HARSH BUDGETS & HARSHER FACTS

Taxation and development in East Africa

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THE POWER TO TAX is the power to govern. A state without effective taxing authority is either powerless or dependent on its financiers. The more pressing the popular demand for public services and the fruits of national development and the more ambitious the government's plans (whether sound or foolish, popular or elitist) the greater the share of domestic production which must be collected in taxes.

In 1964 Professor Paul Clark and Dr. Brian van Arkadie posed the warning that capacity to raise taxes would prove tightest constraint on East African development over the next decade. Economists — unlike Treasury officials — have usually viewed the question of raising tax revenues as a matter of fairly minor technical and rate adjustments. Public finance is usually the study of details of different taxes and collection systems. Economists and Treasury officials alike rarely try to forecast their government's requirements in tax receipts in the medium run. Nor do they try to build a tax system capable of raising these sums while conforming to national criteria of equity or social justice.

In 1965-66 domestic recurrent budget receipts of the three East African states totalled £127-million. In the middle 1960's recurrent expenses have tended to exceed domestic revenues with reserves or foreign aid filling the gap. Development finance raised from domestic tax has become negligible. In half a decade domestic recurrent budget demands will total nearly £250-million and domestic finance for development will call for over £30-million annually. The latter is vital both because a development plan whose public sector is totally financed by foreign aid is — in fact if not in name — designed and determined by the donors, and because relatively little foreign aid is normally available without domestic finance to cover local costs.

FOUR ISSUES FACE EAST AFRICA in the tax field. One, what can be done to attain full coverage of recurrent budget expenditures and a surplus toward development spending now? Two, to what extent can the tax system be revised so receipts will grow parallel to expenditure needs without constant rate increases or new taxes? Three, how can an equitable and operational tax system resulting in a just distribution of public costs and uniform collection from all tax payers be achieved? Four, what does tax reform mean for the East or Eestern Africa economic community?

These questions — and the roads toward answering them — are most clearly read from 1965-66 Ugandan experience. Uganda arrived at a fiscal crisis earlier than its neighbours and has faced it forthrightly — at least on the short-term front. Kenya — buoyed by much higher foreign receipts — has a longer period to adjust its tax system. Tanzania — where the key limitations are personnel and (thanks largely to UDI) foreign development assistance — has adopted a consolidation budget as a prelude to serious tax structure reform within two years. Uganda is not inique — its experience can be highly relevant to Kenya and Tanzania as well as to other African States, not least in showing pitfalls to avoid, and the limited times won by even draconic short-run measures.

The year 1965-66 saw Uganda run a £1.6-million deficit on recurrent expenditure. This came despite receipts that were £2-million over the initial estimates, because expenditures also overshot, although only by £1.5-million. Adding development spending financed by Ugandan resources, the deficit came to £5.8-million, very largely ending as a drain on foreign reserves. These fell to perhaps £18-million (counting Uganda's share of currency board tssets) in January 1966. With anticipated 1966 deficits from private and marketing board transactions estimated at over £4-million, the reserve position left no room for covering further development or recurrent revenue-expenditure gaps.

THE IMMEDIATE CRISIS was the result of 1965-66's "soft" budget. Had it been balanced on recurrent account initially and had recurrent spending been held to estimates, then 1966-67 could have been an interim budget with some use of the £4-million in reserves thus husbanded on development account. However, the basic problems run much deeper — sharp changes were inevitable by 1968-69 if not in 1966-67.

On the one hand *Work for Progress* calls for a rise in government recurrent expenditure from £43-million to £63-million and in development spending from £12-million to £22-million over 1966-67. All of the recurrent, and at least £8-10-million of the development, costs must be raised locally, as against about £41-million total domestic revenue in 1965-66. The annual rate of increase needed is about 13.9% over 1965-66—1970-71 or about 1.75 times as fast as domestic produce growth goals of 7.3%.

On the other hand, Uganda's tax system is not buoyant. The nature of taxes is such that a 1% increase in monetary domestic product results in a .6-8% increase in tax revenue at constant rates and levies. The progress of industrialisation (reducing the share of imported manufactures in national product and thus slowing the growth of customs receipts) and the expected price trends for major exports (slashing export duty receipts relative to domestic product and perhaps even absolutely) underlie this unsatisfactory pattern. If monetary output grows 7.3% a year as planned, proceeds from present taxes at present rates cannot be expected to grow more than 5-6% a year — providing less than half of the required domestic revenue growth.

Further, the tax system is not fully in accordance with the principles of social justice emphasised in the plan. Income tax alone is really progressive. Customs duties have a mixed impact but on balance may be regressive as a number of low income group consumption needs are highly taxed. Excise duties are almost certainly regressive at least for those with cash incomes over £75-100 a year.

Even in the case of income tax, equity problems arise. Those with total incomes under £1,000 — 30 times the national average — pay very little tax unless single. The parallel income in relation to average product in the USA would be on the order of £35,000 and attract very considerable taxation indeed. Further there is a widespread belief that self-employed professionals, individual businesses and corporate entities avoid or evade tax on a large scale.

Certainly the 1956-6 tax system could neither hope to cover 1966-71 expenditure requirements nor to distribute the costs of development to its beneficiaries. In particular the £100-600 income group — who should benefit substantially and be joined by many additional farmers and wage earners — would pay very little and the over-£600 group would remain lightly taxed considering their relative income status.

The 1966-7 Budget faces the first question with a vigour deserving the title of draconic. Recurrent expenditures are to be held to one half million over 1965-6 estimates — £1 million below 1966-7 outturn. Domestic revenues are to be boosted by £6 million — all in taxes — to £44.5 allowing a £.5 million recurrent surplus for the development account.

The overall domestic revenue increase is 15.6%, somewhat above the needed trend rate and allowing a 12% annual rate over the next four years. Let us assume that *recurrent expenditure can be held* in line — doubtful in the case of security, given the aftermath of insurrection, and in health, because staffing of new facilities and services to additional patients seem inadequately covered. Let us also assume that the *tax estimates are correct*, and this is probably a valid assumption — indeed they may be conservative. These assumptions being correct, then the immediate fiscal crisis has been hurdled.

Examination reveals a number of problems, however. The 1966-7 monetary product is expected to rise between £8 and £10 million over the 1965-6 figure. To take 60-75% in taxes (up to 100% if reductions in cotton and coffee board prices to break-even levels are carried out in full this year!) is practicable for one or two years but scarcely for more. Indeed, the political courage shown in taking the risk of unpopularity now in order to achieve a higher growth rate, which in turn would make future tax increase requirements less unpalatable, is of a high order. It will pay off if 6.5-7.5% growth rates (14 million rising to £20 million annual output increases by 1971) result speedily. This is in part a gamble on weather and world prices, and in part a staking of political stability on the effectiveness of economic policy.

Of the new tax revenue only a quarter is to come from rises in existing sources responding to higher income. About a third is sought from higher customs, excise, and consumption duties, a seventh from copper export taxes, and a quarter from a 5% development levy on incomes over £200 a year. For long run purposes these taxes are less than fully satisfactory.

They are not very progressive — albeit mildly so. While they plug some losses due to import substitution excise-consumer-use taxes the manner is specific not co-ordinated. The copper tax yield cannot be expected to rise over time. A development levy of this type does affect the £200-600 group and should be buoyant but it is a rather blunt instrument and likely to prove unpopular if the stated "once for all" period should turn out to be "all time" and not this year or this plan. It is, indeed, an index of popular support for government economic policy that a not inconsiderable number of people have thought the levy for the plan period (five years) reasonable and accepted it — if resignedly not enthusiastically — as such.

A LONG-RUN BOUYANT tax system must be based primarily on those portions of monetary income which rise rapidly with development and/or on those types of purchases which expand at a rate at least equal to domestic product. External trade levies — while very significant absolutely for the foreseeable future — will necessarily yield revenues growing less rapidly than output because there is *no* prospect of imports, let alone exports, growing as rapidly as the overall economy.

Obstacles to rapid rises of income tax revenues centre on assessment and collection for other than wage- and salary-earners, on rates in the £100-1,000 range, and on public acceptability. Unless the first problem is solved the latter two are insoluble. Wage and salary earners in the under-£1,000 bracket cannot equitably be taxed if businessmen and independent professionals can avoid or evade tax. To try is to create seen injustice of sacrifice, which is to undermine the political basis of the entire tax, and for that matter political, system.

More effective assessment and collection depends on making it worthwhile to prepare accurate returns and providing the staff to check all large (say over £1,000 tax due) and a sample of all returns. A two-pronged attack could be devised posing "arbitrary assessment" or accurate accounts as options to the taxpayer and greatly expanding the assessing, auditing, and legal staffs.

The first would apply to self-employed by group: e.g. an independent lawyer would pay tax on £5,000 earnings unless he could demonstrate he had lower net receipts, a taxi owner-operator on, say, £500. Assessment levels should be raised until most people found it "profitable" to produce adequate accounts not pay the arbitrary figure. For businesses a parallel system applying rough profit margin rates to turnover estimates could be used. Great accuracy is not needed — what is essential is to make it expensive *not* to keep and produce accurate accounts.

Auditing and legal services in East Africa — as in other former British colonies — are horrifyingly inadequate. Often they amount to little more than adding up returns for internal consistency and prosecuting the most obvious cases of fraud and delinquency. The careful scrutiny of data presented and the rigorous prosecution of delinquents, combined with legal revisions to eliminate loopholes, characteristic of UK or USA revenue authorities, is all too noticeably absent. So long as wealthy individuals and large firms have access to first-rate accounting and legal talent, so must any government hoping to collect the taxes genuinely due it.

Broadening the tax base to include lower income groups than at present faces severe operational problems. If the effective income level for the tax were £200 (before deductions) not £1,000 there would be about 200,000 returns as opposed to 20,000. An alternative — especially for transferring the share of local government costs now met by the Central Government to local authorities — would be to restructure the graduated personal tax. If it began at 25/ and ran to 1,000/ on a scale which rendered it truly progressive, substantially increased revenues would result.

However, consumption levies hold more medium-run promise than do income taxes. They are easier to formulate and collect and are more favourable to savings promotion. If levied rates are tied to budget study data on consumption patterns, they can be progressive at least to £2,500 (after which surtax would be effective in achieving progressiveness). Again a two-pronged approach is needed.

First, a 4-6% wholesale level sales tax should be placed on rents over £10 a month, construction of dwellings over £200 in value, and all consumer goods except unprocessed and hand-processed foodstuffs and charcoal.

The exceptions both make the tax burden on those with cash incomes under £100 light and make collection — at point of import, factory, *or* wholesale outlet — fairly simple.

Secondly, "purchase" taxes of 20-50% (above present import duties) should be levied on that approximate fifth of consumption which is made up of amenities and luxuries marginally consumed by the £200-600 income class and dominantly by the £600-plus salariat and business-professional community.

Examples include: residential construction over £1,000 per family, rents over £20 a month, automobiles and equipment, electrical appliances and high quality furniture and furnishings, high-cost clothing and textiles, luxury foods and beverages, photographic equipment and supplies (now subject to *no* duty or excise), radios costing over £10 and gramophones, tape recorders and records.

The programme proposed is fairly ruthless for high income groups (including the author!). It has four virtues. The taxes are *collectable*. Overall tax *burden* is *related to income and to benefits* from government expenditure, e.g. the salariat are largely the products of public education, the business community benefits from government-stimulated development. All the new taxes are *buoyant* — their bases will grow as fast or faster than gross domestic product. Finally, and vitally, this set of taxes *would yield the needed revenue*.

The needed growth in domestic revenue (1965-6 — 1970-1) is in the order of £32 million. Of this about £6 was acquired in the 1966-7 Budget. Of the remainder perhaps £10 million will come from growth existing tax revenues at present rates and £2 million from non-tax domestic revenues.

The two consumption taxes outlined could yield £10-12 million.

Better income tax assessment and collection should be able to increase proceeds by £2.5 million and a revised GPT by £1.5 - 2.5 million for a total of £14-17, as against a gap of £14 million unmeetable from growth of present sources of domestic revenue.

The power to tax is — if misused — the power to destroy, but it also is *the power to develop*. There is no way to secure rapid economic growth in Africa without even more rapidly rising tax revenues. To attain these will require more careful overall planning of tax policy in the framework of expenditure requirements on the one hand and social justice on the other. Alike, these considerations require that the beneficiaries of development — including those in the £200-600 cash income range as well as the over-£600 African economic *élite* — pay higher taxes both absolutely and as a share of income immediately and for the foreseeable future.

Failure to lay out and implement such a strategy can lead only to increased dependence on foreign financing, failure to achieve development goals, rapid inflation, and an erosion of the social and political cohesion necessary to all phases of national development. The price of economically successful and politically viable development in Africa today is austerity for the rich and the semi-rich, as well as for the low income groups, who are all too used to it. Refusal by the economic *élite* to pay this price will doubtless be pleasanter in the *short* run. — *Facile descensus avernum.* ●