by Year 7.

- Spending (expenditure) declines as a share of GDP, from 37.3 percent in Year 4 to 34.4 percent in Year 7. Projected spending as a share of GDP in Year 7 is much lower than Year 4 but slightly higher than Year 1.

The above types of trend analyses can give a sense as to whether a proposed policy course is realistic. The aggregate figures presented in Table 2, for instance, indicate a dramatic change of course over just a few years, with revenues rising and expenditures falling as a share of GDP in order to reduce the deficit sharply. Whether such a significant shift in a country's fiscal stance is credible requires examination of the policy changes underlying these figures.

Adjusting for Inflation

All of the figures presented in Table 1 are in "nominal" or "current" dollars; that is, they are measured in dollars in a particular fiscal year. This can make it appear that government is raising more revenue from a particular tax (because nominal dollars increase), when in reality the government does not have more resources at hand, since expenditure programs will also be more costly after factoring in the effects of inflation. It is therefore best to remove the effects of inflation, so that changes due to factors other than inflation can be examined.

Adjusting for Inflation and Population

When there is inflation in an economy, then a dollar in the future will be worth less (in terms of what it can purchase) than a dollar today. If inflation in the economy is 10 percent, for instance, then the same item will cost 10 percent more from one year to the next; this means that revenues must rise by 10 percent merely to fund the same programs as the year before. Adjusting budget figures for the effects of inflation helps to put figures for different years on a comparable basis.

Many analysts also recommend adjusting budget figures to take into account the change in the size of the country's population. When the population increases, revenues usually increase because more people are paying taxes. Similarly, the cost of government programs increases because the number of people needing government services also rises. If government spending remains static in the face of a growing population, either the share of citizens receiving government services will have to fall every year or the average benefits received by each person will have to be cut.

Adjusting for population is obviously more important in countries with relatively high population growth. To adjust for population, one can develop a population index following the same process described in the text for creating an inflation index.

Assessing budget figures as a share of the economy (GDP) over time implicitly adjusts for both inflation and population. The inflation adjustment occurs because inflation is reflected in both the nominal budget figure and the nominal GDP figure; when the budget figure is divided by the GDP figure, the effects of inflation are cancelled out. Similarly, the GDP figure implicitly takes into account population growth, because the size of the labor force is linked to population growth.

One way to exclude the effects of inflation is to use an inflation index. The inflation index shows how the price of a given bundle of goods and services has changed over time. It allows us to convert nominal figures into "real" or "constant" figures.

Some governments provide an index in their budget documents. If they do not, one can usually develop an index using the inflation rates provided in the budget. To calculate the inflation index value in a given year, take the value in the prior year and multiply it by the sum of one plus the rate of inflation in that year. This process begins by setting the index value for Year 1 at 1.000.

The index for Year 2 is calculated by multiplying the index in Year 1 (1.000) by one plus the rate of inflation in Year 2 (1 + 8.7 percent = 1.087). (The rate of inflation is shown in the last line of Table 1.) For Year 3, the Year 2 index is increased by 1.096 (one plus the 9.6 percent inflation rate for Year 3). That yields an index of 1.191 (1.087 × 1.096) for Year 3. This process is continued for all of the years covered in the budget.

Creating an Inflation Index

Index Value Y_1 = 1.000
Index Value Y_2 = Index Value Y_1 × (1 + Inflation Rate Y_2)
Index Value Y_3 = Index Value Y_2 × (1 + Inflation Rate Y_3)
Etc.

The resulting price index, shown in Table 3, can then be used to convert the nominal figures into real dollars. This is achieved by dividing the figure for any year by the corresponding index amount. Because Year 1 is set to 1.000, it is the "base year." That is, the resulting dollar levels shown after applying the index would be consistent with the price levels for Year 1.

In most cases, it is helpful to set the index so that the base year is the current year (or Year 4 in this fictional budget), because people intuitively understand the current price levels that they face. The conversion is achieved by dividing each of the index amounts by the index for Year 4 (1.312). The result is shown in Table 3.

Table 3

Inflation Index

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Index (Year 1=1.000)	1.000	1.087	1.191	1.312	1.435	1.558	1.670
Index (Year 4=1.000)	0.762	0.829	0.908	1.000	1.094	1.188	1.273

Table 4 shows the effect of applying the inflation index to revenue and GDP figures from the budget. (The index could also be applied to the expenditure, deficit, and debt figures, but the focus of the remainder of this discussion is on revenue.)

Table 4 shows that both real revenue and real GDP fell in Year 2, which means the growth in these measures observed in Table 1 was entirely due to the effects of inflation. Because revenues are strongly influenced by economic conditions, they tend to be correlated with the overall size of the economy. When the economy contracted in Year 2, for example, revenues also declined. If, on the other hand, revenues decline when the economy is growing, the underlying explanation is often a policy change rather than economic conditions.

Table 4

Calculating Real Revenue and GDP

(in billions of dollars)

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Nominal revenue	14.1	14.7	17.4	19.1	23.3	28.1	32.9
Nominal GDP	50.0	54.1	60.2	66.8	75.4	85.3	96.8
Inflation Index (Year 4=base year)	0.762	0.829	0.908	1.000	1.094	1.188	1.273
Real revenue	18.5	17.7	19.2	19.1	21.3	23.7	25.8
Real GDP	65.6	65.3	66.3	66.8	68.9	71.8	76.0

Note: Real levels are calculated by dividing the nominal levels by the inflation index.

Rates of Growth

The growth rate of revenue is calculated by taking the difference between revenue in one year and revenue in the preceding year, and dividing this figure by revenue in the previous year. An alternative calculation that yields the same result is to divide revenue in one year by revenue in the preceding year and then subtract 1 from the result.

$$\text{Growth Rate}_Y = (\text{Level}_Y - \text{Level}_{Y-1}) \div \text{Level}_{Y-1}$$

or

$$(\text{Level}_Y \div \text{Level}_{Y-1}) - 1$$

To calculate the expected rate of real GDP growth in Year 7, for instance, one would divide $76.0 billion by $71.8 billion and then subtract 1, for a result of 0.059 or 5.9 percent. Table 5 applies this formula to revenue and GDP in each of the years for which data were provided in the budget. No growth rates are shown for Year 1 because they would require data for the year prior to Year 1, which are not provided.

Table 5

Real Growth Rates

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Revenue	N/A	-4.1%	8.0%	-0.4%	11.5%	11.1%	9.2%
GDP	N/A	-0.5%	1.6%	0.7%	3.2%	4.2%	5.9%

Assessment

Table 5 shows that both real GDP and real revenue declined in Year 2. Further, while there was a rebound in Year 3, real growth is predicted to be less than 1 percent in the current year, and real revenues are expected to decline by 0.4 percent.

Nevertheless, the budget predicts strong and accelerating economic growth over the three-year budget period. By Year 7, the economy is projected to grow in real terms by 5.9 percent. Similarly, revenue growth is predicted to be over 11 percent in both Year 5 and Year 6 and about 9 percent in Year 7. Such an improvement may not be impossible, but it is not common. To achieve high and sustained rates of economic growth would require the government to take a number of significant steps, given the weak growth seen in the previous years. Thus, a key issue is whether the budget provides a convincing explanation for this high predicted growth.

Components of Revenue

Governments typically collect revenue from a variety of sources. It is important, therefore, to know what a country's major sources of revenue are. Table 6 shows that the imaginary country relies on five main sources: an income tax, a value-added tax (VAT), customs duties (such as tariffs and other trade taxes), a variety of smaller taxes (labeled as "other taxes"), and grants from donors. Note that the total revenue shown in Table 6 is the same as the "revenue" row in Table 1.

Table 6

Components of Revenue

(in billions of nominal dollars)

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Income tax	2.1	1.8	2.3	2.8	3.5	4.4	5.7
VAT	3.3	3.2	4.2	5.0	6.9	9.7	13.7
Customs duties	3.9	3.7	4.0	4.1	3.7	3.4	1.6
Other taxes	0.5	0.3	0.1	0.2	0.2	0.4	0.4
Donor grants	4.3	5.7	6.8	7.0	9.0	10.2	11.5
Total revenue	14.1	14.7	17.4	19.1	23.3	28.1	32.9

It will be easier to assess trends by looking at each revenue type as a share of total revenue. To calculate the percentage share, divide the revenue from a given source by total revenue. The data are shown in Table 7.

Percentage Share = Revenue Type ÷ Total Revenue

Table 7 shows that in the current year (Year 4), donor aid is the largest source of revenue, representing nearly 37 percent of all revenue. The VAT accounts for just over one-quarter of all revenue, and customs duties about one-fifth. You can present these conclusions visually by putting them in a pie chart; Microsoft Excel and PowerPoint are commonly used for this purpose, but many other spreadsheet and word-processing programs should have this function as well. (Often, these programs calculate the percentage shares automatically.) The pie chart in Figure 1 shows the components of revenue in the current year.

Table 7

Components of Revenue, Shares of Total

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Income tax	14.9%	12.2%	13.2%	14.7%	15.0%	15.7%	17.3%
VAT	23.4	21.8	24.1	26.2	29.6	34.5	41.6
Customs duties	27.7	25.2	23.0	21.5	15.9	12.1	4.9
Other taxes	3.5	2.0	0.6	1.0	0.9	1.4	1.2
Donor grants	30.5	38.8	39.1	36.6	38.6	36.3	35.0
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0

It is also important to look at changes in the revenue shares over time. To represent this visually, a stacked bar chart is useful (see Figure 2). The stacked bars in Year 4 present the same data that are in the pie chart (Figure 1). Over the budget period, the bars representing customs duties progressively shrink, with a steep decline in Year 7. At the same time, the bars representing the VAT and income tax progressively expand. This bar chart shows, therefore, that the government proposes to reduce its reliance on customs duties and increase its reliance on the VAT and (to a lesser extent) the income tax. The VAT is projected to surpass donor grants in Year 6 as the largest source of revenue.

The tools covered above—adjusting for inflation, calculating year-to-year growth rates, and measuring as a share of the economy—can also be applied to the components of revenue (see Tables 8, 9, and 10 on page 75). These additional calculations can help to shed light on some of the issues discussed above, such as whether the proposed level of revenues is realistic.

Figure 1

Components of Revenue, Current Year (Year 4)

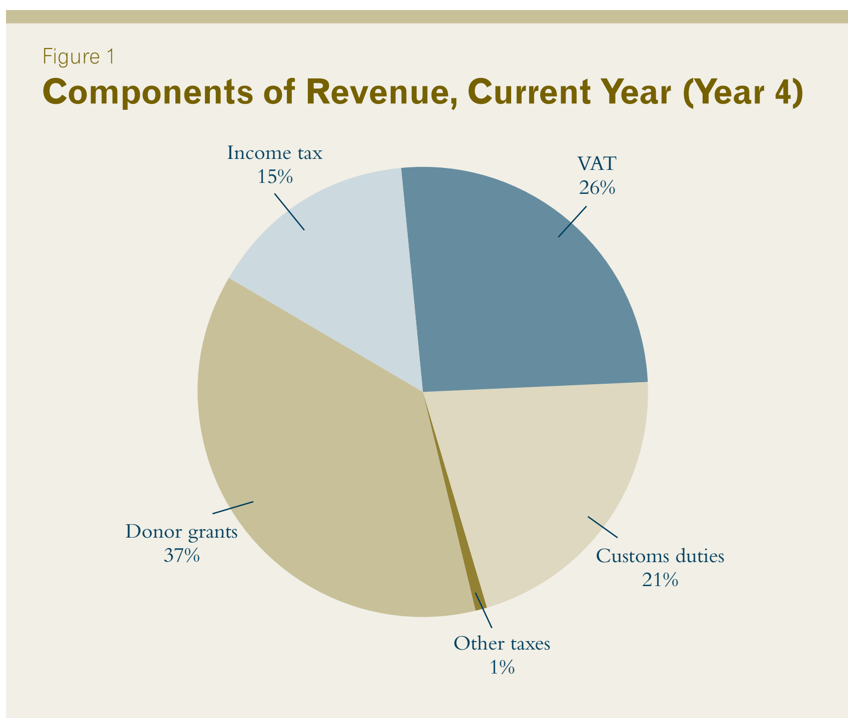
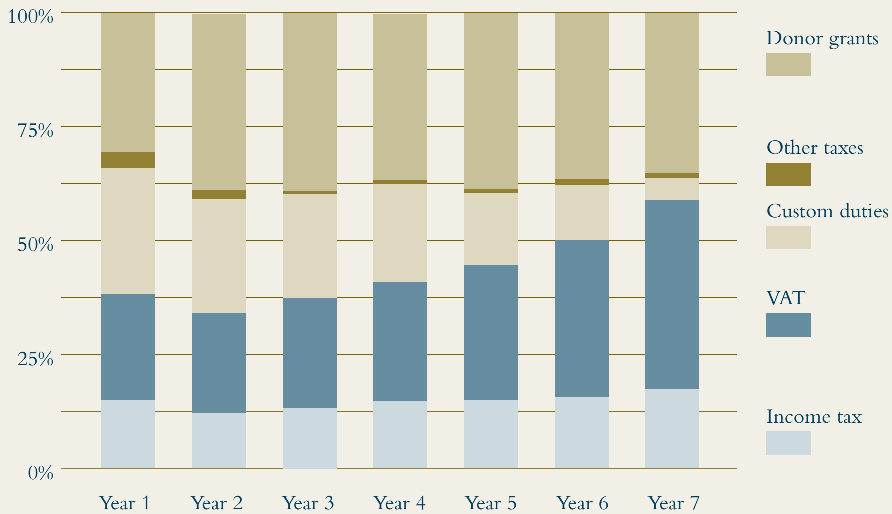


Figure 2

Percentage Shares of Revenue Components, Years 1-7



Assessment

Based on the above, we find the following:

- VAT revenues are projected to jump sharply, showing real growth rates of 26 percent in Year 5, 30 percent in Year 6, and 32 percent in Year 7 (see Table 9).

- Similarly, income tax revenues are projected to grow by at least 14 percent a year over the three budget years. Although income tax revenues had grown rapidly in the prior year (Year 3), this followed a year during which these revenues had declined, and such high growth did not continue in the following year.

- Revenues from customs duties fall sharply in the budget projections. These revenues had been declining in prior years as well, but the fall-off in Year 7 is large.

- Although the real rates of year-to-year growth for "other" taxes appear to be dramatic, exceeding more than 80 percent in some years, the impact on the budget is minimal because the amounts involved are very small. By looking at these revenues as a share of GDP, one can see that changes in "other" tax revenue have little effect on total revenue collections over the period.

Table 8

Components of Revenue, Adjusted for Inflation

(billions of Year 4 dollars)

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Income tax	2.8	2.2	2.5	2.8	3.2	3.7	4.5
VAT	4.3	3.9	4.6	5.0	6.3	8.2	10.8
Customs duties	5.1	4.5	4.4	4.1	3.4	2.9	1.3
Other taxes	0.7	0.4	0.1	0.2	0.2	0.3	0.3
Donor grants	5.6	6.9	7.5	7.0	8.2	8.6	9.0
Total revenue	18.5	17.7	19.2	19.1	21.3	23.7	25.8

Table 9

Components of Revenue, Real Rates of Year-to-Year Growth

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Income tax	N/A	-21.1%	16.6%	10.5%	14.3%	15.8%	20.9%
VAT	N/A	-10.8	19.8	8.1	26.2	29.5	31.8
Customs duties	N/A	-12.7	-1.3	-7.0	-17.5	-15.4	-56.1
Other taxes	N/A	-44.8	-69.6	81.6	-8.6	84.2	-6.7
Donor grants	N/A	21.9	8.9	-6.6	17.6	4.4	5.2
Total revenue	N/A	-4.1	8.0	-0.4	11.5	11.1	9.2

Table 10

Components of Revenue, Shares of GDP

	Year 1 Actual	Year 2 Actual	Year 3 Actual	Year 4 Current	Year 5 Budget	Year 6 Budget	Year 7 Budget
Income tax	4.2%	3.3%	3.8%	4.2%	4.6%	5.2%	5.9%
VAT	6.6	5.9	7.0	7.5	9.2	11.4	14.2
Customs duties	7.8	6.8	6.6	6.1	4.9	4.0	1.7
Other taxes	1.0	0.6	0.2	0.3	0.3	0.5	0.4
Donor grants	8.6	10.5	11.3	10.5	11.9	12.0	11.9
Total revenue	28.2	27.2	28.9	28.6	30.9	32.9	34.0

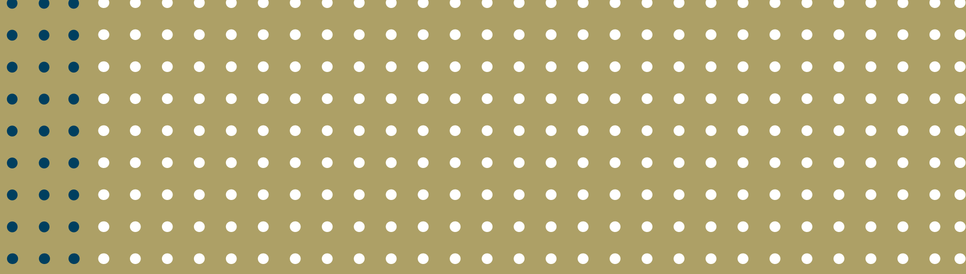
- After declining by nearly 7 percent in the current year, donor grants are projected to grow in real terms over the three-year budget period.

Together, these pieces of information describe dramatic changes to the country's tax system. The overriding question is whether the projected growth in revenues, particularly the VAT, is achievable. Underlying these VAT projections are presumably politically sensitive policy proposals such as broadening the VAT base and/or increasing the VAT rate. The projections also assume that the tax administration has the capacity to implement these changes in a short time frame. Similar policy changes are likely behind the projected growth in income tax revenues. The budget also continues to rely on donor grants to meet over one-third of the country's revenue needs. Any doubts about whether revenues from these various key sources will materialize would raise serious questions about the credibility of other aspects of the budget, such as meeting deficit targets or funding spending priorities.

The tax policy changes assumed in the budget also raise important equity issues. Boosting income tax revenues and shrinking customs duties would make the tax system more progressive. But this is counterbalanced by the significant expansion of the VAT, which could place a heavy burden on the poor. Thus, a close examination of each of the revenue policies and the structure of the taxes (for instance, items exempt from the VAT) would be needed to determine how the proposed changes would affect people with low incomes.

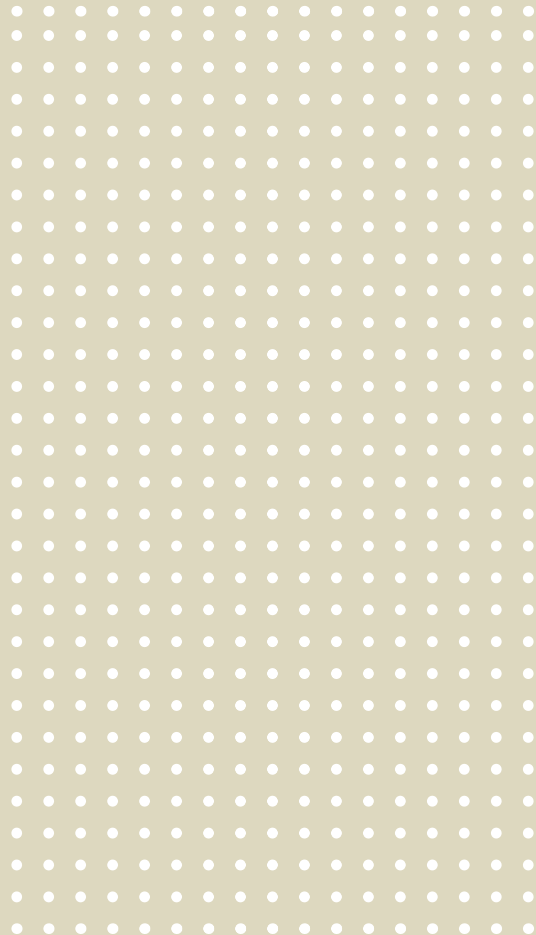
Conclusion

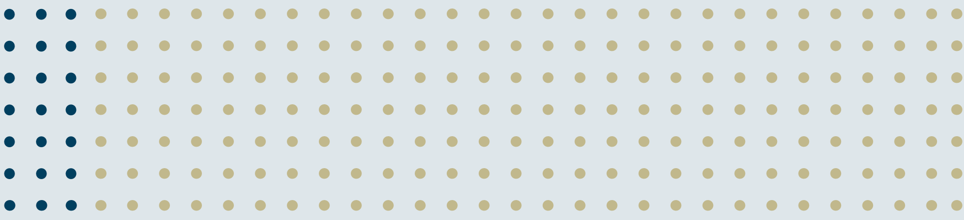
This toolkit provides an overview of some of the analytical tools that can be used to examine a budget. These methods are useful for identifying the impact of the economic assumptions and policy proposals presented in the budget on the budget's revenue, expenditure, and deficit projections. The resulting analyses can help to highlight important trends and facilitate a more in-depth examination of the proposals in the budget.



PART THREE

Selected Revenue Policy Issues and Civil Society Budget Work





9 Value-Added Taxes and Personal Income Taxes

This chapter provides an overview of the mechanics of the value-added tax and the personal income tax. The chapter focuses on these two tax types because of their worldwide prevalence and their prominence in current tax debates. Despite their importance, they are not the only taxes with which civil society groups are likely to be concerned. Other taxes not covered in this chapter, such as corporate taxes and tariffs, are significant sources of revenue in many countries and raise their own issues. (Some issues associated with these taxes are discussed in Chapter 11.)

This chapter examines how the structure of the value-added tax and personal income tax affects equity, efficiency, and tax administration. It also suggests ways for civil society budget groups to engage in country-specific investigations of these taxes.

Issues That Civil Society Can Explore

- Is the government expanding its reliance on the VAT, and is this a sign that the poor are facing a greater tax burden?
- Are VAT exemptions well designed to reduce tax burdens on the poor?
- What is the income level at which one starts to owe income tax, and is it high enough to exempt low-income families?
- Do features of the income tax result in biases against women?

Value-Added Tax (VAT)

The value-added tax has been adopted by at least 136 countries worldwide. Its spread has been rapid in recent years, particularly in developing and transitional countries. Over the past decade, the number of low- and middle-income countries with a VAT has more than doubled (Keen and Simone, 2004; see the box on next page).

VAT supporters believe that, when properly implemented, a VAT can raise significant revenue without "distorting" economic decisions as much as other taxes. As a consumption tax, however, the VAT typically imposes a significant

burden on the poor. Moreover, the VAT has not functioned as smoothly in practice as many economic theorists had projected: businesses often complain about the administrative burden of complying with a VAT; governments find that the VAT does not always raise as much revenue as hoped; and consumers are sometimes wary of the VAT, fearing that merchants who collect the tax are pocketing the receipts rather than turning them over to government. Despite these problems, there is every indication that this tax will continue to be an important source of government revenue.

The Recent Rise of the VAT

First introduced in France in 1948, the VAT initially spread slowly, but in the late 1960s it was adopted by a number of Latin American and Western European countries. The pace of VAT implementation slowed after the 1970s, then picked up in the late 1980s and early 1990s, when it spread to nearly all of the Central Eastern European countries (CEEC). The VAT's rise among the CEEC reflected their need to replace their traditional sources of revenues (such as from state-owned enterprises) as well as a desire to satisfy membership requirements of the European Union. The CEEC have been joined by a large number of countries in Sub-Saharan Africa and Asia and the Pacific, and by the small-island economies. Overall, about one-quarter of the countries with a VAT initiated the tax within the last decade, and three-quarters within the last two decades (International Tax Dialogue, 2005).

Many of the low- and middle-income countries that impose a VAT participate in IMF and World Bank programs, which often strongly encourage adoption of a VAT as part of a broader program of trade liberalization. The argument has been that the VAT would provide a secure source of revenue and thus allow for the phasing out of trade taxes, although in practice the VAT has not always generated as much revenue as the trade taxes being eliminated. (See Chapter 11 for a further discussion of the issues surrounding VAT adoption in the context of trade liberalization.)

Mechanics of the VAT

Unlike a general sales tax, which is collected at the final stage of the production process when the good or service is sold to the consumer (see box on page 82), the VAT is collected in stages. Each stage corresponds to a point at which value is added during the manufacturing and distribution processes. Despite being collected in stages, the VAT (like the sales tax) is paid by the final consumer, because the intermediate actors who manufacture and distribute the good or service are able to recoup the VAT they paid.

The following example shows how the VAT is collected in the case of the production of wooden chairs (McLure, 2005). A single 10 percent rate is assumed.

Table 1

Value-Added Tax During the Production Process

Stage of Production	Harvest	Manufacture	Retail	Total
Basic transactions				
1. Sales	$300	$700	$1,000	
2. Purchases	$0	$300	$700	
3. Value added (sales – purchases)	$300	$400	$300	$1,000
Value-Added Tax				
4. Tax on sales (10% of line 1)	$30	$70	$100	
5. Less: Input tax on purchases	$0	$30	$70	
6. Net VAT liability (10% of line 3)	$30	$40	$30	$100
Final Price				
7. Final sale price (line 1+line 4)	$330	$770	$1,100	

- A wood harvester collects wood and sells it to a chair manufacturer. The manufacturer pays the harvester $300 for the wood, plus an additional 10 percent ($30) for the VAT, which the harvester remits to the government. So, the final price paid by the manufacturer is $330, including VAT charges, as shown in Line 7 of Table 1.

- The chair manufacturer uses the wood to construct chairs, which it sells to the furniture retailer for $700, plus a VAT of 10 percent ($70), for a total price of $770. Of that $70 VAT, the manufacturer receives a credit for the $30 in tax it paid to the harvester, with the remaining $40 going to the government. To put it another way, the chair manufacturer was responsible for $400 worth of value added (the $700 pre-tax price of the chair minus the $300 pre-tax price of the harvested wood), and the government collects 10 percent of that $400 in added value ($40) through the VAT.

- The retailer sells the finished chairs for $1,000 and collects a VAT of $100, so the final price paid by the consumer is $1,100. Of the $100 that the retailer collects from the consumer, it receives a credit for the $70 in tax it paid to the manufacturer; the remaining $30 goes to the government. In other words, the retailer was responsible for $300 worth of value added (the $1,000 final sales price minus the $700 paid to the manufacturer for the chairs), so the government collects 10 percent ($30) of this value added. At the end of the process, total government revenue collected is $100—the sum of the VAT collections for each stage of production.

Sales Taxes and Excise Taxes

Besides the VAT, two other common consumption taxes are general sales taxes and excise taxes. In many countries, the VAT has largely replaced these taxes, though some countries continue to levy excise taxes alongside the VAT.

A general sales tax imposes a tax on the sale of goods and services; the tax is included in the final price paid by the customer. Unlike the VAT, the sales tax is levied only when the good or service passes from the business to the consumer. For instance, if a sales tax with a 10-percent rate were applied in the example shown in Table 1 instead of a VAT, the consumer of the chair would still owe $100 in tax on a $1,000 chair, but all of the tax would be collected at this final stage and none would be collected during the intermediate stages of the production process.

Excise taxes are basically sales taxes that are imposed only on particular items. They may be levied on a specific basis (a set charge per item) or on an *ad valorem* basis (a charge based on a percentage of the value of the item). These taxes are most efficient at raising revenue when they are targeted on a narrow base of "inelastic" goods—that is, goods for which changes in price do not significantly affect demand.

Excise taxes are sometimes referred to as "sin taxes," because they can be a way to put an economic price on activities that are considered harmful for society as a whole. For example, excise taxes can be imposed on the use of fuels or other substances that pollute the environment, or on goods such as tobacco that harm health and impose costs on non-smokers. In some cases, the primary goal of these taxes is not to raise revenue but to impose a cost on undesirable behavior that better reflects the actual cost to society.

The VAT's structure can reduce the risk of revenue loss from tax evasion and encourage compliance with the tax. Because the revenue from a VAT is collected in increments, less revenue is involved at each stage, so individual cases of tax evasion will cost the government less revenue.

In addition, businesses must register with the tax administration in order to be part of the VAT system and must receive invoices from other registered businesses in order to claim credit for the VAT they paid on their purchases. Thus, businesses have an incentive to make sure they are dealing with other registered businesses. Some view this feature of the VAT as making it virtually self-enforcing. In reality, however, the IMF reports that this positive feature of VAT is frequently undermined by fraudulent practices, such as falsifying VAT invoices (Ebrill, et. al., 2001).

Exceptions to the VAT

Consumption represents a significant part of any country's economic activity, so it provides a broad tax base. Governments generally do not, however, tax all consumption. Some activities, such as financial services, are difficult to tax and are therefore not usually included in the VAT base. Further, most developing and transitional countries have informal sectors that operate outside of the tax system altogether. In some cases, the informal sector accounts for a significant share of the country's economic activity.

In addition, most countries exempt from the VAT some or all consumption related to health care, education, housing, and food. The rationales for these exclusions vary. For instance, health care is generally consumed in greater quantities when one is ill, so charging VAT on health care would impose a larger burden on people who are sick. Education is an important social investment that most governments wish to encourage, and charging VAT on education could discourage some from pursuing their education further.

A key rationale for sparing many of these items from the VAT is the need to reduce the VAT's burden on the poor. The VAT can impose a heavy burden on the poor (see Chapters 3 and 5 for more discussion), and governments commonly use exemptions to address this equity concern.

Exempting an item from the VAT means that no tax is charged on the final sale of that good or service. Exemptions are relatively easy to administer, because retailers do not need to file invoices. In addition, governments still collect some VAT revenue from exempt items, since they continue to collect the VAT during the intermediate stages of the production process, but do not provide credit to the retailers for the taxes they paid. A disadvantage is that sellers of exempt goods may increase their prices to account for the taxes they have already paid on their inputs—that is, the VAT collected on inputs will be passed on to the consumer, who will therefore still pay some tax on the exempt item.

Countries often also provide VAT exemptions for small businesses. The usual approach is to set "registration thresholds": businesses with receipts below a given threshold are exempt from collecting VAT on the goods and services they sell. This eliminates the compliance burden for small businesses and also frees the tax administration from the task of monitoring them, which is unlikely to be a cost-effective activity (see Chapter 10).

Governments may also eliminate the VAT entirely on selected items through "zero-rating." Zero-rating involves setting the final VAT rate at zero, meaning no VAT is charged to the consumer and the government collects no revenue. The manufacturer and retailer still receive credit for any VAT they have paid. For instance, if the sale of the chair in the example above were zero-rated, the final price of the chair would be $1,000, rather than $1,100. The furniture retailer would not charge the customer the $100 VAT on the sale of the chair, but all of the businesses involved in the manufacture and sale of the chair would still receive credit for the VAT they paid during the production process. Zero-rating is used with goods that are exported because the VAT is intended to apply only to goods sold in the domestic market.

Another approach used in many countries is to rely on multiple VAT rates, imposing a lower rate on items that are more heavily consumed by the poor and a higher rate on items favored by the well-off. A similar result can be achieved when a single-rate VAT is coupled with an excise tax for selected items.

Zero-rating, exemptions, and multiple rates all have their shortcomings. They reduce revenue collections, and so require higher rates on non-preferential items to collect the same level of revenue. They also pose administrative problems and create opportunities for fraud and tax evasion. Further, this tax relief is not always well targeted. Nevertheless, these are the primary methods available for reducing the VAT's burden on the poor.

Civil Society Analysis of the VAT

Listed below are some ways in which civil society groups can help inform debates surrounding the VAT:

- **Apply tools of basic budget analysis to available estimates.** There are a number of relatively simple calculations that can help determine the significance of the VAT to a country's tax system (see the supplement at the end of Chapter 8). For instance, it may be useful to look at VAT revenues as a share of the economy, track year-to-year changes in VAT revenue, and determine the VAT's relative contribution to total revenue. If these measures show an increasing reliance on the VAT, the overall tax system may be becoming more regressive. (This might not be the case, however, if the VAT is replacing taxes that are as or more regressive.)

- **Examine the rate structure of the VAT.** Groups may want to note whether the standard VAT rate has recently changed, as well as how it compares to the

standard rate in other countries. They should also identify which items are subject to reduced VAT rates or exempt from the tax entirely.

- **Consider the level at which the registration threshold is set.** Most governments exempt some small businesses and traders from having to participate in the VAT system, as noted above. Many tax experts believe that these thresholds are often set too low and that higher exemptions could provide relief to many more small businesses without jeopardizing revenue collections. Groups may wish to examine the threshold applied in their country and assess the case for adjusting it.

- **Assess VAT policies designed to address equity concerns.** In assessing exemptions and zero-rating, groups should try to examine the policy rationale behind the preferential treatment and whether the benefits are reaching the poor. Groups may also wish to advocate additional or more effectively targeted tax relief, which would entail reducing or eliminating tax on those items more heavily consumed by the poor and women so that these groups are not unduly burdened by the VAT. For instance, the 2000 South African Women's Budget recommended that paraffin be zero-rated because paraffin can take up to 20 percent of poor households' income but is rarely purchased by wealthier people. The government adopted this proposal.

- **Consider other ways to address VAT equity issues.** While exemptions are the most common approach to alleviating the VAT's burden on the poor, civil society groups may wish to consider other options. For example, a system of income-support grants or uniform VAT refunds to all citizens might be a more effective way of relieving the poor of their tax burden; such approaches typically require significant administrative capacity, however. Similarly, it may be more appropriate in some countries to make the tax system more equitable by expanding the use of more progressive taxes, such as income taxes or certain excise taxes, rather than by making the VAT itself more progressive.

  Another option is to focus on the uses to which VAT revenues are put. If the VAT itself is regressive, but the tax is an effective mechanism for increasing government revenue, then the overall impact on equity could be positive if the additional revenue is devoted to effective anti-poverty expenditures. Groups will want to carefully monitor how VAT revenues are spent, especially when VAT rates are increased or a VAT is used to replace some other preexisting tax.

Personal Income Tax

Personal income is earned from two sources: labor and capital. Labor income consists of wages, salaries, and other work compensation. Capital income consists of investment earnings and comes in the form of interest, dividends, and capital gains.

Unlike consumption taxes, under which individuals bear the burden but businesses are responsible for collecting the tax and paying it to the government, individuals are generally responsible for paying their income taxes to the government. Nevertheless, businesses often play an important role by withholding part of employees' income taxes from their paychecks and remitting these funds to the tax administration on the employees' behalf. Income tax compliance is usually higher when taxes are withheld at the source of income. In some cases, individuals do not need to file a personal income tax return if the employer withholds tax.

The Income Tax Base

Not all types of income can be easily reached by a personal income tax. For instance, it is sometimes difficult to place a monetary value on fringe benefits such as for housing and transport that are provided to employees as part of their compensation. Such benefits are technically part of labor income, but often they are not included in the income that is subject to tax.

Capital income can be even more elusive. Economists view the increase in the value of an asset (such as stock or real estate) as income. But, unlike other forms of income, appreciation in the value of assets—known as capital gains—is generally not taxed on an annual basis. Rather, taxes on capital gains are paid only after the asset is sold. This gives the taxpayer more control over when the income is declared and taxes are paid.

In addition, usually only income above a prescribed minimum threshold, or "standard exemption," is subject to tax. In many countries, the standard exemption varies according to family structure (increasing with the number of children, for example, or varying by marital status). Further, the exemption is often adjusted each year to compensate for inflation.

A standard exemption helps make the personal income tax progressive, as Table 2 shows. Table 2 assumes a flat rate of 20 percent is applied to the taxable income of two taxpayers: Taxpayer 1, whose total income is 30,000 rupees, and Taxpayer 2, whose total income is Rs.500,000. With a standard exemption of Rs.15,000,

Table 2

Impact of Standard Exemption on Tax Burden *(in rupees)*

	No Exemption		Standard Exemption	
	Taxpayer 1	Taxpayer 2	Taxpayer 1	Taxpayer 2
Total income	30,000	500,000	30,000	500,000
Exempt amount	0	0	15,000	15,000
Taxable income	30,000	500,000	15,000	485,000
Calculation of tax liability:				
Tax at 20 percent rate	6,000	100,000	3,000	97,000
Tax liability as a percent of total income	**20.0%**	**20.0%**	**10.0%**	**19.4%**

Taxpayer 1 would face a tax of Rs.3,000 (taxable income of Rs.15,000 times a 20 percent tax rate), an amount that is equal to 10.0 percent of her total income. In contrast, the higher-income taxpayer (Taxpayer 2) would face a tax of Rs.97,000 or 19.4 percent of his income.

Many countries set the standard exemption high enough to eliminate income taxes completely for a significant portion of the population. In some countries, the exemption is several times higher than the country's per-capita income. Using a high standard exemption to relieve large numbers of low-income households from income taxes not only promotes equity goals, but also simplifies the task of administering the tax by reducing the number of tax filers.

The disadvantage of using a higher standard exemption is that this narrows the tax base, reducing the amount of revenue that government collects. Governments can recoup the lost revenue by raising the tax rate. Further, as discussed below, governments can use a graduated rate structure—which taxes higher incomes at higher rates—as a way to minimize the tax burden for taxpayers just above the threshold while raising additional revenues from those with higher incomes.

Graduated Rate Structure

A graduated tax rate structure, under which higher levels of taxable income are taxed at higher rates, is consistent with the "ability to pay" principle.

Table 3 shows the effect on Taxpayers 1 and 2 from the above example of a graduated rate structure that includes three tax brackets. The first Rs.10,000 of taxable

Table 3

Impact of Graduated Tax Rates *(in rupees)*

	Income Subject to Tax		Tax Rate	Amount of Tax Owed	
	Taxpayer 1	Taxpayer 2		Taxpayer 1	Taxpayer 2
Total income	30,000	500,000			
Exempt amount	15,000	15,000			
Taxable income	15,000	485,000			
Calculation of tax liability:					
1st bracket:					
Rs.0-10,000	10,000	10,000	10.0%	1,000	1,000
2nd bracket:					
Rs.10,000-100,000	5,000	90,000	20.0%	1,000	18,000
Top bracket:					
Above Rs.100,000	0	385,000	30.0%	0	115,500
Total	15,000	485,000		2,000	134,500
Tax liability as a percent of total income				**6.7%**	**26.9%**

income is taxed at a 10-percent rate, the next Rs.90,000 is taxed at a 20-percent rate, and amounts above Rs.100,000 are taxed at a 30-percent rate. The table shows that Taxpayer 1, with a total income of Rs.30,000, would owe Rs.2,000, or 6.7 percent of her income in taxes, while Taxpayer 2, with a much higher income of Rs.500,000, would owe Rs.134,500 or 26.9 percent of his income in taxes. The share of total income owed in taxes is known as the *effective tax rate* (or average tax rate).

A different measure, the *marginal tax rate*, refers to the tax rate that would apply to the next unit (in this case, the next rupee) of income. Economists believe the marginal tax rate has a greater impact on a person's decision to work, save, or invest than the effective tax rate does, because the marginal rate dictates how much of each additional rupee of income the person can keep after taxes. In Table 3, for example, Taxpayer 1 faces a marginal tax rate of 20 percent, while Taxpayer 2 faces a marginal rate of 30 percent.

A graduated rate structure can be an attractive tool for redistributing income. The redistributive impact of the personal income tax is limited, however, in countries in which the income tax collects little revenue, as is the case in most developing countries. The redistributive potential of the income tax may also be limited by a country's administrative capacity, for example if the income tax cannot be effectively levied on capital income or if high-income taxpayers are generally able to evade the

tax. Further, trying to address income inequality by imposing very high income tax rates on the well-off can create problems. Very high rates may encourage tax avoidance or discourage work, thereby reducing revenue collections and making it more difficult to fund expenditure programs that benefit the poor. Thus, there may be a need to strike a balance between promoting progressive policy goals and maximizing tax collections.

"Global" vs. "Schedular" Income Taxes

The income tax system described in this chapter is referred to as a "global" income tax because it typically combines the main sources of income (such as employment, investment, and business income) into a single aggregate measure, which is then subject to tax. Many countries also rely on a "schedular" system for part of their income tax collections, limiting the coverage of the global system.

Under a schedular system, each of the main sources of income is subject to a separate tax. The rates applied and the exemptions available depend only on the individual's income from the particular source of income, rather than on total income from all sources. Because of this feature, schedular systems can often collect taxes entirely through withholding, avoiding the need for the individual to file a tax return. This approach can lower administrative costs for government and compliance costs for taxpayers, while also limiting opportunities for tax evasion.

Deductions and Credits

In addition to a standard exemption, many countries offer exemptions for particular activities or types of income in the form of deductions and credits. These exemptions can be targeted at particular activities or at particular groups of individuals, such as families with children or low-income taxpayers. Under a consumption tax like the VAT, in contrast, tax relief cannot be targeted at particular groups of people, only at the consumption of particular items.

Although deductions and credits are often viewed as two means of achieving similar ends, they affect taxpayers differently. Deductions are applied *before* tax liability is computed and thus reduce taxable income; credits are applied *after* tax liability is computed and thus reduce total tax liability. As a result, the value of a deduction depends on the top tax rate a person faces (the person's marginal tax rate); a deduction is worth more to a higher-income individual who faces a higher top rate. A credit, in contrast, reduces tax liability directly and so is worth the same amount to all taxpayers.

For example, assume that the first Rs.4,000 of education expenses can be deducted. For a taxpayer in the 10-percent bracket, this deduction reduces taxes by Rs.400 (Rs.4,000 times 10 percent). For a high-income taxpayer in the 30-percent bracket, this deduction reduces taxes by Rs.1,200 (Rs.4,000 times 30 percent). Even though the two taxpayers spend the same amount on education, the high-income taxpayer recoups a larger percentage of his or her education costs than the low-income taxpayer. In contrast, if tax relief is provided through a credit set at 25 percent of the first Rs.4,000 of education expenditures, both taxpayers benefit equally: they each have their tax liability reduced by Rs.1,000.

Low-income families are often not able to take full advantage of deductions and credits because their income (and thus their tax liability) is too low. A person with Rs.2,000 of taxable income, for example, could make use of only Rs.2,000 of a Rs.4,000 education deduction. Similarly, a person with total tax liability of Rs.300 could make use of only Rs.300 of a Rs.1,000 education credit. Someone with no tax liability would be unable to receive any benefit from a credit or deduction.

To enable lower-income families to benefit more from tax credits, a few countries have created tax credits that are "refundable": if the size of the credit exceeds a taxpayer's tax liability, the taxpayer receives the remaining amount as a "refund" from the government. In the United States, for instance, a refundable tax credit for low-income working families—the Earned Income Tax Credit, or EITC—lifts more children out of poverty than any other single program. Refundable credits are complex to administer, and therefore tend to be a policy option only in countries with greater capacity for tax administration.

Civil Society Analysis of the Personal Income Tax

Listed below are some ways in which civil society can assess the personal income tax:

- **Apply tools of basic budget analysis to available estimates.** As with the VAT, there are a number of relatively simple calculations that can help determine the significance of the personal income tax in a country's tax system (see the supplement at the end of Chapter 8). One can examine personal income tax revenues as a share of the economy (GDP), track year-to-year changes in personal income tax revenue, and determine the relative contribution of personal income tax revenue to total revenue. If these measures indicate an increasing reliance on the personal income tax, this could indicate that the tax system is becoming more progressive.

- **Examine the standard exemption and rate structure of the personal income tax.** The structure of the personal income tax should be assessed to determine how well it addresses equity concerns. The key features to examine would be the standard exemption and the rate structure. For instance, groups may wish to compare the income level at which one begins to have income tax liability with the poverty threshold. In assessing graduated rates, groups can identify the income levels associated with the different tax brackets as well as the income level at which the top rate begins to apply.

- **Calculate the effective tax rate for taxpayers with different incomes.** The effective tax rate can show the relative burden that the income tax places on people in different income groups. It is calculated by dividing total tax liability by total income. Groups could calculate the effective rate for hypothetical families at different income levels and with different family compositions to illustrate the relative tax burden of the income tax.

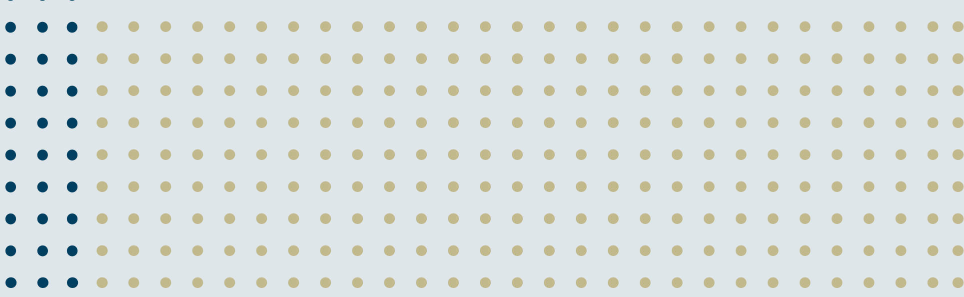
- **Assess targeted relief provided through the personal income tax.** Deductions and tax credits should be examined to see if they are achieving their stated goals. Groups may want to assess whether certain deductions should be restructured as credits, since the benefits of credits are the same at different income levels while deductions are worth more to higher-income people. A related question is whether some low-income populations are unable to benefit from either a deduction or credit because they have no income tax liability. Such low-income populations may be better served by targeted expenditure subsidies.

- **Note whether the various tax parameters are adjusted for inflation.** If the tax code is not adjusted for inflation, then it will impose higher taxes on individuals as their incomes rise due to inflation despite the fact that their purchasing power is unchanged. If inflation erodes the value of the standard exemption, this can have a particularly harsh effect on people with low incomes. Governments sometimes resist adjusting the tax code for inflation in order to bolster their revenue collections. Such "backdoor" revenue increases should be monitored closely.

- **Scrutinize the personal income tax code for gender bias.** Groups can examine the income tax code to assess whether it is biased in its impact on women and men. Even if there are no explicit instances of bias, the structure of the code may have other features that disadvantage women. For instance, some income tax codes penalize two-earner families, who owe higher taxes than two single people with the same combined income. Typically, women are hurt the most by these provisions, because it is the "second" earner who is most affected

by the higher tax and women tend to earn less than their spouses. Similarly, tax provisions dealing with part-time work are likely to affect women more often than men.

- **Look at how the tax code treats different types of income.** While there may be sound policy grounds for levying different tax rates on different types of income, such a policy could have negative effects, including on equity. For instance, the tax code may feature reduced rates on income earned from investments, justified as a means of making investment more attractive. Since wealthier people are much more likely to have investment income, such a provision reduces the progressivity of the tax code. It may also fail to achieve its economic objectives, if it ends up simply rewarding those who are already investing rather than encouraging new investment.



10 Tax Compliance and Administration

Just as groups investigating government expenditure need to look beyond funding allocations and assess how programs are implemented, groups investigating revenues need to look both at the formal tax laws and at how they are administered.

This chapter explores the linkages between tax policy and tax administration and presents some of the major challenges facing tax administrations. It also examines some of the steps that tax administrations are taking to combat tax sheltering and illegal tax evasion. Finally, it suggests ways for civil society to promote beneficial reforms of the tax administration.

Ways That Civil Society Can Help Improve Tax Administration

- Broaden public understanding of the need for a fair and effective tax administration to collect adequate revenues.
- Promote reforms, such as raising tax thresholds, that both simplify administrative requirements and benefit the poor.
- Encourage tax administrations to improve their outreach efforts to bolster voluntary compliance with tax laws.
- Call on large corporations to publish more information on their tax payments.

Tax Policy and Tax Administration

The capacity of the tax administration often determines which tax policies can actually be implemented in a particular country. This fact has led one tax policy expert to write that, in developing countries, "tax administration *is* tax policy" (Casanegra de Jantscher, 1990).

Tax Administration, Revenue Levels, and Equity

Non-payment and under-payment of taxes tend to make a tax system more regressive by reducing the share of taxes paid by the rich. High-income individuals and businesses are more likely to have the flexibility to structure their finances in ways that minimize the taxes that they owe, and they can better afford the services of lawyers and

accountants who advise on tax-sheltering strategies. In some cases, wealthier members of society may simply be better able to bribe the tax collector.

To the extent that the wealthy are able to avoid paying taxes, the burden of supporting government programs shifts to those who are less well-off. Moreover, if the wealthy cannot be effectively taxed, this is likely to reduce overall revenue levels, which may limit the resources available for anti-poverty expenditures.

Tax Administration and Good Government

The operation of the tax administration reflects on the character of government: if the tax collector is seen as corrupt, the government will be too. Failure to enforce the tax laws even-handedly may not only make taxpayers less inclined to comply with the tax code, but also reduce the credibility of the government as a whole, potentially weakening its ability to act effectively in other areas.

Challenges Facing Tax Administrations

To levy a tax effectively, the tax administration must be able to identify the tax base and assign it an accurate value. For example, imposing a property tax requires the tax administration to identify property owners and estimate the value of their property, while imposing a comprehensive income tax requires the tax administrator to identify taxpayers' major sources of income. Implementing even the most basic tax policies can be a challenge if the tax administration lacks sufficient skilled personnel and well-developed information management systems.

In addition to technical challenges, tax administrations can also face political constraints on their ability to collect revenues. For example, a country's potential revenue sources may be concentrated among a small number of wealthy people who use their economic and political power to avoid paying their fair share of taxes.

Tax Avoidance and Evasion

Even when people comply voluntarily with the tax laws, they try to pay as little tax as possible. Taxpayers have the right to take full advantage of legally available tax breaks.

Problems arise when individuals and businesses take advantage of loopholes and ambiguities in the tax law in order to avoid taxes. Taxpayers may shift assets and prof-

its to low-tax foreign jurisdictions, re-characterize income in a form that is subject to preferential tax treatment, or allocate income to other taxpayers with lower tax rates. While these types of schemes may be technically legal, aggressive tax avoidance violates the spirit of the law by exploiting unintended loopholes. Moreover, tax avoidance can easily cross over into tax evasion, or the illegal non-payment or under-payment of taxes.

Every type of tax has its own evasion problems. Under an income tax, individual and corporate taxpayers may underreport income (or fail to report it altogether) and claim larger-than-allowed deductions. Under a VAT, businesses may fail to register with the tax authority, but still charge their customers VAT on their purchases and retain the receipts. Excise and trade taxes can be evaded through smuggling.

Two groups of taxpayers—small businesses and multinational corporations—traditionally pose particular challenges for tax administrations, as explained below.

Taxing Small Businesses

Small businesses are much more numerous than big businesses, and on average they pay much less in taxes than big businesses do. In addition, small businesses tend to have a short existence, and many of them neither register with the tax administration nor keep extensive records. All of this makes it difficult for a tax administration to monitor small businesses in a systematic manner.

At the same time, when small businesses do try to comply with the tax laws, they often spend proportionally more time and resources on this task than big businesses do. In response to these administrative and compliance challenges, and because small businesses typically yield little tax revenue even when they do comply with the tax laws, governments often exempt small businesses from some taxes altogether. For instance, countries with a VAT typically set a minimum threshold (usually based on total receipts) below which businesses are exempt from registering for the VAT.

Another way to reduce administrative costs in dealing with small businesses is to impose presumptive taxes. Under such a system, taxes are assessed on the basis of easily observable factors such as the type of business or the number of employees, rather than the business's actual income. The goal is to use criteria that generally yield a reasonable approximation of the tax the business would owe based on its income. Presumptive taxes are easier to administer and easier for businesses to comply with, since they obviate the need to maintain records. A disadvantage is that presumptive

taxes may be perceived as unfair because they do not take into account that there can be large differences in income even among similar businesses.

Taxing Multinational Corporations

Globalization has made it increasingly difficult for tax administrations in developing countries to collect taxes from multinational corporations. For example, the existence of tax havens around the world helps wealthy individuals and multinational companies (as well as criminals and corrupt leaders) move their wealth and profits offshore to avoid paying tax. The Tax Justice Network estimates that governments worldwide lose some $255 billion in tax revenues each year as a result of tax havens (Tax Justice Network, March 2005).

Multinational corporations are particularly well-suited to avoiding taxes. The Tax Justice Network describes the practice of "profit laundering," whereby businesses move profits out of the countries in which they were earned and into shell or holding companies registered in overseas tax havens. These transactions, which fall into a legal grey area, occur within rather than between companies. It has been estimated that 50 to 60 percent of world trade consists of transactions between different parts of the same company, which creates ample opportunities for profit laundering.

The Tax Justice Network has proposed various approaches to addressing tax evasion by multinationals, including calling on businesses to commit to:

- establishing clear standards for tax payments, including publishing all necessary accounting information;
- eschewing profit-laundering mechanisms that are without substantial economic purpose and are used solely to reduce taxes; and
- listing every country in which the business operates, showing how much profit is derived from activities in each of these countries, and providing a clear statement of where these profits are booked for tax purposes.

Assessing Tax Administration Performance

To assess the "tax gap"—the difference between the total taxes that should be collected under current laws and the total taxes that actually are collected—with any precision requires detailed income, expenditure, and tax data derived from national

The "Tobin Tax"

In response to the revenue-related problems caused by multinational corporations, some have advocated instituting a global tax known as the "Tobin Tax." The tax is named after the Nobel prize-winning economist James Tobin, who in 1972 suggested levying a small tax on all foreign-exchange transactions. The primary aim of the tax was to reduce market volatility and dampen currency speculation. Tobin also noted that due to the great volume of foreign-exchange transactions, such a tax (even if levied at a very low rate of just 0.1 to 0.5 percent) could generate significant revenues, which could be used for international development. Proponents of the Tobin Tax argue that it would fight poverty in two ways—by funding direct pro-poor expenditures and by curtailing the potentially harmful consequences of currency speculation.

The Asian financial crisis of the late 1990s shed light on the potential problems associated with the free movement of global capital and led to the formation of the activist group Attac in France. (In French, "Attac" is an acronym for the Association for Taxation of Financial Transactions for the Aid of Citizens.) Attac has since expanded its focus from the Tobin Tax to a range of issues associated with globalization, and has chapters in over 40 countries. A number of these chapters are affiliated with the Tax Justice Network.

The Tobin Tax is necessarily a global tax, since foreign-exchange transactions are conducted on a global scale. Any country that opted out of the Tobin Tax would quickly become a haven for foreign exchange, which would undermine the tax's ability to collect significant amounts of revenue. So, effective administration of the Tobin Tax would require cooperation across all major economies. There is some debate regarding the feasibility of administering a tax on a global level, as well as strong political opposition among many of the world's dominant economies to backing a global tax. (See Weaver, et. al., 2003.)

accounts and surveys. In the United States, for example, an Internal Revenue Service study involved auditing 46,000 individual income tax returns in order to identify the major components of the tax gap, including underreporting of income, underpayment of taxes, and non-filing of returns. (Among the findings of the study was that a significant share of the tax gap can be traced to small businesses and the self-employed.)

When such detailed information is not available, other indicators can be used to diagnose the general effectiveness of the tax administration (Gill, 2000; Gallagher, 2004). For instance, groups could compare actual revenue collections to the revenue estimates in the budget. Failure to meet revenue targets could signify weakness in the tax administration, though it could also mean that the original targets were unrealistically optimistic. (Similarly, actual revenues might exceed projected levels simply because the original targets were too low.) Groups may also want to investi-

gate how much tax revenue is collected through audits, since this can provide some indication of whether the tax administration is successfully identifying taxpayers who are underpaying their taxes. Finally, surveys of taxpayers can yield helpful information as well, particularly about the difficulties of complying with the tax laws and the perceived integrity and helpfulness of the tax administration.

Even if civil society groups cannot quantify the tax gap, they can still contribute to discussions of tax compliance. The tax gap is most often discussed as a narrow technical issue dealing with tax collections. But, as the Tax Justice Network argues in its report "Mind the Tax Gap," it is crucial to look beyond technicalities. Civil society groups can draw attention to the environment that permits tax evasion to flourish and to the consequences of the tax gap for the functioning of the government.

Steps to Improve Tax Administration

The section below looks at two broad approaches to addressing problems in tax administration: simplifying the tax code to make it easier to administer, and improving the operations of the tax administration itself.

Simplifying Tax Policies

Taxes are most easily administered when they have a base that is easy to identify (i.e., one that neither the taxpayer nor the administrator can easily misrepresent) and on which the rate of tax is easily determined. Simplification not only eases enforcement, but also encourages voluntary compliance. For example, eliminating demands for superfluous information on tax returns may make it more likely that taxpayers will file returns promptly and accurately.

Tax policies need to balance the goals of simplicity and efficiency against other policy imperatives, such as distributing the tax burden equitably across the population. The World Bank describes on its website some issues around designing administratively simple taxes; some of the choices policymakers face are discussed below.

- *Tax base*—Some tax bases are more complex and difficult to define than others. For instance, an excise tax levied on a per-item basis is relatively easy to administer; in contrast, accounting for income from all sources for purposes of levying a comprehensive income tax can be complicated. Adding exceptions to any tax base by exempting certain items or activities not only narrows the base but also complicates the administration of the tax. Such exceptions should be employed

judiciously, limited to cases where they can be clearly defined and identified and in which they further agreed-on policy goals.

- *Tax rates*—Under some circumstances, using multiple rates can pose administrative challenges. For instance, different rates for different types of income (such as capital and labor) or different products (under a VAT) can encourage taxpayers to reclassify (or misclassify) their income or products in order to take advantage of lower rates. Similarly, pushing tax rates up to very high levels can create incentives for tax evasion, increasing enforcement problems.

- *Tax mix*—Finding the right mix of taxes is important. The more kinds of taxes an administration levies, the more complicated and costly it can be to collect a given amount of revenue, all other things being equal. By concentrating its efforts on a smaller range of taxes, a tax administration can keep costs down. Reliance on too few taxes, however, can also be problematic, making revenues collections more susceptible to shocks. The tax mix should also be chosen with concerns such as equity in mind.

- *Tax thresholds*—Raising tax thresholds reduces the number of taxpayers, and thereby eases administrative burdens. Often, it is possible to increase the threshold without significantly reducing revenues, since large taxpayers well above the threshold pay the bulk of taxes. (In this area, equity and administrative simplicity frequently go together, since raising tax thresholds may also exempt more of the poor from taxation.)

Improving the Structure of Tax Administrations

Countries have tried various strategies for improving the effectiveness of the tax administration (Gill, 2003).

- *Provide more autonomy*—Some countries have established a separate cabinet-level ministry responsible for tax administration. More typical is the creation of an independent revenue agency with considerable autonomy. Such agencies are usually constituted outside the civil service, as a way to avoid political influence and patronage problems. There is, however, the risk that giving the tax administration more autonomy can weaken the administration's accountability to elected representatives.

- *Establish Large Taxpayer Units*—Many transition countries have established Large Taxpayer Units (LTUs) within their tax administration to monitor the activities

of taxpayers who pay a significant share of total taxes. Such taxpayers tend to pose special challenges for tax administrators due to the complexity of their financial affairs. The creation of an LTU may help the tax administration target its resources effectively and demonstrate its commitment to ensuring compliance among the largest taxpayers.

- *Improve information technology*—New technologies can improve the ability of tax administrations to process and verify information. IT systems permit tax data to be aggregated and organized in a way that can shed light on issues of concern to policymakers and civil society organizations. They also allow this information to be collected more quickly, so it can be available on a more timely basis. In most cases, however, other institutional weaknesses also need to be addressed in order for computerization to lead to lasting performance improvements.

- *Increase transparency and accountability*—The task of the tax administration has as much to do with encouraging voluntary compliance as enforcing the tax law. Tax administrations can boost compliance through outreach efforts: for instance, by providing information on tax laws and procedures and by making tax personnel more available to answer questions. Since voluntary compliance is also promoted by expectations of fair and equitable treatment—and is discouraged by the perception that wealthy and powerful taxpayers are making back-room deals with tax collectors—transparency in the collection and spending of tax revenue should improve voluntary compliance.

Civil Society and Tax Administration Reform

Tax administration reform is a fairly technical area, and may at first seem only distantly related to the concerns of civil society groups. Yet an effective tax administration is an essential component of good tax policy. Civil society groups can highlight this linkage and try to create a political environment conducive to improvements in this area. They can do so by:

- **Diagnosing the problem,** based on the indicators discussed above. After calling attention to administrative challenges, a study could propose improvements in the operations of the tax administration or simply describe improvements adopted by other countries.

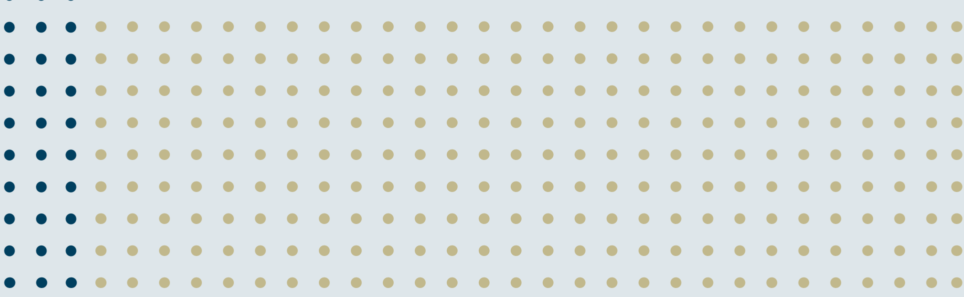
- **Including tax administration issues in a citizen's revenue guide.** Civil society groups can produce "revenue guides" to broaden understanding of their

country's tax systems and to inform tax debates, as discussed in Chapter 7. Since administrative issues are often ignored in public debates about taxes, it would be helpful to include them in a guide. The guide could discuss any recent changes in the tax administration and whether the administration follows any specific rules or codes of conduct (such as a taxpayer's bill of rights).

- **Reviewing tax thresholds.** Civil society groups could examine the country's tax thresholds and assess whether they are appropriate given administrative concerns and equity goals.

- **Calling attention to tax issues surrounding multinational corporations.** Groups could consider joining international campaigns that pressure large multinationals to comply with local tax codes.

- **Advocating for greater transparency in tax administration.** Civil society groups can play a key role in advocating for improvements in the type and quality of information released.



11 Assessing Major Tax Policy Changes

This chapter looks at the some of the issues that surround particular proposals for major tax policy changes. It focuses on three policy changes that have been common in developing and transitional economies in recent years: replacing trade taxes with a value-added tax, introducing a "flat tax," and using tax policies to attract foreign investment. The chapter also suggests ways that civil society groups can contribute to policy debates surrounding tax overhauls.

Ways Civil Society Can Contribute to Major Tax Policy Debates

- Serve as a "reality check" on overly optimistic claims made for tax policy proposals.
- Emphasize the importance of equity concerns when assessing tax proposals.
- Highlight the linkages between changes in revenues and government's ability to fund spending priorities.
- Highlight "best practices" in tax policy adopted by other countries.

The Challenges of Changing Tax Policy

Major tax policy changes are usually difficult to achieve because of their effects on established interests. Even proposed reforms that leave the total level of revenue unchanged inevitably result in "winners" (those who receive a tax reduction) and "losers" (those who receive a tax increase).

The politics of tax overhauls may be even more complicated when proposals are the result of external pressure, as is frequently the case in developing and transition countries. These countries often face conditions on the loans they receive from international financial institutions (IFIs), and these conditions often include changes in tax policies. Even for middle- and high-income countries, international bodies such as the World Trade Organization and the European Union exert influence on tax policy.

At any given time, the tax policy advice given to developing countries tends to reflect the dominant model of

economic development (Stewart, 2002). In the decades following World War II, for instance, theories of economic development called for governments to play a strong role in managing economic growth. Consistent with this approach, trade taxes were encouraged as a way to promote and protect domestic industries. Today, however, most mainstream economists discourage such taxes, believing they can impede growth.

When new tax policies do not deliver promised benefits, controversy often ensues about whether the problem lies with the IFI recommendations or the way the country implemented them. Some argue that IFI reform programs fail because they do not take into account the circumstances of the specific country; others maintain that few IFI-designed reform programs have been followed with sufficient rigor. (See box on the following page about the Bolivian experience with implementing IFI recommendations.)

Recent Tax Policy Issues Facing Developing and Transitional Economies

Replacing Trade Taxes with a VAT

For the past two decades, international financial institutions and influential organizations such as the European Union and the World Trade Organization have promoted lowering trade barriers as a key way for countries to expand trade and ultimately boost economic growth. The IMF has required countries to reform their trade policies (by reducing both tariffs and non-tariff barriers such as quotas) as part of structural adjustment programs.

Trade liberalization often involves reducing or eliminating trade taxes, which are levied on goods entering the country (import duties or tariffs) or leaving the country (export duties). Many developing countries rely on trade taxes as an important source of revenue because they are relatively easy to administer: when goods cross the border, they can be taxed. In addition, the structure of many developing economies, with severe income inequality and large agricultural sectors, can make it difficult to levy other taxes, particularly income taxes.

Supporters of trade liberalization argue that at least some of the revenues lost through reducing trade taxes will be recovered through expanded trade and faster economic growth. Lost revenues can also be replaced by other taxes, particularly a broad-based VAT. A number of countries that have pursued trade-liberalization strategies have thus also introduced or expanded a VAT or sales tax.

Febrero Negro: The Deadly Consequences of Failed Tax Policy in Bolivia

In February 2003, the Bolivian government's attempt to impose major tax changes to help meet deficit-reduction goals set by the International Monetary Fund turned deadly. In what became known as *Febrero Negro* ("Black February"), more than 30 people died in violent protests against a proposed tax increase.

In August 1998, the IMF, the World Bank, and the Bolivian government released a joint paper setting out significant economic reforms, including widespread privatization, labor reform, and deficit reduction. These reforms were implemented, but after four years they had not produced the predicted economic gains; Bolivia's economy had fallen into recession and deficits remained high. In 2002, the IMF responded by setting a new deficit-reduction target as a condition for long-term support for Bolivia. High-level Bolivian officials argued that the new target would require spending reductions and tax increases equal to 8 percent of the country's budget, and was not achievable. But the Bolivians, needing IMF aid, had few choices.

To comply with the target, the government proposed a new tax on the oil and gas industry, but this was abandoned under pressure from foreign oil companies. An income tax increase targeting the wealthiest 4 percent of the population was also developed, but would not have raised sufficient revenue, so the increase was broadened to the point where it would reach people earning twice the minimum wage. While 90 percent of Bolivia's population would not have been affected by the tax increase, many workers with modest wages, including teachers, police, and nurses, would have faced tax increases under the proposal. Government polling showed that many people perceived the proposal as a tax increase on the working poor.

When the proposal was introduced, it sparked mass outrage—particularly among members of the national police, who were already locked in a wage dispute with the government. In two days of protests, more than 30 police, soldiers, and civilians died. The president responded by withdrawing his tax plan, and the government abandoned its deficit-reduction targets. As one government official declared, the tax proposal was "a terrible error, an error of politics and an error of economics" (Shultz, 2005).

However, a recent study by IMF economists of 125 countries between 1975 and 2000 showed that VAT revenue has not adequately compensated developing and emerging market countries for the revenue loss resulting from trade liberalization (Baunsgaard and Keen, 2005). The study found that while high-income countries were able to recover lost trade revenues with ease, middle- and low-income countries were not. Low-income countries were able to replace only about 30 cents for

each dollar of lost trade tax revenue, and middle-income countries were able to replace only slightly more (about 45 to 65 cents per lost dollar).

The VAT's failure to replace lost trade revenues reflects a number of factors. The VAT is more complex to administer than trade taxes and typically requires new capacity within the tax administration. Developing this capacity can take several years. The VAT also tends to be a more visible tax than trade taxes, which can make it politically difficult for governments to raise as much revenue through the VAT. In addition, the VAT's base may not be as broad as its supporters suggest (Emran and Stiglitz, 2005). The VAT is not collected in the informal sector of the economy, which is much larger in developing countries than in developed countries.

Debates over whether to reduce trade taxes as part of trade liberalization are also tied to broader issues, including whether trade liberalization policies in developing countries have been adequately matched by liberalizations in developed countries, particularly reductions in government agricultural subsidies. Like tariffs, subsidies for agricultural production impede trade between countries, typically making it more difficult for agricultural producers in developing countries to compete with those in the United States and Western Europe. But developed countries have often been reluctant to eliminate or significantly reduce these subsidies. For example, talks during the Doha round of negotiations of the World Trade Organization foundered on disagreements over what would constitute an appropriate mix of tariff and subsidy reductions.

Introducing a Flat Tax

A number of countries—most notably Russia and several other Central and Eastern European countries—have changed their tax systems to rely on a single (or flat) tax rate. This has led advocates of the flat tax in the United States and the United Kingdom to declare that a "flat-tax revolution" is sweeping Eastern Europe and bringing with it improved economic and revenue growth. In many cases, however, the tax systems created by these changes differ significantly from a pure flat tax. Further, many of the claims about increased revenues and improved economic performance resulting from flattening tax rates are exaggerated.

As originally developed, the flat tax levies a single tax rate on both business and labor income (Hall and Rabushka, 1985). For businesses, a deduction is allowed for all inputs to production, including business investments (such as the purchase of machinery) and wages and pensions (which are subsequently taxed at the individual level). For individuals, the flat tax resembles an income tax, but with no deductions

or credits other than a personal exemption. Further, the tax applies only to labor income; individuals' investment income is not taxed. Because it does not tax investment, a pure flat tax is technically a consumption tax. (Economists define income as the sum of consumption and savings, so consumption can be thought of as income minus savings.)

The tax rate in a flat tax is typically lower than the top marginal income tax rate in the graduated rate structure it replaces. Theoretically, a government can lower the rate and still raise the same level of revenue, because the elimination of deductions and credits broadens the tax base and because the single rate is higher than the bottom rate used in the old system.

Since the single rate under a flat tax is higher than the previous bottom rate and lower than the previous top rate, the flat tax tends to be more regressive than a graduated income tax. On the other hand, the existence of a personal exemption makes the flat tax less regressive than a standard consumption tax, such as a broad-based VAT. (Despite its name, a flat tax could be combined with a graduated rate structure, which would make the tax more progressive.)

Russia has been widely touted as a flat-tax success story. In 2001, Russia replaced its progressive income tax with an income tax levied at a flat rate of 13 percent and eliminated a number of deductions and exemptions. Income tax revenues increased dramatically in the years after the new tax was implemented. While the broadening of the tax base undoubtedly played a role in this revenue increase, IMF economists concluded that "the strength of personal income tax in Russia over this period was largely driven by a rise in real wage rates, unrelated to the tax reform" (Ivanova, Keen, and Klemm, 2005). Moreover, the Russian reform included major improvements in tax administration and enforcement, which probably contributed significantly to the rise in collections. Russia's new system also is not a pure flat tax. After the reform, taxes on dividends and corporate income were significantly higher than the 13 percent income tax rate. A number of tax breaks were retained as well.

Recent reforms in other Eastern European countries such as Slovakia are closer to a true flat tax. Many of these countries have seen impressive economic and revenue growth since the reforms, and flat-tax advocates have attributed this to the tax changes. In many cases, however, these countries relied on other regressive consumption taxes to make up for income tax revenues lost due to the adoption of a flat tax. Furthermore, tax changes in these countries usually occurred amidst a number of other sweeping reforms aimed at gaining admission to the European Union. Thus, it is difficult to single out the adoption of a flat tax as the reason for recent successes.

Using the Tax System to Attract Investment

Lower corporate income tax rates are often proposed as a way to promote business investment. Developing countries, in particular, have used lower tax rates as a way to encourage foreign investment, which they hope will increase productivity by introducing new technology and building skills in the workforce. Evidence suggests, however, that tax incentives are of questionable value in attracting foreign investment. IMF economists Vito Tanzi and Howard Zee conclude:

> For foreign investors—the primary target of most tax incentives in most developing countries—the decision to enter a country would normally depend on a whole host of factors, among which the availability of tax incentives is only one and frequently far behind the most important one.... If these factors [such as political and economic stability, transparency of the legal and regulatory systems, and a skilled workforce] are favorable, and the country's tax system is in line with international norms, then tax incentives would at best play a role at the margin in influencing an investor's decision (Tanzi and Zee, 2000).

In many countries, corporate tax incentives have been poorly designed to promote long-term investment. For instance, temporary "tax holidays," widely used in developing countries, are simple to administer but tend not to create strong incentives or attract desirable investments. Unless a business turns a profit, and thus would be subject to the corporate income tax, it cannot take advantage of the tax holiday, yet long-term investments usually take a number of years to become profitable. Meanwhile, the investments that can turn a quick profit and thus benefit from these temporary holidays tend to be more mobile and will often exit the country after the holiday has ended. If the tax holiday is extended in an effort to retain these investments, the revenue losses from the tax break grow.

In addition, sometimes corporate tax incentives simply reward investment that would have occurred even without the incentive. This costs the government revenue while doing little to help the economy.

Ineffective investment incentives can inflict damage that is far reaching. Countries often fear that if they fail to lower tax rates or provide special tax incentives, they will lose foreign investment to neighboring countries that are offering such inducements. As developing countries compete for foreign investment, multinational corporations are able to demand favorable tax treatment as a condition for investing in a country. The end result of such "tax competition" is that all of the countries

involved erode their tax bases and deprive their budgets of needed revenues; the loss amounts to some $35 billion a year, according to estimates by Oxfam.

Civil Society and Major Tax Policy Changes

Civil society groups generally try to represent the broad interests of a country's citizens, particularly those who are the most disadvantaged. Other actors, such as businesses and wealthy individuals, are more likely to be concerned about protecting their self-interest. It is therefore important that civil society's voice be heard when tax reforms are being discussed.

Some governments understand the advantage of a more transparent process and follow an open approach to developing major tax proposals. For instance, governments sometimes appoint a special commission to review tax policy options and solicit opinions. Under these circumstances, civil society groups may have good opportunities to air their views and influence the decision-making process.

Often, however, major tax policy changes may be even less open to public participation than other budget and tax debates. The executive, particularly the technical experts in the treasury and finance departments, is likely to play a dominant role. The legislature's role is likely to be small. Governments may also attempt to bypass normal legislative procedures if they are facing a fiscal crisis or pressure from international financial institutions.

As in other policy areas, civil society groups should advocate transparency when major tax policy issues are being considered. Groups should argue against a closed-door approach, reminding policymakers that public understanding and acceptance of tax policies will be crucial to their successful implementation.

Following are suggestions for civil society activities:

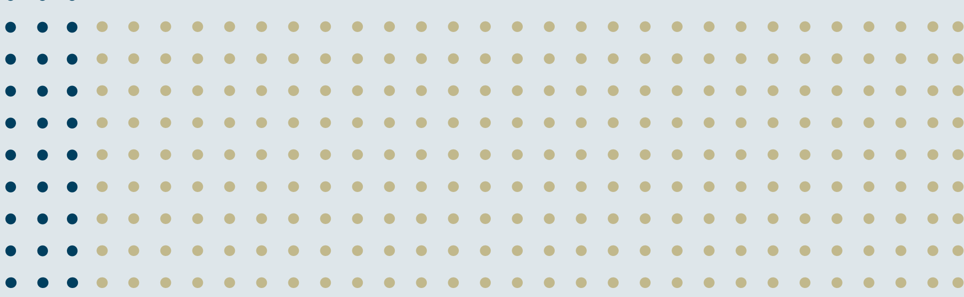
- **Serving as a "reality check."** Civil society organizations can challenge the often overly optimistic claims made by proponents of particular tax policies and improve the realism of tax debates by pointing to relevant academic research or international experiences. For example, proponents may argue that tax cuts will not reduce revenues because they will boost economic growth and improve tax compliance. As discussed in Chapter 5, such claims are rejected by most economists and have not been borne out in practice.

- **Emphasizing equity concerns.** Tax debates are often dominated by government technocrats and powerful business interests. Under these circumstances, equity concerns can take a back seat. Civil society groups should ask who would benefit from tax proposals and how the proposals would affect the distribution of income and wealth (see, for instance, Aron-Dine and Friedman, 2006).

- **Highlighting linkages between revenues and expenditures.** The biggest gains in reducing poverty are likely to come from changes in spending policies rather than changes in the structure of the tax system, since even a progressive tax structure is unlikely to provide significant gains to the very poorest in society. Spending policies require adequate revenues, though, so proposals that reduce revenues may endanger spending programs.

  In cases in which tax changes are intended to provide additional revenue for a pro-poor policy agenda, civil society groups should stress the need for a transparent and participatory budget process and a well-functioning budget planning and expenditure management system to ensure that these funds are used as intended.

- **Highlighting best practices.** Although each country's experience tackling major tax changes is unique, certain "best practices" have emerged in the context of implementing major tax policy changes (Bird, 2003b). Some of them involve issues of tax administration, discussed in Chapter 10. Civil society groups should ensure that these best practices are not ignored amidst calls for a significant overhaul of the tax system.



12 Revenues from Extractive Industries*

Countries with significant extractive industries, such as oil, gas, and mining, face unique budget challenges and opportunities. When the extraction of these natural resources generates a large portion of government revenues, it can pose problems for the management of revenues and expenditures and hamper transparency and accountability in the budget process.

This chapter focuses mainly on issues related to the extraction of oil, though many topics discussed are also applicable to other extractive industries such as natural gas and mining. The chapter describes the financial arrangements between governments and the oil industry and the ways that governments try to manage volatile oil revenues. It also describes some of the ongoing efforts of international institutions and civil society organizations to improve transparency at both national and international levels.

Civil Society Is Working to Improve Revenue Transparency in Extractive Industries

- The Publish What You Pay campaign is pushing for mandatory disclosure of all company payments to governments for the extraction of oil, gas, and minerals.
- Civil society groups are helping implement the Extractive Industries Transparency Initiative, a voluntary initiative to encourage governments to publish data on payments received from extractive industries.
- Civil society groups in countries like Nigeria, Congo-Brazzaville, Azerbaijan, and Peru are trying to track government oil revenues and bring more transparency and accountability to the use of these revenues.

Overcoming the "Resource Curse"

Many people once believed that the revenue-generating potential of oil would dramatically boost the standard of living of the poor in oil-rich countries by funding increased government expenditures for jobs, food, schools, health care, agricultural support, and housing. Unfortunately, the experience of the past several decades tells a very different

*This chapter is drawn from a paper prepared by Ian Gary of Oxfam America. Helpful comments were also provided by Julie McCarthy of the Revenue Watch Institute, Henry Parham of Publish What You Pay, and Carlos Monge of Grupo Propuesta Ciudadana.

story. Most oil-rich countries remain mired in poverty; in many, standards of living actually *plummeted* after the discovery of oil. Oil revenues have often been accompanied by increased corruption and weaknesses in governance, human rights, and poverty-reduction efforts. For this reason, countries with significant oil reserves are often said to be plagued by the "resource curse," which has several aspects (Tsalik, 2003):

- **Economic issues.** Booming oil exports, while generating significant revenues, can still have negative consequences for the economy. An oil state can, for instance, experience large influxes of foreign currency that cause the domestic currency to rise in value. This makes goods produced in the oil state relatively more expensive, which in turn makes it harder for producers to export their goods and to compete domestically with cheaper imports. The result is typically a weakening of the non-oil sectors of the economy. Further, the jobs lost in these other sectors are not replaced, because the oil industry—which is capital intensive rather than labor intensive—does little to generate employment. The resulting unemployment can give rise to political and social instability.

- **Fiscal issues.** The volatility of oil prices often prompts governments to take on large amounts of foreign debt that undermine the country's fiscal position. When world oil prices are high, governments tend to spend oil revenues freely, raising popular expectations and dependence upon this spending. When world oil prices are low, governments then tend to take on loans to avoid making cuts in spending that would fuel discontent. Further, by creating large windfalls of independent government revenue, the extractive industries reduce the need for raising revenues through taxation, which can weaken government accountability.

- **Political issues.** Oil booms and their economic consequences can have a devastating effect on a country's political life. Because revenues from oil exports most often flow to central governments rather than to entrepreneurs spread across the economy, they can increase the concentration of economic and political power. Such concentrations of power reduce accountability and hinder transparency, thereby encouraging corruption and mismanagement of public finances. Public- and private-sector officials compete to obtain a share of the oil wealth through bribes, favors, theft, and other distortions in public policies.

- **Social issues.** Most countries with abundant oil resources have failed to translate oil-derived income into better lives for their citizens. According to the World Bank, about 60 developing or transition countries are dependent on oil, mining, or gas revenues, with two-thirds of the world's most impoverished people living inside their borders on less than $2 a day. Countries that depend on oil and min-

eral wealth also face a much higher chance of civil war and conflict; comparisons show that natural resource-dependent countries are almost a quarter more likely to have civil conflict than other countries.

The "resource curse" is not inevitable. For example, Norway and the U.S. state of Alaska have avoided many pitfalls associated with oil booms and used oil wealth to the benefit of their citizens, through innovative management techniques characterized by high levels of transparency and accountability. Their experiences can offer lessons regarding effective oil-revenue management.

Whether the population of a country will benefit over the long run from oil depends on how the resource is managed, what percentage of the oil revenues remain inside the producing country, and how these revenues are utilized in both the short and long run.

Governments and International Oil Companies

In most countries, natural resources are owned by the government. How it extracts these resources and generates revenues generally follows one of three basic models:

- **Total government management.** In some cases, the government manages all aspects of the industry—from exploration to production and marketing—through a national oil company. This practice is prevalent in the Middle East. For example, in Saudi Arabia, the world's largest oil producer, only Saudi Aramco, the state oil company, has access to the kingdom's reserves.

- **Joint government/oil-company management.** In most other cases, the government enters into joint ventures with multinational oil companies because of their technical expertise and access to the huge sums of capital needed to develop oil fields. For example, Nigeria's oil industry is dominated by six joint ventures managed by a number of well-known multinationals: Shell, Mobil, Chevron, Agip, Elf, and Texaco. These companies have partnered with the Nigerian National Petroleum Company, which holds about 60 percent of ownership in each agreement.

- **Total oil-company management.** Finally, multinational oil companies can manage all aspects of production, with no involvement from an entity run by the host government. This is the case in Chad, where the day-to-day operations of the recently constructed oil pipeline are managed by a consortium of oil companies

led by the multinationals ExxonMobil and Chevron and the Malaysian state oil company, Petronas.

In the cases where the government works with a multinational oil company, the relationship is guided by a contract that determines how the resources will be developed and how the revenue will be divided. These contracts generally are not made public. The two basic types of fiscal arrangements between governments and multinationals used in the developing world are production-sharing contracts and tax/royalty systems (sometimes known as "concession agreements").

Production-Sharing Contracts

In a production-sharing contract (PSC), the multinational oil company enters into a contract with the government to extract the oil. The company retains a certain amount of oil (called "cost oil") to cover its production costs, including the company's initial investment. In some cases, the "costs" to be covered include social-development projects and other "quasi-fiscal activities" that the company carries out on behalf of the government in regions where the extraction occurs (see the box on next page).

After the appropriate amount of cost oil has been determined, the remaining "profit oil" is divided between the contractor and the host government (or national oil company). The host government can decide whether to receive its portion of the profit oil as oil or cash.

Although PSCs are individually designed, many governments base their contracts on some form of "model" contract that adheres to the country's general petroleum laws. Governments or national oil companies sometimes publish model contracts, but these are often modified in secret negotiations.

A few countries have begun to publish their PSCs. In 2004, for instance, the government of Congo-Brazzaville posted some of its PSCs on its website. Yet even when model PSCs or actual PSCs are published, key aspects of the relationship between the multinational and the government may be outlined in other documents and side agreements that are not published.

Quasi-Fiscal Activities

Even if the revenue and benefit streams from resource-extracting entities are published, they may not reveal the complete picture of how these funds fit into a country's budget. This is because many resource-extracting entities (particularly state-owned energy companies) engage in what are known as "quasi-fiscal activities," or QFAs. Broadly speaking, QFAs include activities that could theoretically be carried out by government but are undertaken by other entities, so the funds involved are not clearly identified in the country's budget as revenues and expenditures. QFAs are not necessarily harmful, but there should be more transparency surrounding them in government accounting.

With respect to the provision of energy, the IMF identifies two main types of QFAs: mispricing and tolerating energy consumers' overdue debts or arrears. Mispricing occurs when a state-owned resource company provides energy for domestic consumption at less than market price, thereby providing consumers with an implicit subsidy. Tolerating consumer arrears is also a form of implicit subsidy, since it means consumers receive energy for lower prices. Opponents of these practices argue that although they benefit consumers, they can result in overconsumption of oil and in production inefficiencies.

Another type of QFA is the provision of social services or other services by the resource-extracting entity rather than the government. In some cases, the energy companies may be better suited to providing services than the government is, particularly in remote communities where the companies already operate. Nevertheless, such practices can weaken the government's incentive to meet its mandate to provide essential public services to all its citizens.

The amounts involved in QFAs are often not well known. Estimating the magnitude of QFAs requires data that may be difficult to obtain. Most QFAs are attributable to state-owned enterprises, which often do not publish such data. Expenditures that occur outside the budget are not subject to the same scrutiny and oversight as budgeted funds, and thus can result in the distortion of policy priorities and misuse of resources. For these reasons, the IMF argues for reporting all QFAs in a transparent way. (See the IMF *Guide on Resource Revenue Transparency*.)

Tax/Royalty Systems

A tax/royalty system is more common in industrialized countries, although it is also found in the developing world (for example, in Chad). In a tax/royalty system, the government licenses a company to explore, exploit, and sell the oil. In return, the government receives royalties, or a percentage of the proceeds from oil sales. These royalties vary from country to country. For example, in Chad, the govern-

ment receives 12.5 percent of the sales of oil produced, after transportation costs have been deducted. In addition to these royalties, the company also pays the government certain taxes and fees.

Sometimes the two systems are blended. In some cases a PSC system is in place, but some companies still pay corporate income tax and/or royalties. This blending may be related to the age of oil projects, with older oil fields governed by tax/royalty systems and newer projects governed by PSC arrangements. To improve transparency and accountability, the IMF *Guide on Resource Revenue Transparency* recommends limiting the extent to which blending occurs, unless it is necessary to ensure fiscal stability.

Other Sources of Revenue

While profit oil (under PSCs) or royalties (under tax/royalty systems) tend to be the largest streams of revenue from natural resources for developing countries, governments under both systems often receive additional revenues through the following instruments:

- *Bonuses* may be paid by the company to the government at the licensing stage, when new reserves are discovered, and/or when a production target is achieved. Bonuses can be a significant source of government revenue in the early stages of oil development, but this "front-loading" of payments does not necessarily result in a good deal for the government over time.

- *Corporate income taxes* or *profit taxes* may have to be paid on the company's profits generated in the country.

- The company may pay *fees* to the government for starting exploration or for the retention of a concession area.

- *Customs duties* may be levied on goods and equipment the company brings into the country.

Because of the complex nature of contracts and revenue streams, and the fact that few oil contracts are made public, it can be difficult to determine the overall division of oil proceeds between the company and the government.

Managing Oil Revenues

Revenues from oil and other extractive industries can pose particular problems in the budget process, both in estimating the amount of funds that will be available and in determining how to allocate them. Some governments have taken specific steps to avert these problems.

Addressing Volatility in Oil Revenues

Oil prices are notoriously volatile. This makes it difficult for governments to forecast oil revenues over a one-year budget period, let alone over the medium to long term.

Developing countries have traditionally been advised to adopt conservative projections of oil revenues for the purpose of budget planning. While this may seem prudent, in some cases it can lead the budget to reflect lower levels of revenues than are actually collected. If these unexpected revenues are never accounted for in the budget, the government can use them at its discretion, thereby avoiding legislative and public oversight. A further complication is that oil revenues often flow through multiple government institutions—such as the ministry of petroleum or the state oil company—before reaching the government treasury. This creates opportunities for the diversion of funds.

To counter these problems, the IMF recommends that governments show the price of oil assumed in their budget baseline and how this price was determined. That would make it possible to assess whether the budget under- or over-estimated future oil revenues.

Another challenge for oil-rich countries is to "smooth out" oil revenues over time to create a degree of stability for budget and planning purposes. This can be done through the creation of stabilization funds, into which surplus earnings are deposited when oil prices go above a set price and from which funds are drawn when oil prices go below the benchmark. These funds are sometimes technically difficult to manage in countries with weak institutions, and there may be strong political pressure to use them for immediate purposes. Yet some countries, such as Chile, Russia, and Kazakhstan, have used stabilization funds to maintain fiscal discipline and avoid the negative consequences of revenue windfalls, while simultaneously resisting public demands to raid the fund in favor of imprudent spending.

Other Budget Planning Approaches

Money can also be set aside in "future generations funds." This is typically done when natural resources yielding significant revenues are expected to be depleted over a fairly short timeframe, such as in East Timor and Sao Tome. A portion of these funds is then set aside for future generations. In poorer countries, though, some argue that setting aside funds for future generations is not a viable option because current needs are so urgent. (This was the argument used by Chad's government when it abolished its short-lived future generations fund in 2006; see below.)

Oil-revenue funds that are separate from the budget can be created for other reasons as well. Some countries with governance problems may try to quarantine resource revenues from the rest of the budget to minimize waste and corruption. One such country is Azerbaijan, which created the State Oil Fund of the Azerbaijan Republic (SOFAZ) in 1999 as a condition to receive an IMF loan. According to the IMF, the fund was established "to manage the revenues from the oil production and ensure that they are used in the interests of the future development of the country" (IMF, 2004). There has, however, been some controversy regarding how SOFAZ money is being spent. The fund is controlled by the president rather than parliament, and the rules governing spending money from the fund are ambiguous. In a particularly contentious move in 2002, the president allocated SOFAZ expenditures to help fund a commercial oil pipeline. To critics, this went directly against SOFAZ's purported goal of promoting non-oil development in the country.

Chad is another example. Under Chad's agreement with the World Bank, all direct oil revenues (royalties and dividends) are paid by the ExxonMobil consortium into Chadian government-controlled escrow accounts at Citibank in London. Indirect revenues (such as income taxes and customs duties paid by the oil companies) flow directly into Chad's treasury. (These revenues are estimated to be $1.3 billion in 2007.) After debt payments to the World Bank and European Investment Bank are withdrawn from the Citibank account, the remaining direct revenues are allocated according to fixed percentages: 10 percent to a future generations fund for the post-oil era; 72 percent to capital investments in antipoverty efforts in the areas of education, health and social services, rural development, infrastructure, and environmental and water resources; 4.5 percent to the oil-producing region in southern Chad; and 13.5 percent to Chad's treasury for discretionary spending.

Chad's oil revenue management scheme was thrown into crisis at the end of 2005, however. The government unilaterally ended the World Bank earmarking arrangement, demanding more funding for security and other non-poverty-oriented pri-

orities and doubling the amount of revenues flowing directly to the general government. The government also abolished the future generations fund. In addition, the government added security, justice, and territorial administration as "priority sectors" for the use of oil funds. The World Bank responded by temporarily suspending loans and freezing the revenues in the Citibank account. In April 2006, an interim agreement was reached with the World Bank whereby the share of direct revenue going to discretionary spending was increased to 30 percent, and the World Bank reinstated loans to Chad and gave the government some access to the Citibank account. Through a subsequent elaboration of the agreement in July, Chad agreed to submit a new budget law guaranteeing that 70 percent of all government revenues would still go to non-military spending programs.

Regional Distributions

In some countries the struggle over oil wealth has spurred secessionist movements and civil wars. To help address these problems, some countries share oil revenue with sub-national bodies such as state or regional governments. In Nigeria, Chad, and Indonesia, for instance, specific percentages of oil revenues are directed to the states and localities from which the oil is extracted.

These revenue-sharing arrangements raise a host of issues. On the one hand, oil-producing regions often bear the brunt of the social and environmental impact of oil production and are typically the country's *least* developed areas—facts that make a strong argument for special compensation. On the other hand, there are also strong arguments that oil wealth should be distributed on a national basis to help develop the country as a whole. Distributing natural-resource wealth before it reaches the national treasury is typically an inefficient revenue-management strategy. Rather, all revenue should be collected and then publicly allocated back to various regions and sectors as part of an overall prioritizing of the nation's needs.

Monitoring Oil Revenues

Both at the international and national levels, there have been increasing efforts to track government oil revenues and bring more transparency and accountability to the use of these revenues. These include efforts by international financial institutions, governmental bodies, and civil society organizations.

International Financial Institutions

World Bank

The World Bank's private-sector financing arm, the International Finance Corporation, has funded oil and gas projects around the world, including high-profile projects such as the Chad-Cameroon oil pipeline project. The World Bank is also involved in developing and promoting policy reforms, including the Extractive Industries Transparency Initiative (discussed below). The World Bank has helped a number of countries develop laws governing oil extraction with the aim of creating an attractive investment climate. It has also provided oil-related technical assistance to a number of governments, including Chad, Congo-Brazzaville, East Timor, and Equatorial Guinea.

The World Bank received sustained criticism from civil society groups during the 1990s for its heavy involvement in oil, gas, and mining. Groups argued that these activities did not further the Bank's poverty-reduction mandate but instead led frequently to increased poverty, environmental degradation, and corruption. In response, in 2001 the Bank launched the Extractive Industries Review (EIR), a three-year independent consultative review of World Bank activities in the extractive sector.

The final EIR report recommended significant changes in the Bank's operations in many areas, including governance, transparency, human rights, and social and environmental impacts. World Bank management agreed to "require revenue transparency as a condition for new investments in EI (extractive industries)—in line with our support of the EITI. For new large projects, we will require transparency immediately to ensure that revenues are properly and transparently accounted for; for new smaller projects we will expect it within two years." Some civil society organizations have questioned whether the Bank is meeting this commitment. In 2006, the Bank took steps to condition all future lending for extractive-sector projects from the Bank's International Finance Corporation on those transparency requirements but delayed implementation until the beginning of 2007.

International Monetary Fund

In 2005, the IMF issued the *Guide on Resource Revenue Transparency*, which describes best practices in the management of oil, gas, and mining revenues, as well as the challenges in implementing transparent revenue management. The guide is a supplement to the IMF *Manual on Fiscal Transparency*, published in 2001.

The guide fits into a broader array of IMF efforts in individual countries to promote transparent management of oil wealth. In countries such as Angola and Congo-Brazzaville, for example, the IMF has set clear requirements for revenue disclosure and audits of oil companies prior to resuming formal lending programs or approving debt relief.

IMF reports, such as annual "Article IV" mission reports and fiscal transparency ROSCs (Reports on the Observance of Standards and Codes) that can be requested by member countries, often examine a country's oil revenue-management situation. These documents can be useful sources of information for civil society groups.

Civil society groups have been lobbying the IMF to include transparency as an explicit, core condition for all forms of financial and technical assistance to resource-rich countries. Activists also argue that the IMF, as part of the Poverty Reduction and Country Assistance Strategy process, should conduct more targeted and meaningful consultations with local actors in resource-rich countries about the disclosure of revenues from resource extraction and how they are to be spent.

International Civil Society Efforts

"Publish What You Pay" and Other Civil Society Responses

More than 300 civil society groups around the world are now members of the Publish What You Pay (PWYP) campaign, which advocates mandatory disclosure of all extractive company payments to governments for the extraction of oil, gas, and mineral resources. The PWYP campaign was launched in 2002 by Global Witness, Catholic Agency for Overseas Development (CAFOD), Save the Children UK, Transparency International, and George Soros, chairman of the Open Society Institute. PWYP was soon joined by groups such as Catholic Relief Services, Human Rights Watch, Partnership Africa Canada, Oxfam, Pax Christi Netherlands, and Secours Catholique/CARITAS France, along with a large number of groups from developing countries. The coalition continues to expand worldwide.

National civil society coalitions in Azerbaijan, Australia, Cameroon, Chad, Congo-Brazzaville, France, Kazakhstan, Kyrgyzstan, Liberia, Mauritania, Nigeria, Norway, the United Kingdom, the United States, and numerous other countries are promoting greater resource revenue transparency. PWYP has called on the G-8 industrialized nations, in particular, to amend their accounting and corporate reporting regulations to ensure transparency of payments made by companies to every country in which

they are active. It advocates changes to existing legal and regulatory frameworks to ensure transparency among companies, governments, and state-owned enterprises for payments made and revenues received from extractive sectors.

For instance, PWYP has suggested that stock market regulators require oil, gas, and mining companies to publish net taxes, fees, royalties, and other payments to all national governments as a condition for being listed on international stock exchanges and financial markets. Relying on voluntary disclosure by companies of this information has been challenging to date, in part because companies are leery of taking positive steps toward transparency unless all of their competitors are obligated to do the same. Other PWYP proposals include making project financing from international financial institutions, banks, and export credit agencies conditional on disclosure of revenues and contracts. Revenue disclosure can also be a requirement in IMF and World Bank loan programs to resource-rich developing countries.

Other international research and advocacy groups working on this issue include:

- **Revenue Watch Institute (RWI).** RWI began as the Revenue Watch Program of the Open Society Institute in 2002, and was spun-off into an independent operating and grantmaking non-profit organization in 2006. It works with civil society, media, and policymakers in resource-dependent countries to counter the effects of the so-called "resource curse" and enhance public participation in these countries' economic governance. RWI's mission is to improve democratic accountability in resource-rich countries by equipping citizens with the information, training, networks, and funding they need to become more effective monitors of government revenues and expenditures.

- **Global Witness.** Global Witness works to reveal linkages between natural resource extraction and human rights abuses. Its activities focus on issues surrounding the extraction of timber, oil, and diamonds.

- **Save the Children UK.** Save the Children UK worked with the Revenue Watch Institute and other members of the PWYP coalition, investors, and industry representatives to develop the "Measuring Revenue Transparency in the Extractive Industries" framework. This framework relies on a range of financial disclosure and anti-corruption indicators to provide an independent assessment of efforts by oil and gas companies and governments to improve transparency with regard to resource revenues. The framework, now being managed by Transparency International, can also be used to gauge the progress of mining companies and home governments.

- **Catholic development agencies.** A number of Catholic development agencies, including the U.S.-based Catholic Relief Services, CAFOD in the United Kingdom, and Secours Catholique in France, have been engaged in efforts related to the extractive industries. These groups have been particularly active in Africa.

- **Human Rights Watch.** Human Rights Watch has done a significant amount of research related to the extractive industries, much of it focused on Angola, Congo, and other African countries that have been sites of conflict.

- **Oxfam.** Oxfam America supports partners in Latin America and West Africa and has prepared two reports on transparency regarding revenues from extractive industries in Peru and Mali. Intermon Oxfam Spain and Oxfam Australia are also active on revenue transparency issues.

Extractive Industries Transparency Initiative

The major governmental—and, to some extent, corporate—response to PWYP has been the Extractive Industries Transparency Initiative (EITI). The initiative was announced by British Prime Minister Tony Blair in 2002 and is led by the UK's Department for International Development. A high-level conference was held in 2003 to agree on a set of EITI "principles," and another conference was held in 2005 to agree on EITI "criteria" (see box on next page). The G-8 countries have endorsed the EITI.

The EITI is a voluntary initiative designed to encourage governments to publish data on the oil, gas, and mining revenues they receive, reporting the information according to an EITI-designed template. Once a country signs up to implement EITI, all extractive-industry companies are then required to fill out the template reporting their payments. This report on company payments and government receipts of oil revenues is then reconciled by an independent agent, audited, and published for public scrutiny.

EITI's 2005 conference established an international advisory group (IAG) chaired by Peter Eigen, founder and former chairperson of Transparency International. During its first year, the IAG prepared a report detailing proposals for the future organization of the initiative, the management of international support to the EITI, incentives for implementing EITI, and a suitable process for evaluating implementation. It also examined how EITI complements other international efforts to promote budget transparency. This report will be presented and some version of it adopted at the next EITI conference (scheduled for October 2006) by the various stakeholders,

Criteria of the Extractive Industries Transparency Initiative

1. Regular publication of all material oil, gas, and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive, and comprehensible manner.
2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.
4. This approach is extended to all companies including state-owned enterprises.
5. Civil society is actively engaged as a participant in the design, monitoring, and evaluation of this process and contributes towards public debate.
6. A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

Source: EITI Source Book, March 2005.

including governments of resource-dependent countries, donor governments and institutions, international and local civil society, extractive companies, and investors.

Implementing EITI

As of August 2006, 23 developing countries had endorsed EITI principles, but only about half of them were taking steps to implement the requirements. Nigeria and Azerbaijan are seen as the furthest along in implementing EITI.

Nigeria launched EITI in 2004, establishing a working group of national stakeholders and an EITI secretariat. In 2005, President Obasanjo introduced legislation in the National Assembly that would require annual revenue audits and mandate disclosure of oil-company payments. The first such audit was released in January 2006. While the PWYP-Nigeria coalition welcomed the audit and commended the effort, the coalition is concerned about the lack of civil society representation on the working group, as well as other aspects of the legislation. As of mid-September 2006, the landmark EITI bill was stuck in the National Assembly, and it may falter if it is not passed before the upcoming presidential elections.

In an effort to ensure that implementation by countries is meaningful and comprehensive, and to establish some kind of "brand integrity" for EITI, the IAG and EITI Secretariat have proposed a methodology to "validate" whether a country is truly implementing EITI. Pending final agreement on the details of this methodology, validation will begin starting November 2006.

Some civil society groups have significant concerns about the voluntary nature of EITI and its failure to call for the publication of contracts. They also see a need to link revenue transparency to broader governance and human rights reforms, as publication of revenue figures through EITI would be largely meaningless in countries that curb freedom of expression and restrict civil society activities. (Under the new EITI validation system, countries will not be able to claim they have met EITI requirements if civil society groups are excluded from the process.)

Others, however, believe that EITI has been an effective mechanism for bringing local civil society actors to the table with governments, international financial institutions, and extractive companies. They maintain that EITI has established a strong multi-stakeholder commitment to and momentum around revenue transparency and accountability in resource-dependent countries. The success or failure of EITI in developing a robust and truly global reporting scheme for resource revenues over the coming few years will demonstrate whether voluntary approaches to revenue transparency can have a real impact.

Country-Level Work by Civil Society Groups

A growing number of civil society groups in developing countries are attempting to track government oil revenues and bring more transparency and accountability to the use of these revenues. Highlighted below are the examples of Congo-Brazzaville, Chad, Azerbaijan, Kazakhstan, and Peru.

Congo-Brazzaville

Congo-Brazzaville is a significant oil producer in sub-Saharan Africa, where the oil boom has been accompanied by years of violent conflict—often over oil. More than 70 percent of the population in Congo-Brazzaville lives below the poverty line. The Catholic Justice and Peace Commission from Pointe Noire (the nation's oil capital) began an advocacy campaign on oil revenue management in 2002, with support from Catholic Relief Services (CRS). Protestant churches and local human-rights organizations subsequently joined the campaign, and the country's Catholic bishops called on President Sassou-Nguesso and the parliament to be transparent with the

country's oil revenues and contracts and to establish a committee to monitor the management of oil revenues.

Since then, a coalition of the country's church and civil society groups has created strong alliances with groups in Europe and the United States, including Secours Catholique, Global Witness, CRS, and others. Congolese members of the coalition have received training in advocacy and developed technical expertise in oil-revenue monitoring. They have visited France (the home of Total, Congo's largest oil company) to lobby the French government and French oil companies. In addition, Secours Catholique led a postcard campaign demanding that Total publish oil-revenue information.

These efforts have met with some success. The government of Congo began publishing some information on the oil sector—namely, quarterly oil-revenue data, some production-sharing contracts, and annual audits of the state oil company, though the auditors still refuse to sign off on the accounts. On the whole, however, the information that has been disclosed remains incomplete and is inaccessible to Congolese citizens. The government also announced its intention to join EITI in 2004, but has done little to move forward with implementation.

In 2005 the PWYP-Congo coalition held its first roundtable on oil-revenue management, a historic and ground-breaking event. It was the first public multi-stakeholder gathering to discuss oil and transparency in Congo, involving civil society, government, embassy officials, and representatives of Total and ChevronTexaco. PWYP-Congo has also publicized corruption in the state oil company, a scandal that was brought to light by a Global Witness report in 2005.

Unfortunately, Congo's revenue-transparency campaign experienced a sudden and significant setback in 2006 when the government imprisoned two leading civil society anti-corruption campaigners for "breach of trust" and subjected them to judicial proceedings that violated Congolese law and international human rights conventions signed by Congo. The arrests have been widely interpreted as an attempt to stifle public debate on management of the country's oil wealth. The government's commitment to reforming its management of public finances was further thrown into doubt when it obtained a loan of $32 million from China in June 2006, in contravention of the terms of its Heavily Indebted Poor Countries (HIPC) agreement.

Chad

Chad's law governing the management of oil revenues, which was a World Bank condition for funding the oil and pipeline project in 2000 and which was significantly modified in 2006, created a direct and official role for civil society in monitoring oil revenues and expenditures. The law established a Petroleum Revenue Oversight and Control Committee, which includes five representatives of government and four representatives of civil society (from human rights groups, religious communities, development organizations, and trade unions). The committee works with other government authorities to verify the revenue received from the oil fields and monitor the execution of the budget to make sure that Chad's oil revenues are being used to fight poverty.

When Chad's oil revenue management system was thrown into chaos in late 2005 (see page 118), local civil society actors accused the government of attempting to undermine Chad's development through oil-funded increases in military spending and greater internal repression. Some members of local and international civil society had argued back in 1998, before the World Bank agreement was announced, that the government lacked commitment to the revenue-management scheme. Many activists who oppose the project feel that the World Bank and other project financiers ignored these warnings. While the agreement between Chad and the World Bank pledges greater support and an expanded mandate for the oversight committee, it is unclear how this will work in practice.

Azerbaijan

Azerbaijan announced its commitment to EITI in 2003. The following year, with the support of the local Revenue Watch program, more than 30 Azerbaijani non-governmental organizations (NGOs) established a coalition to improve transparency in the extractive industries and to raise public awareness of the importance of transparency. The coalition includes think tanks, trade associations, environmental groups, human-rights groups, and lawyers, among others. Their workplan includes research, monitoring, advocacy, media and public outreach and capacity-building.

In 2004 and 2005, the NGO coalition participated in a monitoring project on the Baku-Tbilisi-Ceyhan pipeline, which will transport oil from Azerbaijani oil fields to the Turkish port of Ceyhan on the Mediterranean. The project included document reviews, data collection, and site visits to more than 100 communities along the pipeline.

With the support of the EITI coalition and the local Revenue Watch program, an Azeri NGO called the Public Finance Monitoring Center (PFMC) regularly publishes analyses related to oil revenues and other budget issues and has been a vocal advocate for increased transparency. PFMC and other members of the coalition have also conducted a series of lectures on transparency of oil revenues and budget procedures at two higher educational institutions and held training sessions (which included analysts from the World Bank) to increase public awareness about EITI.

In 2005, a group of civil society organizations active on oil monitoring also launched a National Budget Group to provide expert assistance to civil society groups working for public-finance transparency. The group's goals are to expand and disseminate budget information, improve the quality of budget legislation, gain greater public involvment and decision-making in budget processes, and increase efficiency in the budget's implementation.

Kazakhstan

In 2004 the NGO coalition Oil Revenues – Under Public Oversight! was established in Kazakhstan. It consists of more than 20 Kazakhstani groups that work on issues such as human rights, environment protection, and elections monitoring. The Public Policy Research Center, a Kazakhstani NGO that conducts research and advocacy related to tax policy, has taken one of the leading roles in the coalition.

The coalition has pressed the government of Kazakhstan to endorse the EITI, which it did in late 2005. The government's first EITI report is due to be published in October 2006. The NGO coalition is represented on the committee set up by the government to implement the initiative, and as the primary civil society watchdog monitoring the issue, the coalition will provide an independent assessment of the implementation process.

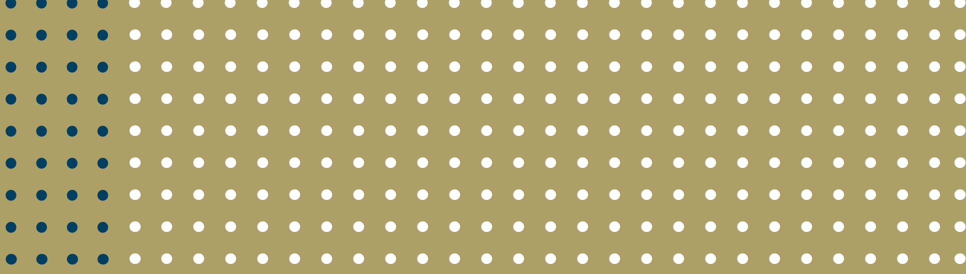
Peru

In Peru, non-governmental groups and church-related institutions have established two consensus-building mechanisms to address mining issues: Mesa de Diálogo Minero, where civil society and business representatives exchange information on the mining sector; and Red Muqui, a coalition of national, regional, and local civil society organizations that address issues related to the social, economic, and environmental impact of mining in Peru. Some of the institutions that are part of these consensus-building mechanisms have also helped monitor the extractive industries.

In 2005, Peru formally endorsed EITI on the recommendation of a working group comprised of representatives from government, business, and civil society and led by the Ministry of Energy and Mines, with assistance from the World Bank. The working group proposed a work plan for implementing EITI, which the government approved shortly before leaving office in 2006. The government also created a working committee to lead the implementation effort.

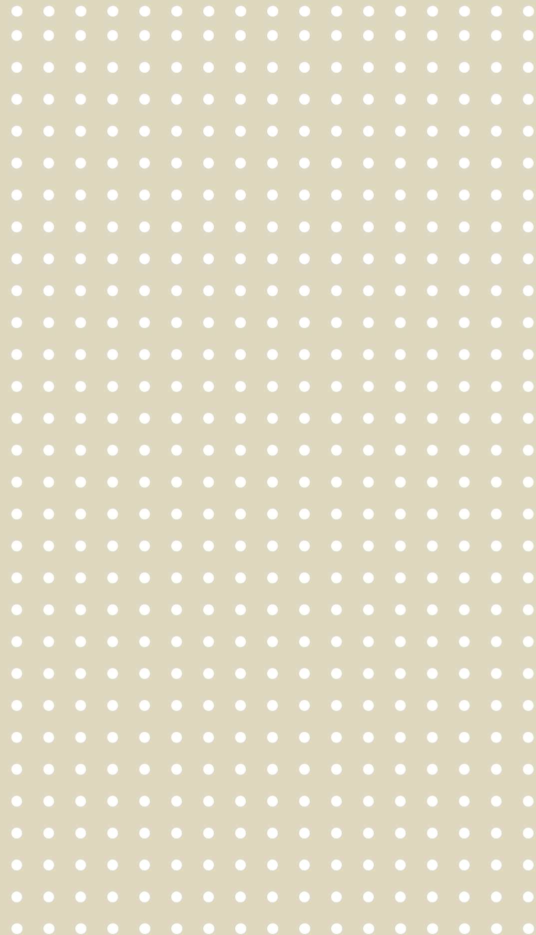
Following the election of a new government, however, there has been uncertainty about the future of Peru's implementation of EITI. The new government has named its representatives to the working committee, but it has not yet formally endorsed EITI or the approved work plan. More seriously, the government has gone back on its campaign statements regarding re-negotiation of royalty rates for mining companies, provoking a national debate around tax rates, royalties, and windfall taxes that has pitted some civil society groups against government and business.

Civil society groups have pressed the new government to continue with EITI implementation and have worked with the Ministry of Energy and Mines to move ahead with the election of civil society and university representatives to the working committee. Amidst the controversy regarding payments by the extractive industries, transparency remains an important national issue.



PART FOUR

Additional Resources and Bibliography



Additional Resources for Revenue Work

The Internet provides a wealth of resources for civil society groups wanting to learn about revenue work. This chapter presents a list of useful websites, including the sites of many of the organizations referenced in the guide.

International Budget Project (IBP)

http://www.internationalbudget.org/

The IBP website contains a number of resources that can help groups learn more about applied budget work and connect with other civil society budget groups in developing and transitional countries. These resources include a comprehensive library, information and contact details for many of the budget groups the IBP works with, an extensive resource section, and information about the IBP's international events. The IBP also publishes a bi-monthly newsletter.

- *A Guide to Budget Work for NGOs*
  http://www.internationalbudget.org/resources/guide/index.htm
  The guide to budget work was the predecessor to this guide on revenue work. It provides information on the principles and practices of applied budget work and an extensive list of resources for further information.

- *Case Studies of Six Established Budget Groups*
  http://www.internationalbudget.org/casestudies.htm
  The IBP and the Institute for Development Studies conducted an extensive study of the impact of applied budget work in six countries: Brazil, Croatia, India, Mexico, South Africa, and Uganda. The study concludes that the budget groups in these countries have had a significant impact in a number of areas, including enhancing budget transparency, increasing resources for pro-poor programs, and improving how these resources are used.

- *Open Budget Questionnaire*
  http://www.openbudgetindex.org
  The IBP's Open Budget Questionnaire was developed to evaluate public access to budget information and the openness of the budget process from the perspective of civil society organizations. It focuses mainly on the expenditure side of the budget. There are, however, several questions that provide information on how revenues fit into the budget process.

- *IBP Electronic Library*
  http://ibp.forumone.com/resources/library/index.php
  IBP's electronic library contains links to reports, studies, and other documents on budget-related issues available online. It includes a section on "Taxation and Revenue Issues."

International Governmental and Donor Institutions

Extractive Industries Transparency Initiative (EITI)

http://www.eitransparency.org/

The EITI is led by the UK Department for International Development, in cooperation with the IMF and World Bank. EITI aims to increase transparency in transactions between governments and companies in the extractive industries. EITI's website provides background information on the initiative, a description of the EITI principles, and information on the governments, companies, and non-governmental organizations that are participating in the initiative.

- *EITI International Advisory Group (IAG)*
  http://www.eitransparency.org/section/iag
  The IAG was established in 2005 to develop recommendations on the future of EITI. It has issued reports addressing key issues, including the organization of the initiative and its implementation.

Gender Responsive Budget Initiatives (GRBI)

http://www.idrc.ca/gender-budgets/ev-64152-201-1-DO_TOPIC.html

This website is home to the GRBI, a collaboration between the United Nations Development Fund for Women (UNIFEM), the Commonwealth Secretariat, and Canada's International Development Research Centre (IDRC). GRBI supports government and civil society in analyzing national and/or local budgets from a gender perspective and advocating for the formulation of gender-responsive budgets. It contains links to gender-budget initiatives around the world, some of which are engaging with tax issues.

International Monetary Fund (IMF)

http://www.imf.org/

The IMF has a number of resources that can be used to assess a country's tax system. The IMF's website also includes a large body of research on tax policy issues.

- *Government Finance Statistics Manual (GFS)*
  http://www.imf.org/external/pubs/ft/gfs/manual/
  The GFS system is designed to provide a framework for government financial accounting that is applicable to a broad range of countries regardless of their institutional or legal structures.

- *Manual on Fiscal Transparency*
  http://www.imf.org/external/np/fad/trans/manual/index.htm
  This publication provides guidance on implementation of the IMF's "Code of Good Practices on Fiscal Transparency." The manual includes a description of how revenues fit into the budget process and an explanation of key revenue concepts.

- *Guide on Revenue Resource Transparency*
  http://www.imf.org/external/pubs/ft/grrt/eng/060705.htm
  The guide offers a comprehensive description of good practices in the management of oil, gas, and mining revenues. It also outlines challenges in implementing transparent revenue management. The guide supplements the IMF *Manual on Fiscal Transparency*.

- *Tax Law Design and Drafting*
  http://www.imf.org/external/pubs/nft/1998/tlaw/eng/
  This two-volume book looks at the development of tax legislation from a comparative law perspective. The book, which is targeted toward government officials, presents the basic mechanics of different tax types.

- *Research Papers*
  http://www.imf.org/external/pubind.htm
  This link provides access to a searchable database of IMF publications.

International Tax Dialogue (ITD)

http://www.itdweb.org/

The ITD was created by the IMF, OECD, and World Bank to connect national tax officials and international organizations. The network is meant to facilitate the sharing of good practices and research related to tax policy and tax administration issues.

- *Global Conference on the Value Added Tax*
  http://www.itdweb.org/vatconference/
  In March 2005, the ITD held its first global conference, which was attended by high-level VAT policymakers and administrators active in their respective ministries of finance or revenue authorities. The conference website includes links to conference papers.

Organisation for Economic Co-operation and Development (OECD)

http://www.oecd.org/

The OECD is an international organization of 30 mostly high-income countries. The OECD examines tax policy and tax administration issues, and is also a good source of detailed revenue data and statistics for member countries.

- *OECD Tax Glossary*
  http://www.oecd.org/document/29/0,2340,en_2649_201185_33933853_1_1_1_1,00.html
  The glossary defines many of the tax terms used in this guide.

- *Survey on Budget Practices and Procedures*
  http://ocde.dyndns.org/
  This survey, which is a joint venture between the World Bank and the OECD, examines budget practices in more than 60 countries. The results include some information on how revenues fit into the budget process in different countries.

- *Source OECD*
  http://www.sourceoecd.org/
  This link is to the OECD's online library of statistical databases, books, and periodicals. The site also includes useful OECD working papers and country reports.

UK Department for International Development (DFID)

http://www.dfid.gov.uk/

DFID is the branch of the United Kingdom's government that coordinates international aid to poor countries. It has supported, for instance, enhancing the capacity for tax administration and the Extractive Industries Transparency Initiative.

United Nations University, World Institute for Development Research (WIDER)

http://www.wider.unu.edu/

WIDER's staff conducts research on a range of topics related to the interactions between policy and poverty. Most relevant to this guide, WIDER researchers have addressed issues related to tax policy in low-income countries. All of WIDER's publications can be accessed online.

World Bank

http://www.worldbank.org/

The World Bank's website includes country-specific information as well as more general resources related to tax policy and tax administration. Like the IMF, the World Bank publishes a large body of research, much of which is available online.

- *Tax and Customs Policy Administration*
  http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTPUBLICFINANCE/EXTTPA/0,,menuPK:390373~pagePK:149018~piPK:149093~theSitePK:390367,00.html
  This section of the World Bank's website (which is part of "public finance" in the "public sector governance" area) is devoted to tax and customs administration. The sub-section on tax administration is divided into five sub-themes: (i) the institutional framework of tax policy, (ii) designing tax structures, (iii) the institutional framework of tax administration, (iv) tax administration, and (v) evaluating tax policy and administration. Each sub-theme page contains brief descriptions of the topic and recommends related readings.

- *Practical Issues of Tax Policy in Developing Countries*
  http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTPUBLICFINANCE/EXTTPA/0,,contentMDK:20234772~pagePK:210058~piPK:210062~theSitePK:390367,00.html
  This was a course sponsored by the World Bank on April 28–May 1, 2003. Papers prepared for the course cover a range of useful tax topics.

- *Data and Research*
  http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/0,,menuPK:476823~pagePK:64165236~piPK:64165141~theSitePK:469372,00.html
  This link provides access to a searchable database of World Bank publications. This page is also the gateway to the World Bank's "World Development Indicators," which include basic revenue information available to the public.

International Civil Society Organizations

Association for Accountancy and Business Affairs

http://visar.csustan.edu/aaba/aaba.htm

The AABA is a small professional body in the UK with close ties to the Tax Justice Network. The AABA maintains a website that is generally considered to be the largest online source of information on tax abuse in the world. The website contains a list of links to stories on the issue and is updated daily.

Catholic Relief Services (CRS), Extractive Industries in Africa Initiative

http://www.crs.org/get_involved/advocacy/extractives/index.cfm

CRS supports training, research, policy, and advocacy activities at the local, national, regional, and international levels as part of an effort "to ensure that natural resource exploitation fosters poverty reduction and development and does not come at the expense of human rights, the environment and the human dignity of the poor who live amidst such massive wealth."

Global Witness

http://www.globalwitness.org/

Global Witness undertakes investigations to reveal linkages between natural resource extraction and human rights abuses. The website contains information about current campaigns, as well as reports on various issues.

Oxfam

http://www.oxfam.org/en/

Oxfam International is a confederation of 12 organizations that seek to expand public understanding of the link between economic and social justice and sustainable development. Oxfam organizations have been active on issues, and released analyses, related to revenue transparency and extractive industries.

Publish What You Pay (PWYP)

http://www.publishwhatyoupay.org/

PWYP is a coalition of over 300 non-governmental organizations working to improve transparency in the extractive industries. The coalition calls for mandatory disclosure of the payments made by oil, gas, and mining companies to governments. The website outlines the objectives of the coalition and offers resources for groups wanting to get involved.

Revenue Watch Institute (RWI)

http://www.revenuewatch.org/

The RWI works with civil society, media, and policymakers in resource-dependent countries to improve democratic accountability. It seeks to equip citizens with the information, training, networks, and funding they need to become more effective monitors of government revenues and expenditures.

Tax Justice Network (TJN)

http://www.taxjustice.net/cms/front_content.php?idcat=2

The TJN works to promote "tax justice" around the world. Its aim is to show that taxation is a critical component in successful development. The TJN website provides further information about the international coalition's mission and current activities, and it includes TJN reports and TJN's newsletter.

Country-Based Civil Society Organizations

Center on Budget and Policy Priorities (CBPP, United States)

http://www.cbpp.org/

The IBP is part of CBPP. The CBPP website contains a wide range of reports on U.S. federal and state budget and tax issues; food, housing, and health policies; and poverty and income distribution. Although they are focused on U.S. budget issues, CBPP reports can serve as examples of the types of analyses that groups in other countries may wish to undertake.

- *CBPP Federal Tax Policies page*
  http://www.cbpp.org/pubs/fedtax.htm/
  This link provides access to all of CBPP's work on federal tax policies. This work includes comprehensive analyses, shorter fact-sheets, and slideshows depicting some of the main conclusions of the reports.

Centre for Budget and Policy Studies (CBPS, India)

http://www.cbpsindia.org/

CBPS specializes in social sector expenditures (particularly health and education) the impact of policies on women and children, and local government finances. Its work is primarily focused on state and local finances in the Indian state of Karnataka.

Citizens for Tax Justice (CTJ, United States)

http://www.ctj.org/

CTJ examines tax policies at the federal, state, and local levels in the United States. Its mission is to give ordinary people a greater voice in the development of tax laws. Its analysis and advocacy are aimed at fair taxes for middle- and low-income families; requiring the wealthy to pay their fair share; closing corporate tax loopholes; and taxation that minimizes distortion of economic markets. CTJ also examines revenue levels to see whether revenues are available to fund important government services and reduce the federal debt.

The Democracy Center (Bolivia)

http://www.democracyctr.org/

The Democracy Center's work covers a range of human rights issues. Although its main focus is on Bolivia, the Center has been involved in campaigns around the world, including campaigns for greater transparency and critiques of IFI-led tax reforms.

FUNDAR Center for Research and Analysis (Mexico)

http://www.fundar.org.mx/

FUNDAR's work focuses on two major areas: monitoring of public spending, and governance and human rights. It works on budget issues ranging from health policy to monitoring oil revenues. It has had a particular impact on Mexico's expenditure policies in the area of maternal health and reducing maternal mortality. FUNDAR has also coordinated multi-country studies in Latin America on budget transparency and HIV/AIDS and has written a guide on how budget analysis can be used to promote economic, social, and cultural rights.

Group for Alternative Research and Monitoring of the Chad-Cameroon Petroleum Project (Chad)

http://www.gramptc.org/

Known as GRAMP-TC, this group was formed in 2001 to monitor the impact of the Chad-Cameroon pipeline. It focuses on the socio-economic, legal, and environmental issues related to the pipeline and oil revenues. In addition to conducting research, GRAMP-TC also works with and provides technical support for other stakeholders in the process of monitoring Chad's oil revenues.

Grupo Propuesta Ciudadana (GPC, Peru)

http://www.propuestaciudadana.org.pe (in Spanish only)

GPC concentrates on intergovernmental financial issues related to the budget decentralization process in Peru. GPC is part of a larger effort to monitor the decentralization process, and it produces regular reports on allocations in the national budget as well as on regional budgets. It also monitors the mining industry and associated revenue issues.

Institute for Democracy in South Africa (IDASA, South Africa)

http://www.idasa.org.za/

IDASA has a special focus on children, HIV/AIDS, budget transparency, and budget process issues. It provides extensive training to civil society groups and legislators to improve their understanding of budgets. The Africa Budget Project works with civil society groups throughout Africa.

Institute for Public Finance (IPF, Croatia)

http://www.ijf.hr/eng/

IPF conducts research on Croatia's budget and tax policies and publishes materials for a range of audiences. The institute is particularly notable for its work on the underground economy, as well as its accessible budget and tax guides.

- *IPF Newsletters*
  http://www.ijf.hr/eng/index.php?ime=28

- *The Citizen's Guide to Taxation*
  http://www.ijf.hr/eng/index.php?ime=16

Integrated Social Development Centre (ISODEC, Ghana)

http://www.isodec.org.gh/

ISODEC's applied budget work is coordinated by the Centre for Budget Advocacy (CBA) coordinates. This work has expanded to include tax work, with the publication of a guide to Ghana's tax system and analyses of tax proposals in Ghana's budget.

- *Guide to Taxation in Ghana*
  http://www.isodec.org.gh/Papers/Revised%20Taxation%20Paper.pdf

Public Finance Monitoring Center (PFMC, Azerbaijan)

www.pfmc.az

PFMC focuses on monitoring and analyzing oil revenues at the State Oil Fund of the Azerbaijan Republic; expenditures in the budget, particularly for development projects; and the financial activities of state-run enterprises. PFMC has also conducted trainings to increase public awareness of issues around transparency and oil revenues.

Public Policy Research Center (PPRC, Kazahkstan)

www.pprc.kz

PPRC specializes in budget and budget transparency issues and intergovernmental fiscal relations as well as in monitoring revenues from extractive industries. In addition to conducting research, PPRC organizes public events and trainings for NGOs.

South Africa's Women's Budget Initiative

http://www.idrc.ca/gender-budgets/ev-64152-201-1-DO_TOPIC.html

The analyses of the Women's Budget Initiative are now hosted on the website of the Gender Responsive Budget Initiatives, a collaboration between the United Nations Development Fund for Women, the Commonwealth Secretariat, and Canada's International Development Research Centre.

State Fiscal Analysis Initiative (SFAI, United States)

http://www.cbpp.org/sfai.htm

SFAI grantees analyze state budget and tax policies with regard to how they affect low-income working families. Many of these groups started as grassroots organizations, which expanded their operations to include more technical analyses of budget and tax policy. The above website has links to all of the groups' individual websites. The SFAI groups discussed in Chapter 6 include:

- *Alabama Arise*
  http://www.alarise.org/
  Alabama Arise lobbies on behalf of low-income people in the U.S. state of Alabama. The group's research arm, the Arise Citizens' Policy Project, analyzes state budget and tax policies.

    - *The Alabama Tax & Budget Handbook*
      http://www.alarise.org/Tax%20Handbook%20final%20for%20Web%208-10-05.pdf

    - *Arise Citizens' Policy Project website*
      http://www.arisecitizens.org/

- *Arizona Children's Action Alliance*
  http://www.azchildren.org/caa/welcome.asp
  The Arizona Children's Action Alliance analyzes policies in the U.S. state of Arizona in terms of their effects on children in the state. Its work includes analysis of state tax policies.

  - *Analysis of State Budget and Tax Policies*
    http://www.azchildren.org/caa/_mainpages/_Fiscal_Project_.asp

- *The Emergency Campaign to Protect Ohio's Future*
  http://www.protectohio.org/
  The Emergency Campaign to Protect Ohio's Future was formed in 2002 in response to significant cuts to human services proposed in the U.S. state of Ohio's budget to address declining state revenues. This website showcases the more recent activities of the coalition.

Tax Policy Center (United States)

http://www.taxpolicycenter.org/home/

The Tax Policy Center is a joint project of the Urban Institute and Brookings Institution, two respected Washington, D.C.-based think tanks. TPC produces analyses of tax policy issues and proposals and generates revenue and distributional estimates of tax policies. Most of the work is focused on U.S. tax issues, but some of the analyses have wider application.

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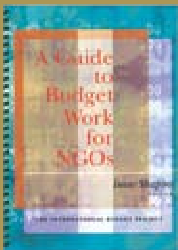

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