



Policy Paper 2024/02

Domestic Revenue Mobilisation for Sustainable Development and the Contribution of IDA-20

The Assessment of Tanzania, Kenya, Uganda and Rwanda

REPOA

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1.0 INTRODUCTION

1.1 Key DRM Enhancing Baselines

As indicated under the Policy Paper 1, the following seven sets of interventions are essential to enhance DRM efforts in the medium-to long-run:



3. Tax Policy and Administration

- Whether taxation helps or hurts will depend on governments' ability to implement effective and equitable tax policy.
- Improving governance around tax collection helps to close gaps in DRM and recover funds previously lost to tax evasion.
- Improving tax enforcement through transparency and tax audits, and strengthening judicial and executive oversight can help governments retain these funds. (*"Tax and Governance," International Centre for Tax and Development.*)

4. Efficient and Equitable Spending

- Governments should consider how increased DRM could reduce inequality by improving access to social programmes and essential services, especially for poor and marginalized citizens.
- Participatory budgeting improves public service delivery and increases tax compliance. (*Michael Ryan Touchton, Brian Wampler, Tiago Carneiro Peixoto, "Of Governance and Revenue: Participatory Institutions and Tax Compliance in Brazil," World Bank Group.*)

5. Open Contracting

- Efficient and effective procurement is key to good governance.
- Improving procurement practices saves governments and taxpayers money, freeing up resources for other development spending.

6. Audits

- Publicly available, independent auditing is foundational to good public sector governance.

7. Formalization of the Informal Sector

- An informal sector or grey economy refers to the segment of the economy that is neither taxed nor managed by the government.
- According to the International Labor Organization (ILO) broader definition, the informal sector refers to “all uncovered economic activities by law or in practice.”

1.2 Background Notes

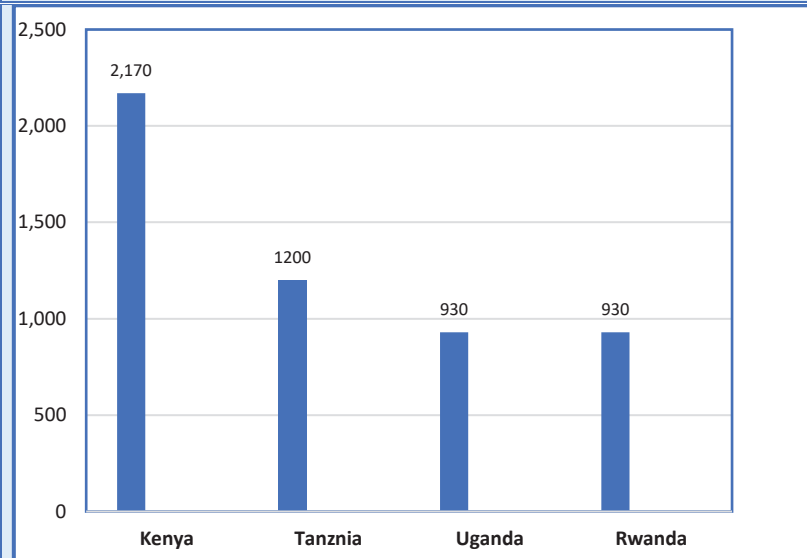
At the core of the East Africa’s policy thrust for inclusive growth and sustainable development was the intent of “**Ensuring that no one is left behind nor by the wayside**” across all segments of the respective countries’ population. Economic growth is inclusive if there is a simultaneous reduction of POVERTY AND INEQUALITY across all segments of the population.

EAC Policy Thrust

- “Ensuring that no one is left behind nor by the wayside” across all segments of the respective countries’ population.

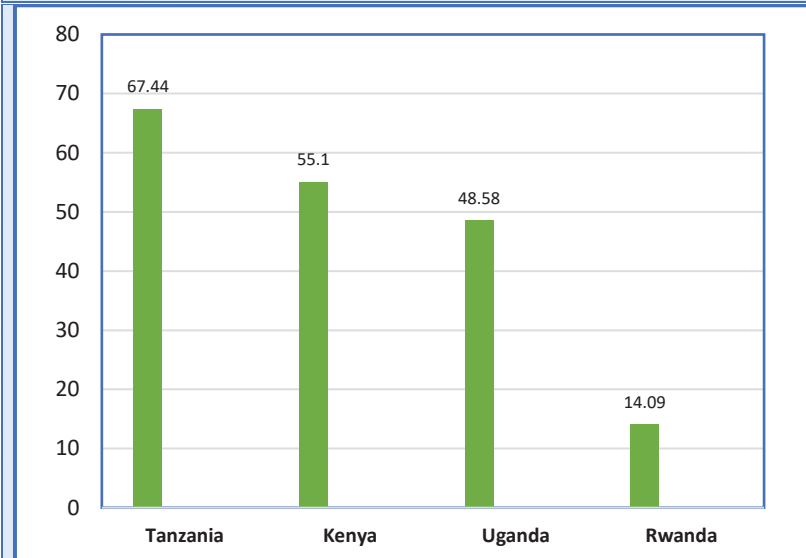
Realizing a demographic dividend requires multiple investments, and the most essential are building the capabilities of people and ensuring their rights and freedoms to achieve their potentials. Young people need the chance to gain the education and experience to succeed in a competitive global workplace, which demands more skills, education, and technical expertise than ever before. While a total of two (2) EAC Countries have achieved the Lower Middle-Income status (Kenya and Tanzania), two of the other reference countries (Uganda and Rwanda) are still in the LIC category. Figures 1 and 2 show the relative GNI per capita and population sizes of the four EAC countries. The challenges facing the EAC countries—both Low and Lower-Middle Income (the focus of this Policy Paper)—include the urgency to mobilise domestic revenue for effective and sustainable reduction of economic inequality, joblessness, poverty, and inadequate service provision. The Multilateral Development Banks (MDBs) support to these countries could sustainably enhance domestic revenue mobilisation (DRM) and effectively address the related economic and social challenges head-on.

Figure 1: GNI Per Capita, 2022 in Current US\$--SELECTED 4 EAC COUNTRIES



Source: World Bank—GNI per Capita, Atlas Method—SSA, 2024

Figure 2: Population for Selected 4 EAC Countries—in Millions, 2023



Source: WORLDOMETER, April 2024



Further, demographic dividends will be constrained without simultaneous investments in decent job creation, good governance, infrastructure, and functioning institutions to foster a conducive investment and business climate for the private sector to thrive. Going forward, the population of East Africa will have doubled in size, adding millions of young people to the working-age population each year. Creating conditions for decent livelihoods will be an enormous task, especially given that, currently, about 80 percent of the people who work in these countries are in the informal sector—basically unemployed, underemployed, or irregularly employed. Additionally, the shortage of financial resources—especially government revenue in the respective countries—will make it difficult to maintain, let alone increase, spending on health, education, and nutrition.

The EAC countries need significant financing to close the development and infrastructure gaps, meet the SDGs, and attain sustained demographic dividends. Historically, many of these countries have relied on fiscal consolidation as a strategy for financing development ostensibly aimed at reducing debt vulnerabilities and boosting resilience. A common dilemma facing governments in these countries is how to meet the sizeable fiscal costs of providing and maintaining infrastructure networks. Over the past decade, developed and developing countries (including EAC countries) have looked to fiscal rules, budgetary reforms, tax policy and administration measures, public-private partnerships, and other innovative financial instruments to raise additional finance for enhancing development expenditure, in particular infrastructure investment.¹



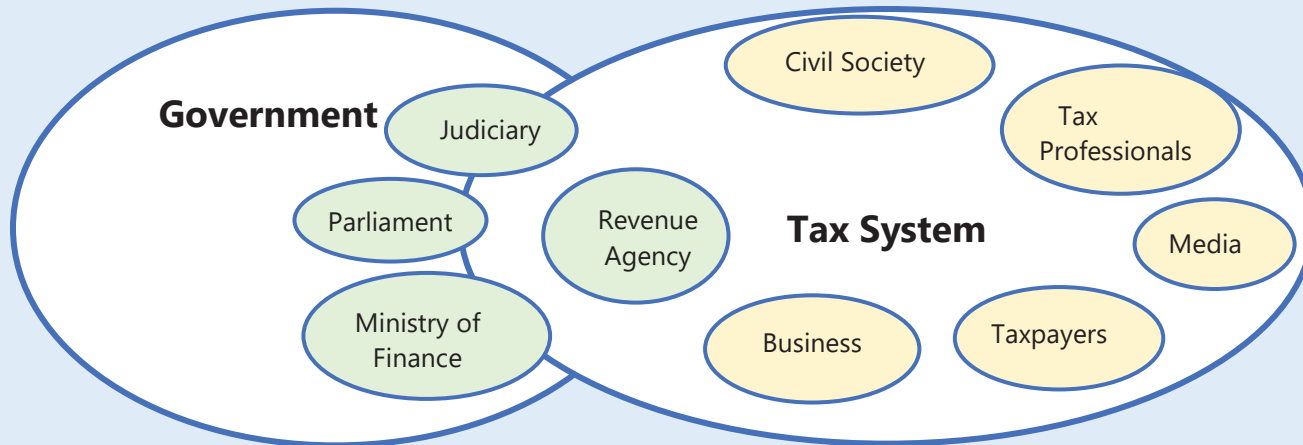
But in the context of changing financing trends around the globe, **enhancing domestic resource mobilisation** will remain key for developing countries, especially those in the East African Community.

¹ Teresa Ter-Minassian, Richard Hughes, and Alejandro Hajdenberg; Creating Sustainable Fiscal Space for Infrastructure: The Case of Tanzania; 2008 IMF Working Paper.

1.3 Building Tax Capacity and Creating Fiscal Space for Development Expenditure

Building tax capacity—the policy, institutions, and technical capabilities to collect tax revenue—is central to the role of government in development.² Tax capacity is also integral to achieving the Sustainable Development Goals (SDGs), addressing climate change, and ensuring debt sustainability. Beyond its fiscal function, tax capacity is associated with accelerated growth and better institutions. Revenue collection enables the state to fund public spending and improve the quality of market-supporting institutions. In this sense, tax capacity is the cornerstone of state capacities to finance and ensure their economic and social progress. Figure 3 provides a mapping of stakeholders who constitute the tax systems in the respective countries.

Figure 3: Stakeholders Shaping Tax System Performance

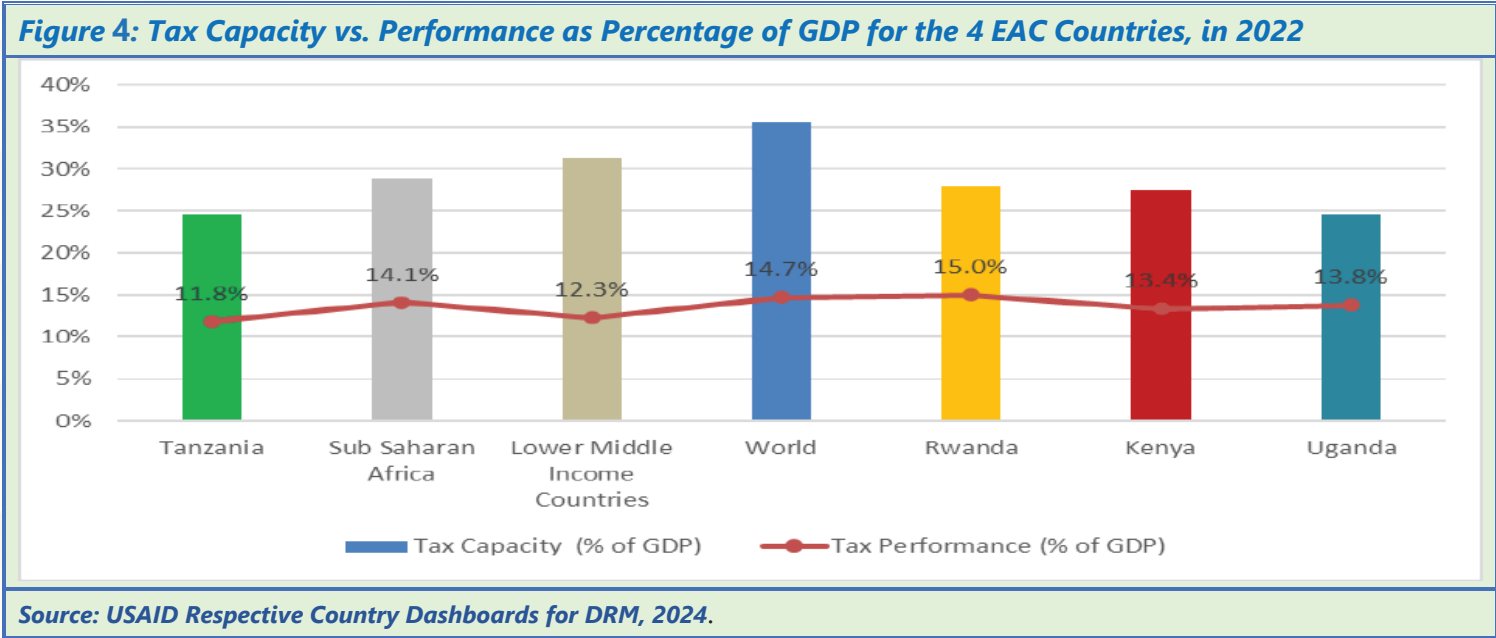


Extending the scope for taxation requires forward-looking investments in institutions, tailored to individual country circumstances.

Source: IMF, OECD, UN, and WB—*Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries*. July 2016.

² IMF Staff Discussion Notes; Fiscal Affairs Department. Building Tax Capacity in Developing Countries Prepared by Juan Carlos Benitez, Mario Mansour, Miguel Pecho, and Charles Vellutini; September 2023.

According to the IMF assessment, tax revenue has progressed in developing countries, with the average tax-to-GDP ratios increasing by about 3.5 percentage points since the early 1990s, to 13.8 percent in 2020.³ New empirical evidence suggests that a significant further increase is possible. Achieving this goal will require a firm commitment to building better institutions that govern the tax system, manage tax system reform and improve the design of core taxes.⁴ For the four case countries for this Policy Paper—Kenya, Rwanda, Tanzania, and Uganda—the tax capacity for the respective countries in accordance to the USAID Country Dashboards in 2022 are presented in Figure 4. Figure 5 presents the determinants of tax revenue collection.

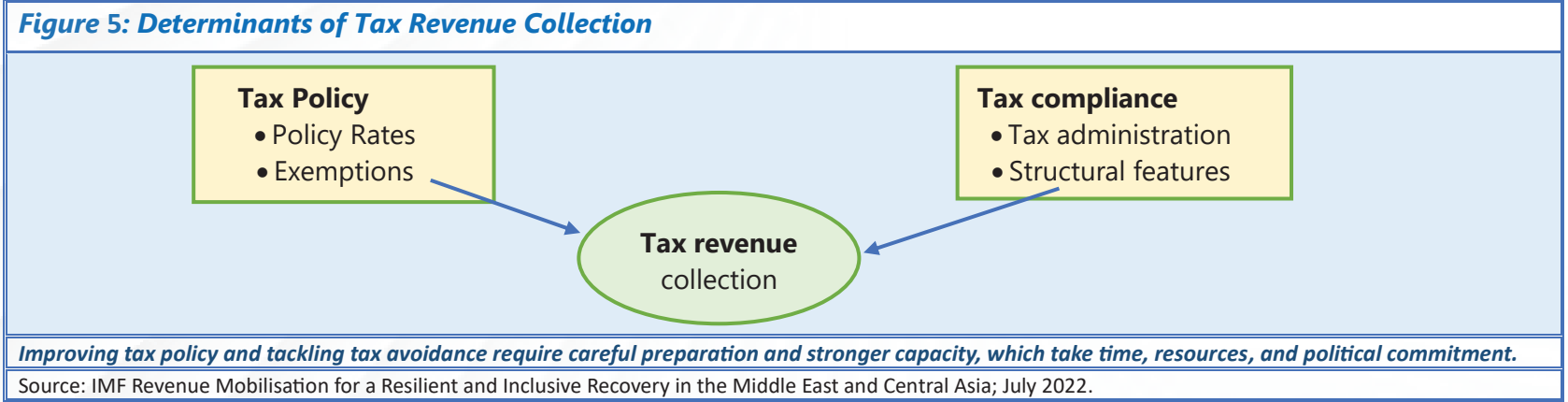
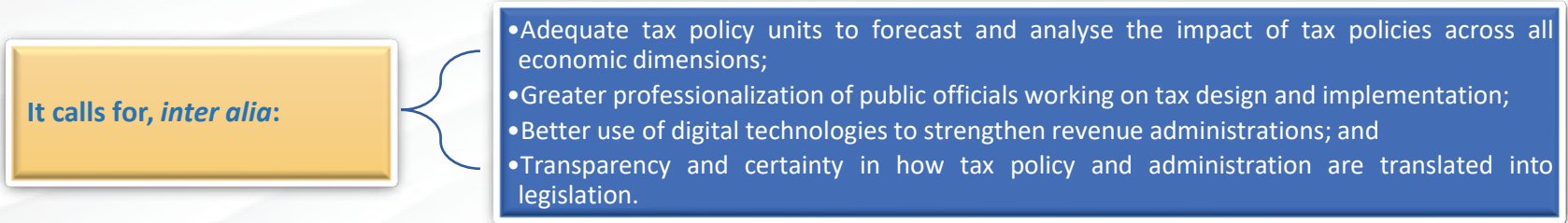


³ Ibid.

⁴ Ibid.

Meeting the medium to long term desire of the four case countries to close their tax gaps requires strengthening the design of core taxes—in particular the VAT and excises and personal and corporate income taxes. To that end, the focus should be on tax base broadening by reforming ineffective tax expenditures, more neutral taxation of capital income, and better use of real property taxes—thus accounting for both efficiency and equity considerations.⁵

Improvement in institutions that govern the tax system and manage tax reform is key to yielding better Domestic Resource Mobilisation (DRM) results.



⁵ Ibid.

EAC countries' search for creating fiscal space for development expenditure such as additional infrastructure investment within their respective budgets has four broad options at their disposal:

Reprioritization of spending away from less productive forms of expenditure toward growth-enhancing infrastructure investment and **improvements in expenditure efficiency** within a given overall expenditure envelope;

Identification of **new sources of domestic revenue** which can be used to finance additional infrastructure investments without affecting the overall fiscal balances;

Attracting additional **grants and concessional finance** from bilateral or multilateral sources;

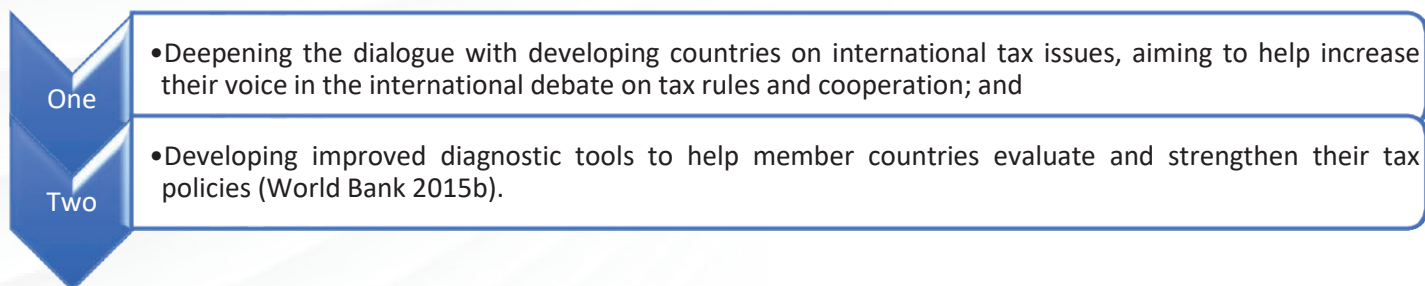
An expansion of **sovereign and concessional borrowing** on domestic or multilateral development banks (MDBs).

Tax policy and administration reforms are usually necessary but not sufficient. To bring sustainable in government revenue, other well-functioning institutions, such as the judicial system, are necessary and other pervasive issues, such as corruption, must be addressed across the public sector. Further, the World Bank may need in-house capacity to conduct analytical and diagnostic work to support tax components in Development Policy Operations (DPOs), especially where the IMF does not have a relevant program.⁶

⁶ Tax Revenue Mobilization: Lessons from World Bank Group Support for Tax Reform. IEG, 2017. WBG.

1.4 MDBs' Support for Enhancing Domestic Resource Mobilisation (DRM)

In July 2015, the World Bank and the IMF committed to a joint initiative to help countries strengthen their tax systems. Raising additional revenues is crucial to finance development in a sustainable manner. The World Bank-IMF initiative has two pillars:



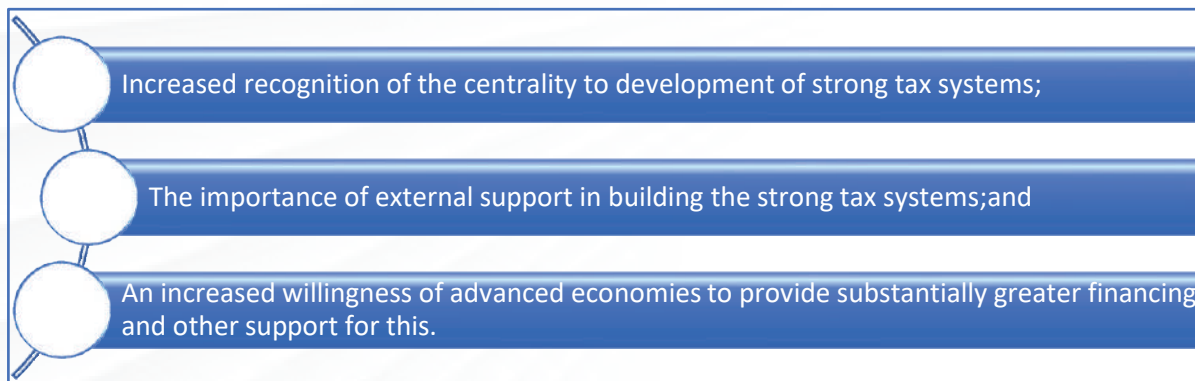
One of the pillars of the World Bank–IMF Joint Initiative to Support Developing Countries in Strengthening Tax Systems includes the development of “improved diagnostic tools to help member countries evaluate and strengthen their tax policies”. Common diagnostic tools have been developed by the World Bank and the IMF, such as the Tax Administration Diagnostic Assessment Tool, which was launched in 2015 and is now operational in 30 countries. A Tax Policy Assessment Framework is under preparation. Other tools used by the World Bank include the fiscal incidence analysis developed with the Commitment to Equity Assessment, the Custom Assessment Trade Tool kit, an integrated tool for measuring customs performance across countries and over time, and the Integrated Assessment Model for Tax Administration.

The tax payment aspects of the Doing Business indicators (payments, time, and total tax rate for a firm to comply with all tax regulations) generally guides the business tax work that often includes drafting and enacting tax laws. Harmonization of the legal environment is sometimes addressed through regional projects (as in East Africa).⁷

At the request of the **G20 Finance Ministers**, the International Monetary Fund (IMF), the World Bank Group (WBG), the Organisation for Economic Co-operation and Development (OECD), and the United Nations (UN) in July 2016 jointly submitted a

⁷ Ibid.

detailed report on modalities for “**Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries**”. The G20 Finance Ministers’ request arose in the context of:



The MDBs, OECD, and UN support premised on the fact that strong revenue performance is a core ultimate objective, but a single-minded pursuit of revenue can be deeply counter-productive. The total amount of tax (and non-tax) revenue is the primary concern in meeting development, social, and other spending needs, including those required to achieve the SDGs and infrastructure, while also reducing dependence on volatile and the sometimes-disempowering aid—which may also blunt the incentive to develop own sources of revenue—and securing macroeconomic stability and resilience.⁸

Strict pursuit of ill-conceived short-term revenue targets, however, is a common source of bad practice—for instance, the denial of VAT refunds, the harassment of taxpayers, or offering tax amnesties that undermine the credibility of the wider tax system. This damages economic activity and feeds a vicious cycle of mistrust between taxpayers and tax authorities.

An additional premise was that an indispensable prerequisite to improving tax capacity is enthusiastic country commitment.

⁸ IMF, OECD, UN and WB—Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries. Prepared for Submission to G20 Finance Ministers, July 2016.

Given such commitment, the report points to five key enablers to building tax capacity:

- A *coherent revenue strategy* as part of a development financing plan;
- *Strong coordination* among well-informed and results-oriented providers;
- A strong *knowledge and evidence-base*;
- Strong *regional cooperation* and support; and
- Strengthened *participation of developing countries* in international rules setting.

The Joint MDBs, OECD, and UN report arrived at a number of recommendations for measures to strengthen or achieve those enablers.

The primary recommendations include I:

- Options through which the G20, MDBs, International Organizations and other development partners can encourage political support for tax systems development;
- The development of country-owned medium-term revenue strategies, or tax reform plans depending on country circumstances;
- Support to non-government stakeholders;
- Support by MDBs and development partners to increase managerial, as well as technical skills in taxation agencies.

The primary recommendations include II:

- Various approaches to developing better coordination and collaboration among providers, and avoidance of fragmented support and approaches;
- Intensification of work by the Platform for Collaboration on Tax partners and others to produce comparable and reliable data;
- Increased partnerships and support for regional tax organizations; and
- Support to developing countries to facilitate meaningful participation in international tax policy discussions and institutions.

Against this background, this policy paper analyses the selected EAC countries' domestic resource mobilisation by focusing on the performance of various taxes overtime, identifying additional sources of revenues including from resource-intensive sectors, compliance, and associated challenges, the use of technology in tax collection; and broadening of tax base by formalization of the informal sector. The paper goes further to analysing the role played by IDA 20 in enhancing domestic resource mobilisation and their implications for IDA 21.

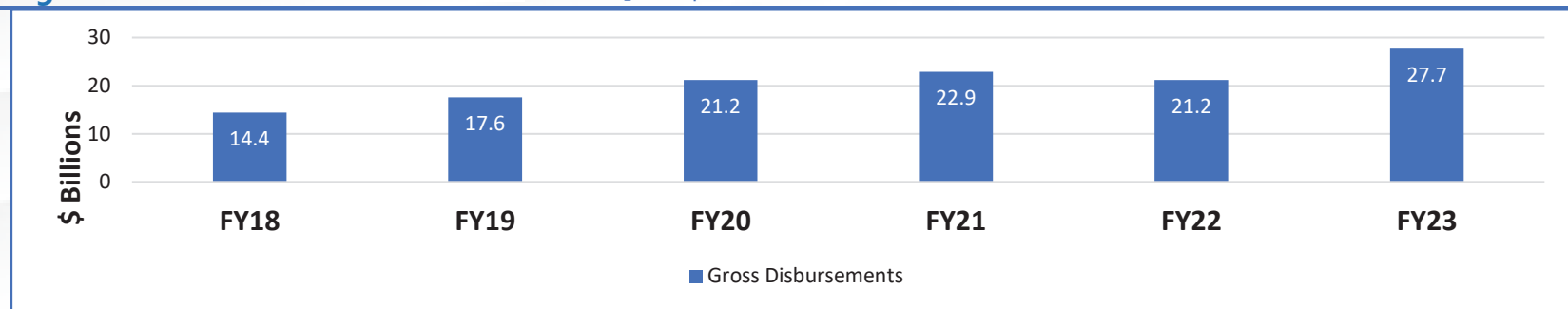
IDA 20 is a \$93 billion three-year cycle of the International Development Association for the period 2022-2025 that aims to support the world's poorest countries' recovery from COVID-19 by focusing on their sustainable development goals. IDA 20 focuses on 25 policy commitments across five thematic and four crosscutting policy areas.



The four cross-cutting issues are Crisis Preparedness; Governance and Institutions; Debt; and Technology. Historically, IDA replenishment cycles have been instrumental in mobilising financial resources to support development efforts in some of the world's most vulnerable countries. The impact of IDA's activities is measured through various indicators, including improvements in income levels, access to basic services, infrastructure development, and progress towards achieving the SDGs.

To date, some \$48.9 billion have been disbursed under IDA 20 with Tanzania having received \$2.13 billion among its top five borrowers⁹. Figure 6 presents the trends in gross disbursements between 2018 and 2023.

Figure 6: Total IDA disbursements FY18-FY24Q1 in \$ Billions

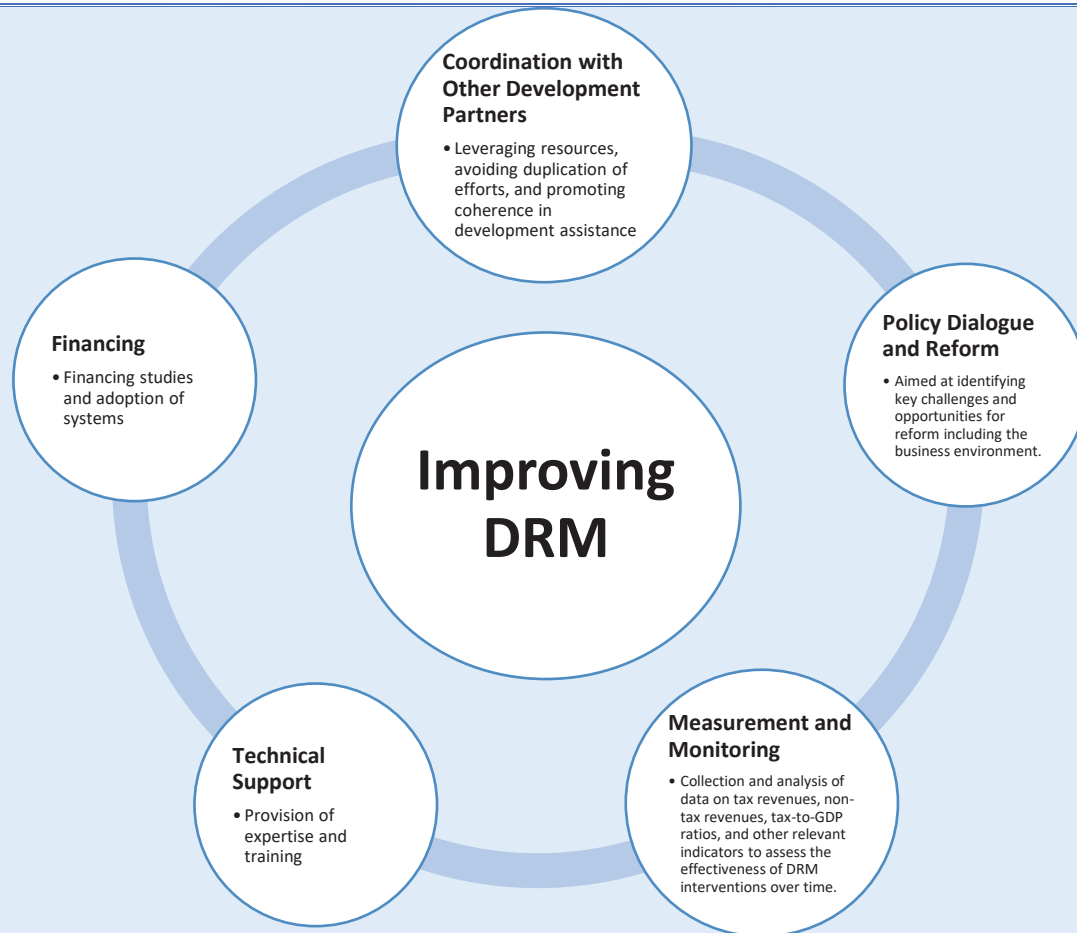


Source: Development Finance, Corporate IDA & IBRD (DFCII) (2023)

IDA20 recognizes that DRM is crucial for countries to finance their own development priorities, reduce reliance on external assistance, and build self-sufficiency. IDA20 was designed against the backdrop of the COVID-19 pandemic which among others underscored the importance of a fiscal space to effectively respond to emergencies and building resilience in social spending. Consequently, IDA 20 focuses on many of the initiatives advanced by its predecessor, IDA 19, including strengthening DRM, which as a policy commitment under the crosscutting theme of Governance and Institutions. In principle, IDA 20 supports recipient countries to address tax equity constraints primarily through technical assistance, policy advice, and financial resources aimed at improving tax administration, enhancing compliance, broadening tax bases, and modernizing revenue collection systems. The full range of IDA 20 DRM-strengthening support is summarized in Figure 7:

⁹ Other leading borrowers under IDA 20 include Bangladesh (\$3.2 bil), Ethiopia (\$2.82 bil), Pakistan (\$2.45 bil) and Nigeria (\$2.25 bil). Source: [International Development Association - World Bank](#) (Accessed March 26, 2024)

Figure 7: Envisaged the role of IDA 20 on DRM



Source: Authors

Overall, domestic revenue mobilisation remains a central pillar of IDA's efforts to support sustainable development and poverty reduction in the world's poorest countries, including those covered under IDA 20.

Initially, IDA 20 sought to support some 15 countries to enhance DRM through fair and progressive taxation reforms aimed at attaining a yield ratio of at least 15 percent in the medium term. As of the first quarter of 2024, some 21 countries¹⁰ have enrolled in the DRM initiative with mixed results, with the unweighted average increase in tax-to-GDP ratio declining to 0.24 percent in the last two years, from 0.34 percent¹¹. These results have occurred amidst a general slowdown in the global economy that has affected revenue collection from already exhausted bases, institutional rigidities among IDA countries that have impacted their ability to leverage globalization and digitalisation for effective taxation of incomes, increased tax avoidance through Base Erosion and Profit Shifting (BEPS), as well as distortionary tax exemptions in many of IDA countries.

In subsequent sections, we focus on country specific analysis of DRM efforts, roles of MDBs and IDA on DRM for each country, and policy recommendations for improving DRM for sustained economic growth, macro-economic stability and poverty reduction. It is important to note that while some of these recommendations are targeted at governments and implementing agencies of IDA countries and World Bank/IDA's support instruments for these countries, those recommendations can also be implemented outside the IDA support framework such as through support from bilateral development partners and other multilateral agencies. The most important aspects of these recommendations are the effectiveness and efficiency of execution of such recommendations and the sustainability of robust DRM that encompass both revenue collection and expenditure efficiency.

¹⁰ These include Bangladesh, Benin, Bhutan, Cambodia, Cameroon, Central African Republic, Chad, Congo Rep of, Côte D'Ivoire, Fiji, Lao PDR, Liberia, Madagascar, Nicaragua, Niger, Nigeria, Pakistan, Senegal, Sierra Leone, Somalia, Tanzania, Uganda.

¹¹ Development Finance, Corporate IDA & IBRD (DFCII) (2023). IDA20 Mid-Term Review: Implementation Update and Issues for Discussion ("Omnibus Paper"). Found at, [World Bank Document](#) (Accessed March 21, 2024)

2.0 DOMESTIC RESOURCE MOBILISATION (DRM) IN TANZANIA

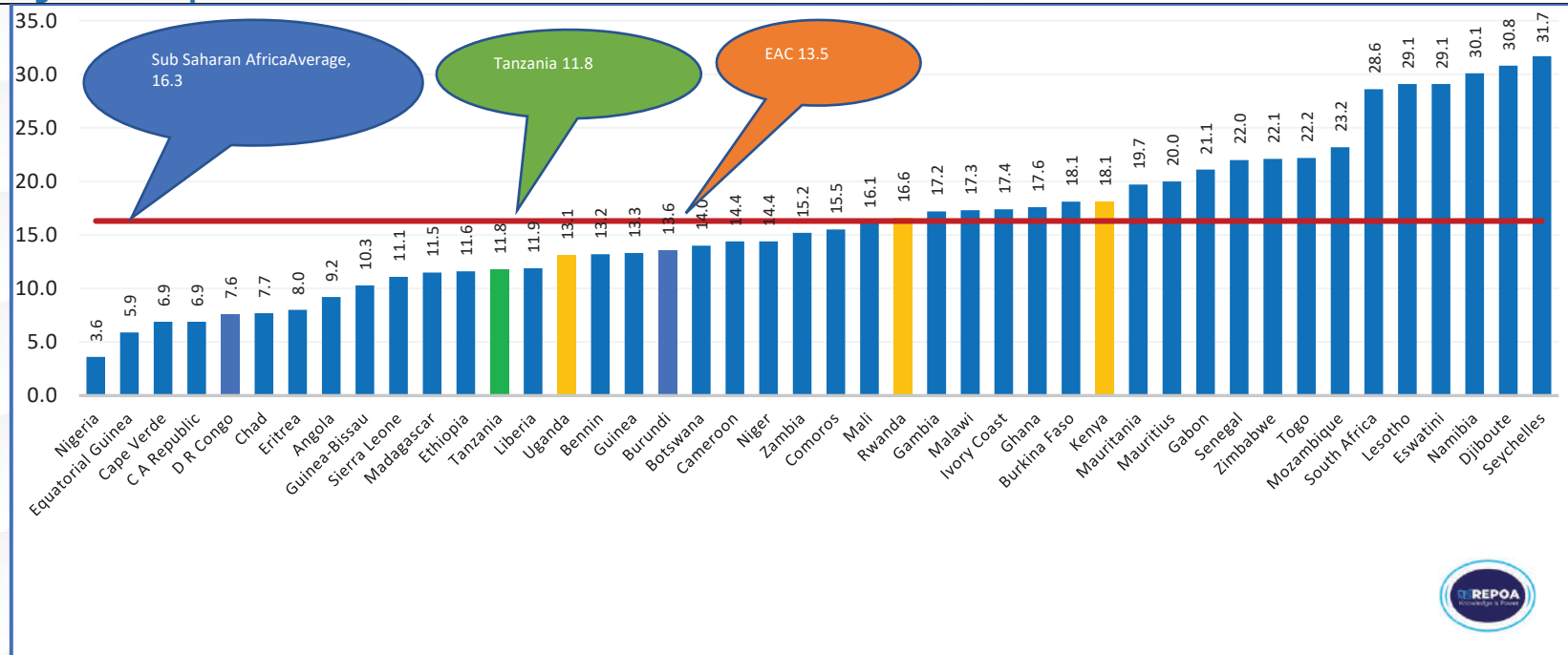
2.1 Introduction

Tanzania is a lower middle-income country with an estimated GDP per capita of US\$ 1,200 in 2023. It has faced slightly increasing revenue collection as a share of GDP from 13.8 percent of GDP in the FY 2018/19 to 14.4 percent of GDP in the FY 2022/23 (Figure 8B below). Domestic revenue mobilisation has averaged 14.52 percent of GDP in the last five years (2023c) with taxes contributing an average of 12.02 percent of GDP.

2.2 The Country's Domestic Resource Mobilisation

Domestic resource mobilisation, is essential in allowing countries to own and flexibly chart policies that address their specific development challenges while mitigating the risks of debt distress. However, on average SSA collects only 16.3% of GDP (16% for the whole African continent) from taxes compared to Asian and Pacific economies (19.1%), Latin America and the Caribbean (LAC) (21.9%), and the OECD (33.5%). Only 12 African countries have tax-to-GDP ratios of above 20%. Figure 8 below provides details of tax to GDP ratios of Sub-Saharan African countries showing the relative position of Tanzania and EAC countries.

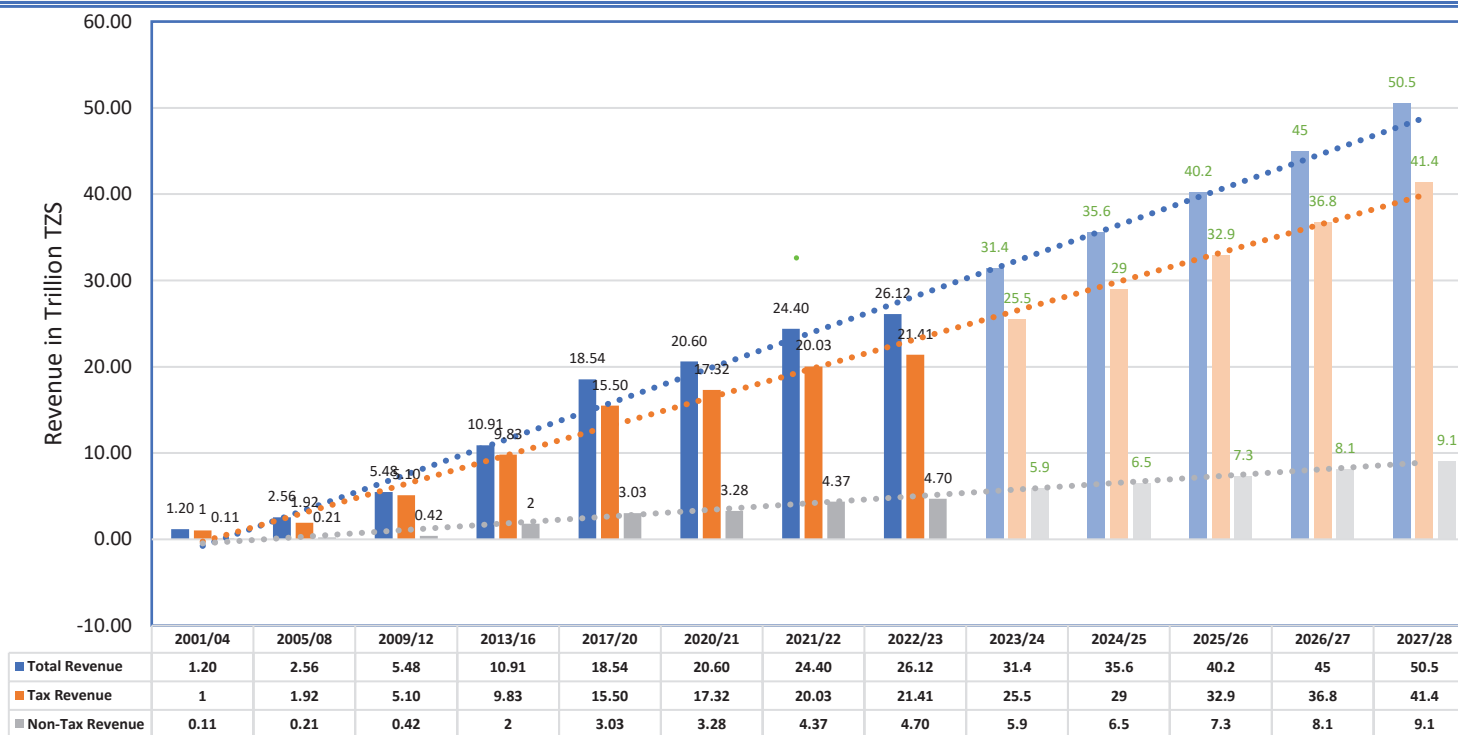
Figure 8: Tax performance % GDP—LICs, LMICs, MICs in EAC and Sub-Saharan Africa



Source: OECD/AUC/ATAF, 2020

Tanzania has made impressive progress in boosting domestic tax revenues in recent years and levels of domestic revenue mobilisation now compare well with comparable countries in the region. Tanzania’s domestic revenue mobilisation has grown consistently over the last two decades. Specifically, the country’s tax and non-tax revenues increased 26-folds from TZS 0.8 to 20.6 trillion between 1999/00 and 2020/21; and is projected to rise to TZS 35.6 trillion in 2025/2026 and further to TZS 50.5 trillion in 2027/28 as per Figure 9 below.

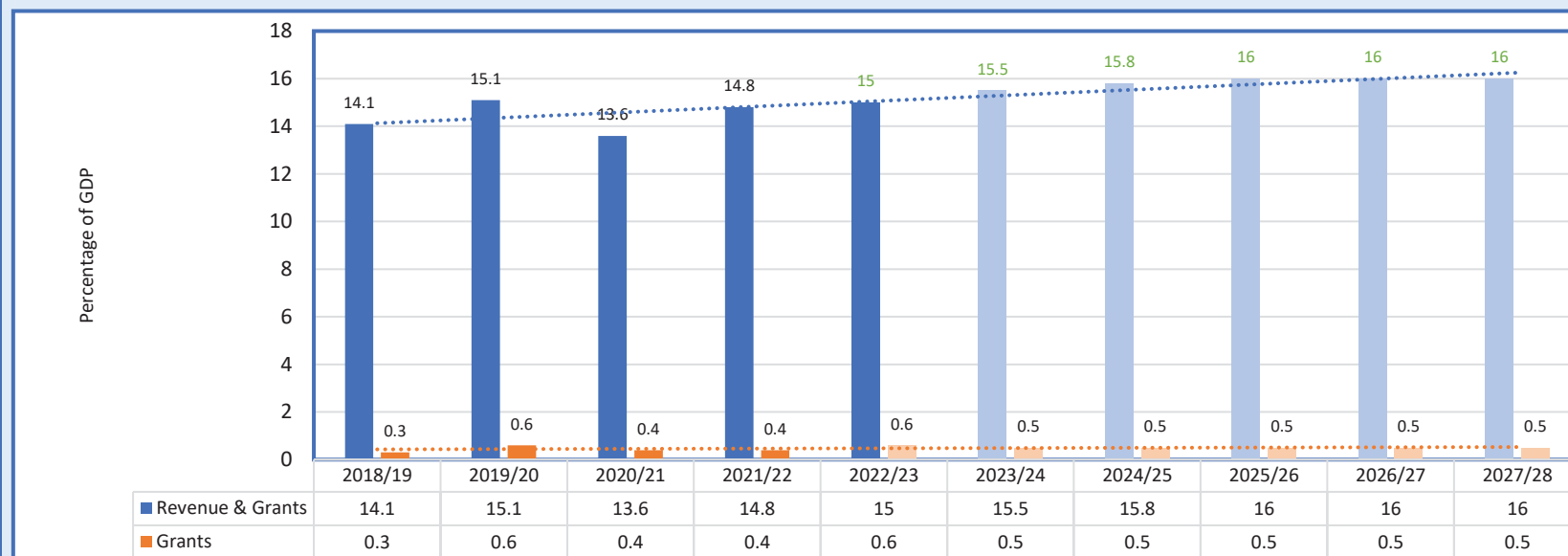
Figure 9: Tanzania's Domestic Revenue Performance in Trillion TZS



Source: Ministry of Finance; IMF-Tanzania Art IV Consultation 2023. Figures for 2023/24-2027/28 are Projections.

Domestic revenue as a percentage of GDP is projected to increase from 13.6% in 2020/21 to 16.0% in 2027/28 as per Figure 10 below.

Figure 10: Revenue & Grants as Percentage of GDP—Total fiscal revenue has remained broadly stable over time



Source: IMF-Tanzania Art IV Consultations, 2023. 2023/24 to 2027/28 are projections

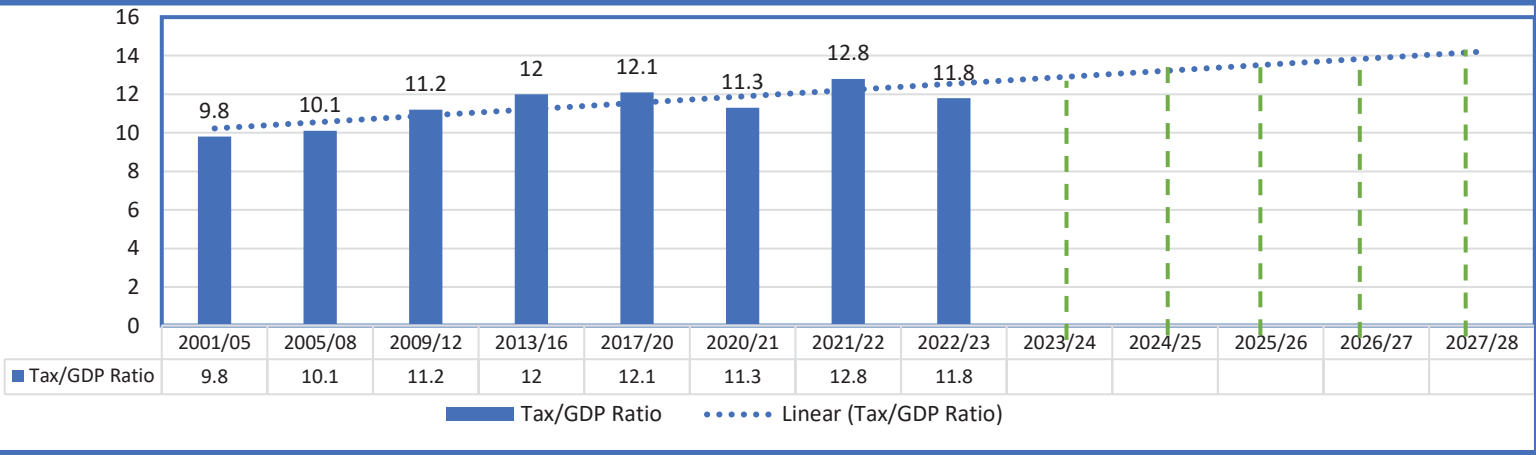
Between FY09 and FY19, total fiscal revenue (including grants) remained stable at about 15 percent of GDP. In FY15 and FY16, total fiscal revenue fell by more than 1 percent of GDP, but revenue recovered in the following year. Tax revenue represented 75 percent of total revenue over the period (or 11.6 percent of GDP on average), while grants fell gradually from 23 percent of total revenue in FY09 to 5 percent in FY19. The decline in grants was offset by an equivalent increase in nontax revenue.

A growing body of evidence suggests social and infrastructure spending are critical for promoting resilient growth and inclusion—two mutually reinforcing objectives. Resilient growth supports social development and mobility, while economic inclusion is necessary to sustain growth and political stability. Resilient growth will also require future spending to be covered without building debt vulnerabilities. Increasing public resources through domestic revenue mobilisation would create space to invest in resilient

and inclusive growth in a sustainable manner.¹² Figures 11 and 12 show the composition of taxes in Tanzania in relation to GDP and total revenues.

Tanzania’s improved tax collection helped narrow the tax gap from 8 percent of GDP in 2000 to 11.8 percent of GDP in 2023. The government can further increase tax productivity—in line with the projections in Figure 13 below by adjusting rates, rationalizing exemptions, expanding the tax base, leveraging digital technologies to enhance tax administration, and improving compliance management. Introducing a more rigorous system for taxing income from capital and immovable property could bolster the government’s revenue position while updating cross-border taxation policies could reduce the risks associated with base erosion and profit-shifting by multinational corporations.¹³

Figure 11: Tax / GDP Ratio



Source: Ministry of Finance & Bureau of Statistics. 2023/24 to 2027/28 are projections.

¹² World Bank Group—The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Public Expenditure Review FY22. June 2022.

¹³ Ibid.

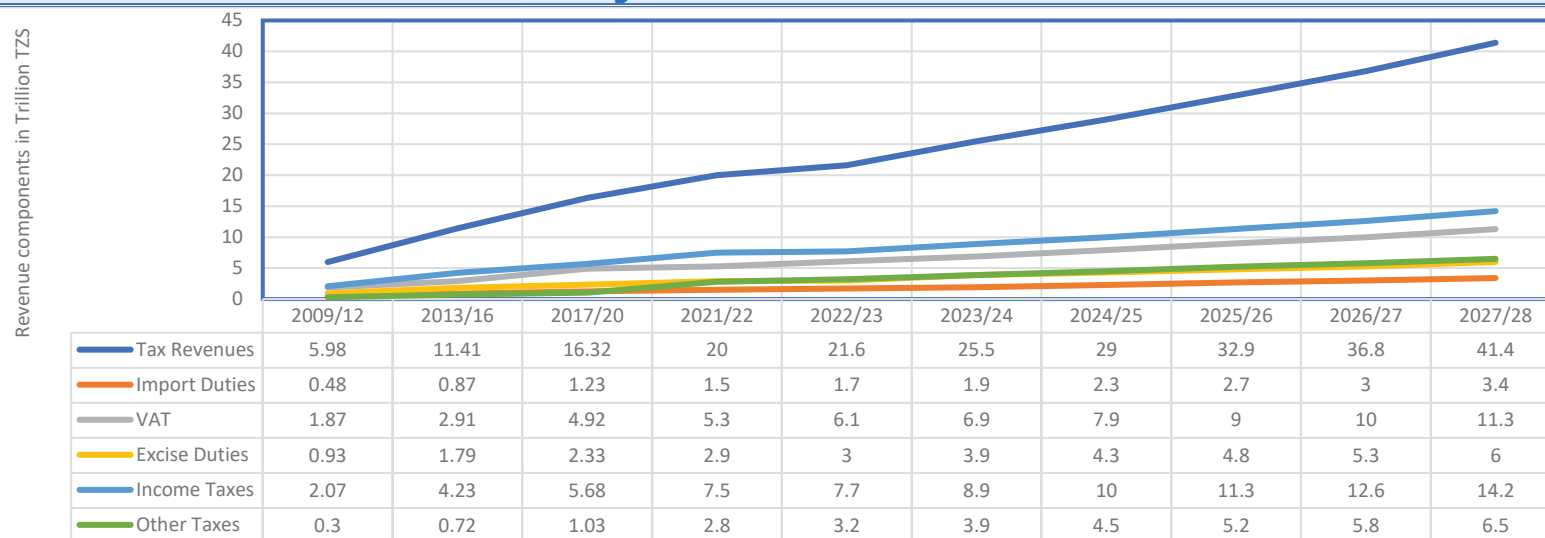
Tanzania's fiscal revenue collection remains low by the standards of its aspirational peers, indicating room for improvement. Between FY15 and FY19, Tanzania's tax-to-GDP ratio remained broadly stable at an average of 11.9 percent as per Figure 12. Increased tax collection facilitated Tanzania's economic development during 2000-2015 and enabled it to reach LMIC status in 2020, but in recent years the growth of the tax-to-GDP ratio has stalled and begun to decline.¹⁴ Measures that boost revenue collection efficiently and effectively can help Tanzania recover in the wake of the COVID-19 pandemic and the ongoing political conflicts in Russia and Ukraine. Over the medium term, increased public spending will be necessary to ensure inclusive and sustainable growth, further underscoring the importance of revenue mobilisation.

Strengthening tax administration at the top of the income distribution would improve the tax system's equity while increasing revenue mobilisation and reinforcing the social contract. Building the capacity of the tax authorities will be essential to expand collection efficiently and equitably and could lay the groundwork for further reforms. The authorities can complement the ongoing e-filing rollout by enhancing the integrity of the taxpayer database, which will be necessary to expand registration. Improving data collection and data analytics, adopting a risk-based approach to compliance management, and hiring and training more auditors could help ensure that all registered taxpayers report and pay their true tax liabilities.¹⁵

¹⁴ Ibid

¹⁵ **TANZANIA Economic Update**—The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Issue 19, 2023; World Bank Group

Figure 12: Tax Revenues in Trillion Tanzania Shillings



Source: Ministry of Finance & IMF-Tanzania Art IV Consultation. 2023/24-2027/28 are projections

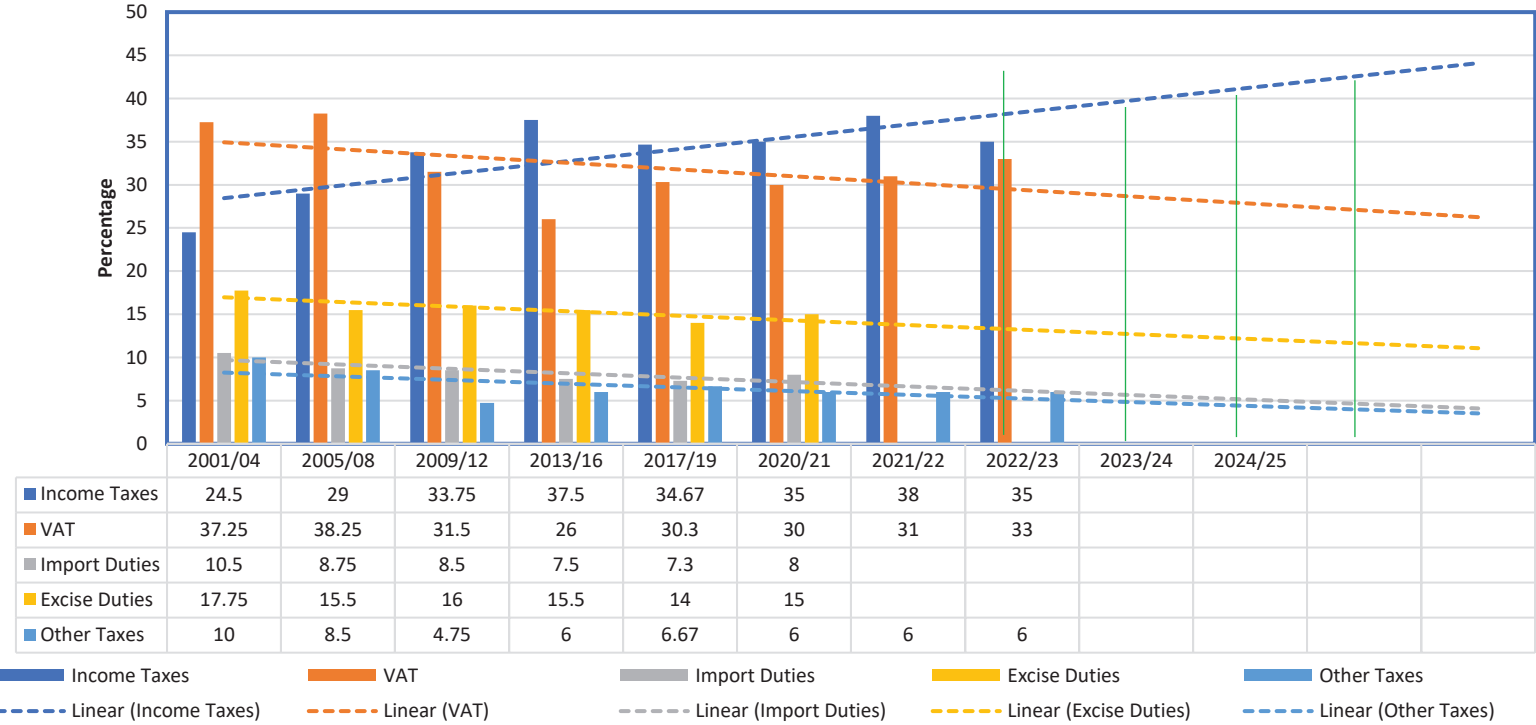
Nontax revenue rose sharply over the last decade. From FY09 to FY19, nontax revenue led overall revenue growth, rising by 1.4 percent of GDP. Meanwhile, income tax revenue increased by 0.3 percent of GDP, and revenues from excise taxes and import duties each grew by 0.2 percent. This increase largely compensated for a decline in grants, which fell by 2.8 percent of GDP, and other taxes, which slid by 0.6 percent of GDP. Value-added tax (VAT) remained stable as a share of GDP over the period but is projected to increase substantially in the coming years as per Figure 13 above.

Improvements in tax administration drove the growth of nontax revenue. Between FY09 and FY19, nontax revenue rose from 4 percent to 14 percent of total revenue (Figure 13 above). The introduction of electronic devices to collect taxes played a key role in improving nontax revenue mobilisation. Subnational government revenues, which represent one-quarter of all nontax revenue, rose by 0.1 percentage point of GDP over the period.¹⁶

¹⁶ Ibid.

Income tax and VAT supported the robust performance of tax revenue. Income tax contributed about 31 percent to total tax revenue between FY09 and FY19. The income-tax to GDP ratio rose from 3.4 percent of GDP in FY09 to a peak of 4.9 percent in FY14, reflecting large transactions in the gas sector, then eased to 3.8 percent in FY19. VAT remained stable as a share of GDP from FY09 to FY14, though larger-than-anticipated refunds and weaker tax compliance undermined VAT performance. From FY15 to FY19, a sharp reduction in tax refunds pushed VAT from 0.7 percent of GDP to 3.5 percent (Figure 13).

Figure 13: Tax Components as Percentage of Tax Revenues



Sources: Ministry of Finance

Improving the design of taxes can help balance the efficiency-equity trade-off. For example, measures to broaden the base for consumption taxes are found to be more supportive of growth than raising consumption tax rates. Similarly, income taxes can be designed to minimize the distortions to growth.

It is important to emphasize here that in all tax reform efforts, the equity-efficiency trade-off can only be assessed when evaluating the impact of net taxes: not only the impact of taxes on growth and incentives but also the benefit from financing growth-friendly and equity-enhancing spending.

2.3 Taxation of the Resource-Intensive Sector

The mining sector plays an important role in Tanzania and well as many SSA countries, but its overall contribution to revenue mobilisation could be enhanced. Tanzania is among the fifteen SSA economies that are considered “**resource-intensive**” (excluding oil), with mining making a significant contribution to the country’s national output, exports, and foreign direct investment (FDI) inflows. But overall revenue from mining in most resource-intensive sectors as well as most of the resource-intensive economies in SSA remains relatively limited.

The capital-intensive nature of resource-intensive sector—in particular the mining sector—and the long lead times between exploration and production mean that significant costs incurred prior to commencement of production may be ignored in the event the TRA prioritizes short-term revenue measures, and become statutorily barred from challenge, leading to substantial revenue losses. Moreover, the administration of the sector is often a shared responsibility between multiple regulatory agencies creating challenges of incomplete data sets for risk assessment purposes (each agency collects and maintains data relevant to their mandate), and duplication of functions, leading to confusion and inefficiency.

To develop capacity, the TRA must accelerate the development of sector expertise and implement robust compliance risk management capabilities to enable effective risk identification and mitigation from the onset of resource-intensive activities to protect revenue mobilisation. The best practice is to establish and build resource-intensive expertise within an integrated resource-

intensive unit typically within the Large Taxpayers Office to perform non-routine functions such as audit and targeted client assistance.

Fiscal and cost audits are the main tools for budget revenue. A fiscal audit checks that the tax declaration complies with all pertinent laws and contractual requirements. The cost audit is a prerequisite for the fiscal audit: overstating costs—deliberately or accidentally—means understating profits, and thus tax losses. The higher the marginal tax rates—and for excess-profits taxes, they can be well over 50 percent—the greater the temptation for companies to overstate costs. Abusive transfer pricing is an insidious way of doing so.¹⁷

Audit rights are described in national legislation or contracts (or both). Usually, a government can ask for any information it deems pertinent. Companies must keep all records on-site, but only for a limited period. After that period, an audit is much costlier and more cumbersome. Eventually, the audit rights expire. Auditing of resource projects therefore should start early during the exploration and development phases. The greatest costs are incurred during that phase, to be deducted from revenue many years later, when it may be too late to audit. Companies have rights too: once the audit exercise has ended, even if it was poorly done, the audit rights will expire.

A hard-nosed audit of a sophisticated, well-resourced, internationally operating company poses great challenges to developing country governments. One challenge is human resources. The skills and experience to match those of company specialists are hard to develop and retain. Arguably, talented national staff would be better deployed to improving spending, where they have a comparative advantage than to collecting resource revenue according to international rules. Outsourcing to specialized firms with solid international reputations is the logical solution.¹⁸

It may appear expensive but given the revenue to be gained it has the potential to be highly cost effective. The TRA staff should be trained to organize the outsourcing as well, and they should be capable of taking up with the resource companies any opinions

¹⁷ Charlotte J. Lundgren, Alun H. Thomas, and Robert C. York; Boom, Bust, or Prosperity? Managing Sub-Saharan Africa's Natural Resource Wealth. IMF 2023.

¹⁸ Ibid.

of the auditors on underpayments or other contentious issues. Auditors should comply with the International Standards on Auditing (ISA).¹⁹

Transparency and the involvement of parliament, civil society, and other stakeholders is also crucial. The Tanzania government could regularly publish an exhaustive accounting of how it used its natural resource auditing rights, and what results it achieved.

2.4 Compliance Challenges – Administrative and Structural Shortcomings

International cooperation can also affect administrative capacity. Internationalization of global value chains and financial services has created new opportunities for tax evasion and avoidance by large firms and high-net-worth individuals through practices such as profit shifting and concealment of assets and revenue. Meanwhile, the rapid digitalization of the global economy has also generated challenges for revenue administrations.

Beyond administrative capacity, structural bottlenecks, such as large informal sectors, may hinder tax compliance. Large informal sectors often result in a disproportionate tax burden on the formal sector. Furthermore, underfunded social and public services resulting from low contributions by the informal sector could undermine their quality and limit their size, reducing the benefits of compliance and creating an informality trap.

Perceived weaknesses in the control of corruption also create challenges for tax compliance. Given the nature of their role in collecting funds from the private sector, TRA is exposed to risks of corruption and collusion. More broadly, weaknesses in control of corruption create opportunities for taxpayers to evade their obligations or obtain undue advantages and for corrupt officials to extract rents, whether during the elaboration of the tax legislation, at all levels of the taxation process, or in the resolution of disputes between governments and tax administrations. To address corruption risks at the TRA level, the Government should

¹⁹ Ibid.

enhance the implementation of a range of safeguards, such as, *inter alia*, internal investigation units, universal electronic payment of taxes, but also tax payers' education on tax payment obligations.

More broadly, the quality of public institutions matters for compliance. Comparative weaknesses in regulatory quality, voice and accountability, government effectiveness, and rule of law could be detrimental to tax revenue mobilisation. Stronger governance is indeed correlated with better tax performance as sound legal institutions and adequate dispute resolution mechanisms enhance fairness and tax certainty, protect taxpayers' rights, and support the credibility of enforcement, thereby promoting compliance. Tax compliance is also encouraged by stronger trust in government, perception of reciprocity, and retribution of tax payments through the provision of public services. That is, fiscal contracts between the government and citizens should be vividly verifiable.

2.5 Leveraging Digital Transformation to Collect Taxes

Revenue administrations across the world are embarking on a new wave of digital transformation. Even though earlier waves in automating core functions of revenue administrations—such as e-filing—go back to the 1990s in some advanced and emerging market economies, the current wave is showing the potential to deeply transform the way low-income countries collect taxes. By improving the way that revenue administration functions are carried out:

Digitalization:

- Reduces the burden on taxpayers by simplifying procedures and enhancing service delivery;
- Allows for more effective compliance measures through data collection and matching;
- Improves governance by reducing arbitrary interactions between taxpayers and tax officials; and
- Leaving an audit trail of transactions.

Successful cases involve revenue administrations that:

Invested in a comprehensive digital transformation, including redesigning core functions and the organizational structure (to modernize and simplify process instead of adopting solutions to automate old ways of doing business);

Worked with taxpayers to “educate” them in the use of the new technologies and had a clear taxpayer-oriented vision in place;

Embraced good medium-term planning and proper sequencing to implement change.

Specifically, digitalization reduces physical contact between taxpayers and tax collectors, thereby reducing the risk of temptations and negotiations on levels and rates of tax payments. While digitalization helps the Government and TRA secure information, it also provides new avenues for fraud as well as privacy and cybersecurity risks. Individuals and firms can take advantage of new technology to hide information or evade taxes. The risks of fraud arise when taxpayers intentionally falsify information to reduce tax payments, obtain tax refunds, or hide transactions, or when TRA staff, contractors, and other trusted parties carry out fraudulent activity. Data breaches through hacking, leaks, and ransomware expose TRA to privacy and disclosure risks (likelihood of the TRA to lose control of tax information and personal data) which can further erode citizens’ trust in the tax system and consequently reduce voluntary compliance. In line with good practice, TRA should implement cyber security and data protection measures in their systems, as well as establish governance arrangements that will reduce risks to reputation, privacy, and revenue.

2.6 Formalization of The Informal Sector

An informal sector or grey economy²⁰ refers to the segment of the economy that is neither taxed nor managed by the government. According to the International Labor Organization's (ILO) broader definition, the informal sector refers to “*all uncovered economic activities by law or in practice*”. The concept has evolved over the years from self-employment in unregistered micro and small-scale enterprises to wage employment and unsecured jobs. The nature of the informal sector is predominantly dominated by domestic/casual workers, without fixed employers, and the self-employed who are mostly hawkers locally known as “*machingas*”. In a nutshell, the nature of the informal sector entails Micro and Small enterprises which are labor-intensive, self-employed, or unpaid workers with uncertain incomes, and unregistered businesses with no financial records. On the other hand, the three vital stages to formalize an entity include business name registration, business licensing, and payment of taxes which partly involve the licensing process.

In Tanzania, it is estimated that the informal sector's contribution to the GDP is 50 percent (IMF, 2017) which is considerably higher than the agriculture's sector contribution to GDP, currently at 29 percent. The sector is, therefore, an important source of livelihood for a significant portion of the country's population. With the increasing unemployment in the formal sector, a large share of unemployed youths will consistently be absorbed in the informal sector. Integrating the informal economy into the formal sector is, therefore, a pertinent policy consideration.

As part of the government's efforts, the government developed the Property and Business Formalization Programme (PBFP) that works towards formalizing the informal sector businesses by profiling the range of activities and businesses in the sector. Similarly, the TRA introduced a new simplified tax schedule for small taxpayers and linked the TRA's taxpayer identification system to the national system, which will allow the authority to more accurately quantify the informal economy and encourage compliance. The government also plans to enlist the support of village leaders to identify and register businesses.

²⁰ The terms “informal sector” and “informal economy” are interchangeably used. According to the country's National Bureau of Statistics (2021), the informal sector is expressed as the number of individuals employed in the informal sector to the total number of employed individuals in the formal sector.

One of the key constraints for the flourishing of the informal sector is to avoid bureaucratic procedures (cumbersome registrations), and unfriendly legal and policy environments (e.g. multiplicity of taxes). The other interpretation is that informality is largely driven by the limited space provided in securing formal jobs. Generally, the constraints are categorized as Regulatory and Non-regulatory constraints that include factors such as:

- labour legislation (e.g. employee benefits and rights);
- location-related factors (e.g. processes such as the acquisition of land, site development, obtaining utility connections, environmental laws, etc.); and
- reporting requirements (registration, licensing, taxes and duties, property rights, etc.).

Table 1: Constraints to formalize the informal sector in Tanzania

Regulatory	Non-regulatory or operational
<ul style="list-style-type: none"> • Labor laws • Absence of a policy for the informal sector (the current SME development policy does not highlight the way MSMEs can graduate to large-scale enterprises etc.) • Reporting: registration, licensing, and taxation • Land acquisition and availability of utilities. 	<ul style="list-style-type: none"> • Access to finances • Infrastructure • Supply-related: access to inputs, capacity building, markets etc.

Therefore, the interventions should consider ways of minimizing the cost of doing business in the informal sector and formulating policies that are specifically tailored to address regulatory and non-regulatory constraints and address the needs and risks of the informal sector. In this context, the government’s focus should be to change the sector by promoting its capacity to grow and

create productive employment coupled with simplified legal requirements and business procedures to motivate SMEs to formalize their businesses.

2.7 DRM's Impact on Income Inequality

Tanzania's fiscal system targets at substantially reducing income inequality, while public spending on social services more than offsets a moderate increase in poverty. In line with the results of previous studies, Tanzania's direct taxes are found to be highly progressive, while its VAT also appears to be moderately progressive, unlike VATs in many comparable countries. Several excise taxes are regressive, including those on wine, spirits, tobacco, and kerosene, but these taxes may reduce the consumption of products associated with negative social and health consequences. Overall, taxes and transfers in Tanzania reduce inequality to a greater extent than in most comparable countries.²¹

World Bank's policy simulations using the CEQ methodology show that broadening the VAT base would reduce inequality, and the additional VAT revenue could be used to offset a marginal increase in the poverty rate. Expanding the VAT base is also consistent with improving its fiscal efficiency, as exemptions distort relative prices. Implementing a standard VAT rate for water and petroleum products would slightly increase poverty by expanding tax liability, but its distributional impact would be progressive, and the resulting revenue could be used to finance poverty-reducing expenditures. Based on the CEQ analysis, dedicating a portion of the VAT revenue increase to augment the funding of the conditional cash transfer program would likely have a highly positive impact both on poverty and inequality.²²

Regularly assessing the impact of fiscal policy options on household income, poverty, and inequality, would enable the government to maximize its contribution to national development goals.

²¹ World Bank Group—The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Public Expenditure Review FY22. June 2022.

²² Ibid.

The CEQ methodology enables policymakers and their international partners to analyze:

- the tax incidence across different types of households,
- the benefit incidence of fiscal transfers, including in-kind transfers in the form of social services and indirect transfers provided through public subsidies, and
- the aggregate effects of taxes and transfers on household income, poverty, and inequality.²³

2.8 IDA 20 Support for DRM In Tanzania

Recent IDA support for DRM builds on past interventions that have targeted various facets of DRM as outlined in Box 1, below.

Box 1: Recent IDA support for DRM in Tanzania

The World Bank has supported several DRM interventions in Tanzania in recent years. IDA 20 is currently supporting two long medium-term DRM components of wider public finance programmes in Tanzania. These include the four-year US\$278 million Tanzania Cities Transforming Infrastructure and Competitiveness Project (TACTIC) that began in 2024, and the five-year US\$50 million P-for-R Public Finance Management and Procurement Systems for Service Delivery Program (PFMPS) which supports four key areas of the sixth phase of Tanzania's Public Financial Management Reform Programme (PFMRP VI) for the period 2022/23 – 2026/27). Component 1 of TACTIC builds on work started under Dar es Salaam Metropolitan Development Project (DMDP) and Tanzania Strategic Cities Project (TSCP) that set up the Local Government Revenue Collection Information System (LGRCIS), which enabled a 457 percent increase in own source revenue collection in participating LGAs from 2010-2020. TACTIC finances Technical Assistance (TA) for collection, processing, and use of revenue collection data; development and operationalization of Revenue Enhancement Strategies and capacity building in procurement and financial management; strengthening of financial management in areas flagged in annual CAG reports; and the refinement and operationalization of new functions of the Local Government Revenue Collection Information System (LGRCIS).

²³ Ibid.

Through the PFMPs, IDA 20's support for DRM features of PFMRP VI include the strengthening institutional capacity and efficiency of the collection systems for tax aimed at increasing the percentage of taxpayers filing VAT returns and making payments thereunder on time from 78 to 89 percent and increasing the number of businesses registered to pay tax by around 360,000.

IDA 19 extended DRM support for the eight-year US\$ 292 million Dar es Salaam Metropolitan Development Project (DMDP) by financing the completion and rolling out of the Local Government Revenue Collection and Information System (LGRSIS) popularly known locally as *TAUSI*. IDA 19 support enabled the migration of data to LGRSIS, updating of the valuation roll improvement of billing and collections systems, provision of hardware and software systems, and training. Some 184 Local Government Authorities (LGAs) currently use the system to send bills and collect taxes, except the billing and collection of solid waste fees, which is not activated, yet. IDA 19's support also enabled the training of 378 ministerial and municipal officials on the LGRSIS/*TAUSI* and a public awareness campaign through social media about the link between paying local taxes and the provision of urban services.

Between 2010 and 2015, the World Bank also supported DRM interventions through the Tanzania Strategic Cities Project. This \$340mil IDA-17 project developed and scaled up the use of the Local Government Revenue Collection and Information System (LGRSIS) from 8 to all 185 LGAs in mainland Tanzania. A subsequent evaluation credits LGRSIS with reducing revenue losses due to siphoning of manually recorded revenue collections. LGRSIS automates billing through bar codes on invoices. By project closure, taxpayers in all project cities had access to electronic bills for taxes and fees due, and electronic receipts upon payment.

In pursuit of the cycle's performance target of a tax-to-GDP ratio of 15%, support for DRM under IDA 20 in Tanzania has focused on strengthening the implementation of the Public Financial Management Reform Programme VI (PFMRP VI--2022/23-2026/27). PFMRP VI seeks to improve and consolidate Public Finance Management systems to enhance efficiency, effectiveness, and accountability in managing public resources at all levels of Government. PFMRP VI prioritises six strategic areas of intervention including Domestic Revenue Collection and External Resources Management; Budget Management, Financial Management, and Reporting; Procurement and Asset Management; and Audit and Oversight functions.

A review of PFMRP VI's performance and extent of IDA20 support is summarised in Table 2 below:

Table 2: Extent of IDA 20 support for Tanzania’s DRM efforts

	PFMRP VI Key Results Strategic Objectives for DRM	IDA 20 Support	Current Performance ²⁴
1	70% of taxpayers voluntarily comply with tax obligations.	The World Bank has been supporting studies and innovations on behavioural approaches to voluntary compliance. These include the sending of SMS reminders to taxpayers alerting them on their due payment dates.	Voluntary compliance is rated at 57%, a marginal improvement over the 2022 baseline figure of 55%.
2	Outturn on domestic revenue collection increased to 93%.	The World Bank and IMF are supporting the development of a medium-term revenue mobilisation strategy aimed at improving forecasting and aligning revenues with expenditure.	Domestic revenue collection (including LGAs own source) during the period of July – September 2023 amounted to \$2.8 billion, equivalent to 96.2 percent of the target.
3	7 Revenue management information systems in local government authorities (LGAs) upgraded.	No ongoing support.	The number of upgraded revenue management information systems in LGAs has remained the same as the 2022 Baseline figure of 3.
4	150 LGAs attaining own source revenue target against budget.	No ongoing support.	The number of LGAs attaining own source revenue target against budget has increased to 108 against a baseline of 100. Further, LGAs collected 99% of own source target during the period of July – September 2023.
5	Gender mainstreamed in LGAs revenue collection increased to 40%.	No ongoing support.	15% of special groups members are currently participating in LGAs revenue collection. Revenue collection window for special groups established in all LGAs.

²⁴ Ministry of Finance (2024). The budget execution report for the first quarter of 2023/24 (July to September 2023). Dodoma: Government of United Republic of Tanzania.

6	Natural resources revenue collection information system developed.	No ongoing support although the African Development Bank has been financing the implementation of an Institutional Support Project for Domestic Resource Mobilisation and Natural Resources Management (ISPGG DRM &NRM) since 2017. The initiative seeks to strengthen the Tanzania Revenue Authority to maximise DRM from the natural gas sector, through enhancement of the revenue gateway system, better forecasting, and capacity building of staff.	No system has yet to be established.
7	Domestic revenue collection increased to 95% of the budget in Zanzibar.	The IMF through AFRI TAC East maintains a limited portfolio, supporting the training of officials from the Zanzibar Revenue Board on forecasting.	Domestic revenue collection performance for FY 2022/23 regressed to 48% of the target against a 2021 baseline of 75%. ²⁵
8	Revenue Management Information System in Zanzibar Improved.	No ongoing support.	3 Revenue Management Information Systems improved as of July 2023.

As per Figure 11 above, it is unlikely that Tanzania will attain a tax to GDP ratio of 15% by end of June 2025 in part due to previously highlighted structural and institutional bottlenecks as well as the unrealistic nature of the target itself as the country had averaged tax yields of 12.2% in the five years prior to IDA 20 with a historical high of 13.4% in 2017/18. Further, the implicit ambition of the DRM 20 required profoundly concrete efforts beyond the crosscutting of DRM policy commitments that deprioritised spending and technical support in favour of the more thematic areas of human capital, jobs, and economic transformation. While the long-term sustainability of any revenue policy lies in its fairness and progressiveness, reaching the ambitious IDA 20 DRM target requires enhanced efforts to raise the performance of tax revenues in light of the historical underperformance of the current tax system in

²⁵ Ofisi ya Rais-Fedha na Mipango (2024). Mwelekeo wa mpango wa taifa na bajeti ya serikali kwa mwaka 2024/2025. Available at [mwelekeo_mpango_24.pdf \(mofzanzibar.go.tz\)](http://mwelekeo_mpango_24.pdf(mofzanzibar.go.tz)), Accessed March 22, 2024.

Tanzania. Not only have policy deficiencies affected the ability of tax revenues to adjust to economic growth but research on tax buoyancy²⁶ indicates that the tax regime remains incapable of providing short-run stabilization assurance nor guaranteeing long-run fiscal sustainability.

Interventions to improve Tanzania's DRM need a more focused approach particularly as only income and excise taxes are currently buoyant in the long and short run and thus progressive. This is relevant as fiscal policy has regularly focused on changes to the politically safe excise taxes typically levied on price inelastic goods and services consumed by the middle classes. Despite their robustness as the source of tax revenue mobilisation, interventions are needed to sustain the progressivity and fairness of such taxes to avoid exhaustion of the tax base.

Further, Tanzania is utilizing only about 47 percent of its tax revenue potential²⁷. This suggests that greater mileage could be gained by focusing DRM efforts on the income tax category. This source which, on average, accounted for 36 percent of the country's tax revenue during the last decade, not only has the highest potential (30 percent of GDP) but experiences the lowest tax efficiency level (12 percent of GDP). This requires considerable investment in both systems and personnel to enhance tax efforts, especially in tax policy design, administration, and compliance.

2.9 Policy Recommendations

Closing compliance gaps can help bolster revenues while establishing a fairer, more efficient tax system. The government can further increase tax productivity by adjusting rates, rationalizing exemptions, expanding the tax base, leveraging digital technologies to enhance tax administration, and improving compliance management. Introducing a more

²⁶ See Semboja, J., Kamugisha, G., Msafiri, D., & Mmassy, R. (2023). Analysis of Tax Revenue Mobilisation in Tanzania. REPOA, Dar es Salaam. Available at [REPOA 6 REV 7](#) (Accessed March 24, 2024)

²⁷ Semboja et. al (*ibid*)

rigorous system for taxing income from capital and immovable property could bolster the government's revenue position while updating cross-border taxation policies could reduce the risks associated with base erosion and profit-shifting by multinational corporations.

Strengthening tax administration would improve the tax system's equity while increasing revenue mobilisation and reinforcing the social contract. Building the capacity of the tax authorities will be essential to expand collection efficiently and equitably and could lay the groundwork for further reforms. The authorities can complement the ongoing e-filing rollout by enhancing the integrity of the taxpayer database, which will be necessary to expand registration. Improving data collection and data analytics, adopting a risk-based approach to compliance management, and hiring and training more auditors could help ensure that all registered taxpayers report and pay their true tax liabilities.²⁸

Short-term policy priorities include boosting the productivity of value-added tax (VAT), personal income tax (PIT), and corporate income tax (CIT) by adjusting rates and rationalizing tax exemptions. The low productivity of the PIT and CIT, as well as structural weaknesses affecting electricity and fuel subsidies, tend to disproportionately benefit wealthier households while diminishing the overall equity of fiscal policy. Strengthening taxation at the top of the income distribution would improve the tax system's equity, as wealthier taxpayers often pay relatively little in taxes.

Over the medium term, systemic reforms that promote voluntary compliance and narrow compliance gaps could bolster revenue mobilisation while strengthening the social contract. Building the capacity of the revenue administration will be essential to expand collection efficiently and equitably. Capacity-building efforts could also lay the groundwork for additional reforms, such as lowering the VAT registration threshold to broaden the tax net. Hiring and training more auditors could help ensure that all registered taxpayers report and pay their true tax liabilities.²⁹ Further recommendations are summarized in Table 3 below:

²⁸ **TANZANIA Economic Update**—The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Issue 19, 2023; World Bank Group

²⁹ Ibid

Table 3: Summary of the key recommendations

Benchmarking Tax Revenue ³⁰		
Issue	Recommendation	Time Frame
Productivity of indirect and direct taxes	Consider adjusting the tax rates for indirect taxes (VAT and excise taxes) and direct taxes (CIT) to boost their productivity and mobilise additional revenue.	Short to Medium-term
Excise taxes on tobacco	Re-evaluate excise taxes on tobacco to increase revenue and support public health objectives.	Short term
Equity of the tax system	Strengthen taxation on those at the top of the income distributions to improve the tax system's equity and mobilise additional revenue.	Short to Medium-term
Tax Administration capacity	Strengthen the capacity for tax auditing to expand collection efficiently and equitably.	Medium-term
Tax Registration thresholds	Broaden the tax net by realigning registration thresholds.	Medium-term
Improve tax administration and budget management	<ul style="list-style-type: none"> • Rationalize corporate tax holidays, ensure regular adjustments of excise rates, and remove multiple layers of taxes, fees, and levies imposed on the same goods. • Strengthen tax administration by repaying and preventing arrears on VAT refunds, improving the registration of taxpayers, and identifying non-registered ones, and upgrading the IT system. 	Short to Medium-term
Distribution Impact of Fiscal Policy		

³⁰ Ibid; **TANZANIA Economic Update**--The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Issue 19, 2023; World Bank Group; and IMF-Tanzania Art IV Consultation 2023.

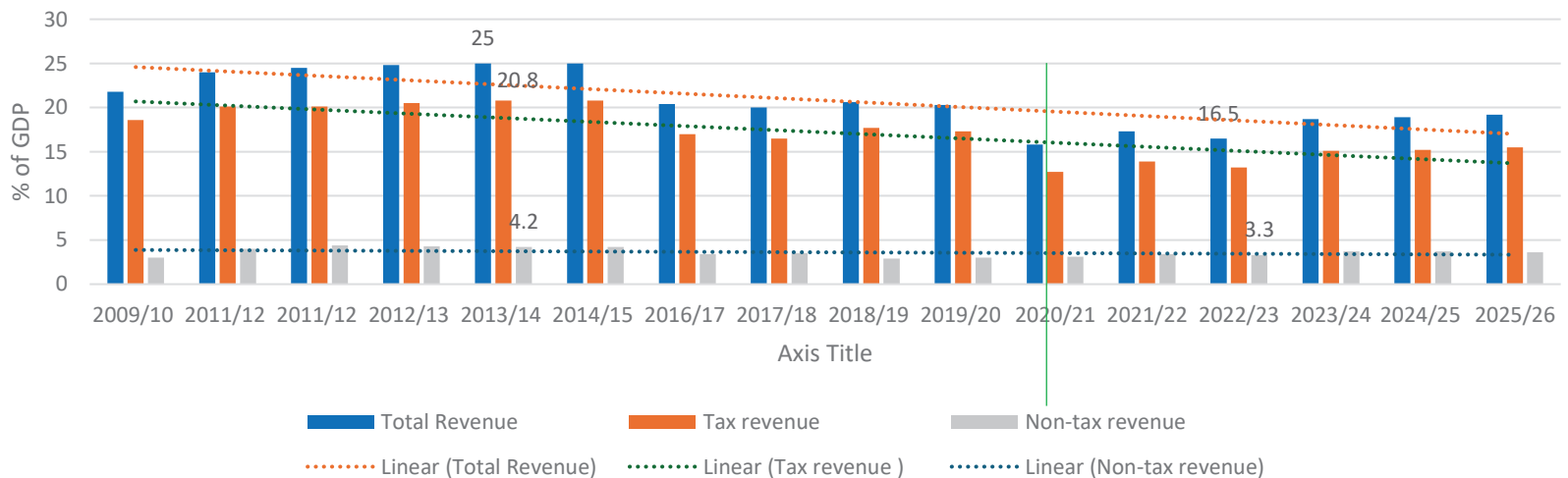
Revenue mobilisation	<ul style="list-style-type: none"> • Formulate tax policy and administrative reforms, including by reviewing recommendations of the 2022 Tax Policy Diagnostic IMF TA. • Conduct Customs diagnostics and TADAT and follow-up to identify medium-term priorities for reform to assist the authorities in developing, planning, and implementing a medium-term revenue strategy. 	Short to Medium-term
Resource intensive sector	Develop a fiscal framework for natural resource revenue management with a particular focus on oil and gas in order to promote sustainable use for the benefit of present e and future generations.	Short to Medium-term
CEQ analysis	Review proposed changes in taxation and public expenditure policies, including subsidies, to assess their potential impact on household income, poverty, and inequality.	Short to Medium-term
Broadening VAT base	Broaden the VAT base and use a portion of the revenue generated to increase funding for social services.	Medium-term
Conditional cash transfer	Consider increasing conditional cash transfers to compensate poor households for the negative impact of an expanded VAT base or other fiscal policy changes.	Medium-term

3.0 DOMESTIC RESOURCE MOBILISATION (DRM) IN KENYA

3.1 Introduction

Kenya is a lower middle-income country with an estimated GDP per capita of US\$ 2,113 in 2023. It has faced declining revenue collection as a share of GDP from a peak of 25 percent of GDP in FY 2013/14 to 16.5 percent of GDP in FY 2022/23 (Figure 14, below). Domestic revenue mobilisation has averaged 16.8 percent of GDP in the last five years (2023c) with taxes contributing an average of 13.4 percent of GDP.

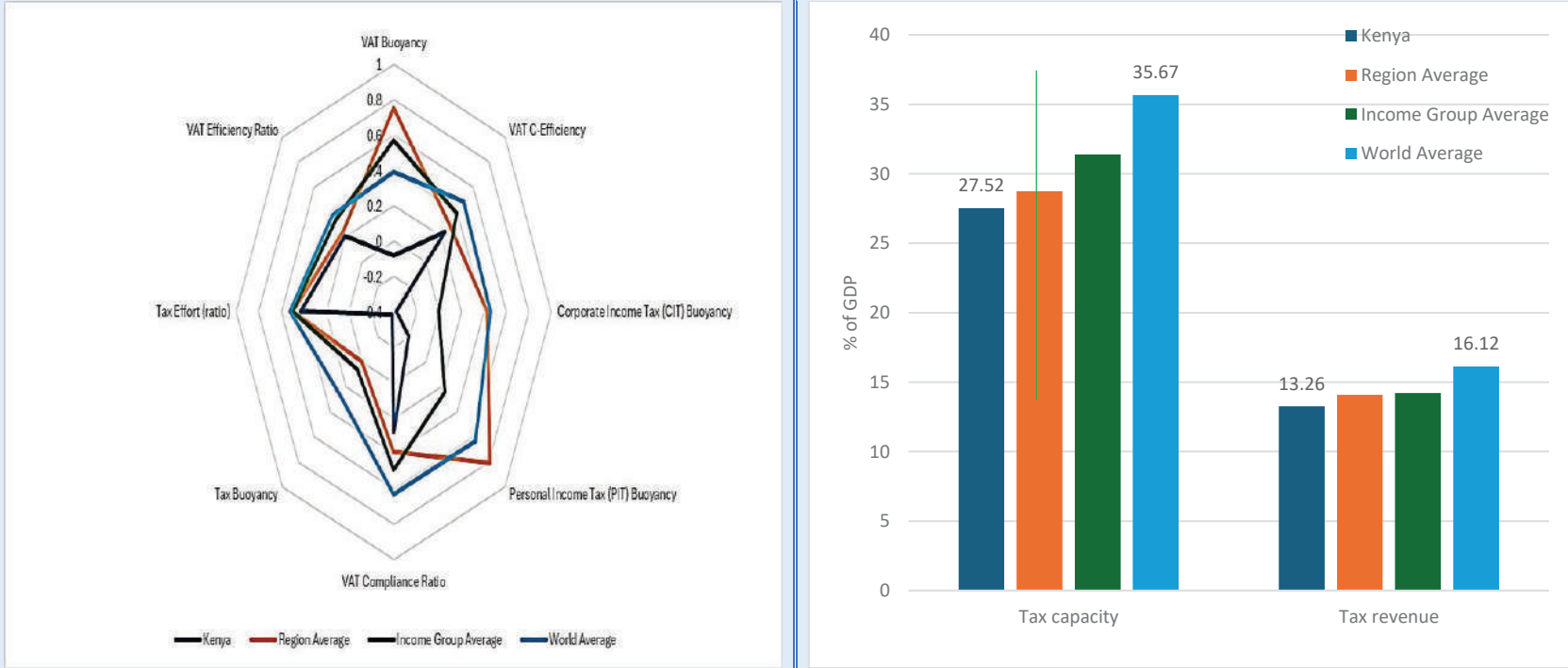
Figure 14: Tax and Non-Tax Revenues in Kenya



Sources: IMF (Various)

Both DRM and taxation enhancing efforts have in the last five years lagged those of regional peers (17.6 and 14.08 percent), income group (21.9 and 14.21 percent), and the global average (25.6 and 16.12 percent). With an average tax gap of 14.26 percent of GDP (Figure 15, below) and effort ratio of 0.43, DRM efforts have been below the frontier while at the same time exhibiting room for improvements in both administration and widening of the revenue base.

Figure 15: Comparative tax collections, Kenya vs. Neighbours



Sources: USAID (2022) Country Dashboard

3.2 DRM Challenges in Kenya

DRM efforts in Kenya have historically faced numerous challenges, some of which are examined in detail below:

First, the prevalence of hard-to-tax sectors. Similar to much of Sub-Saharan Africa, the economy is dominated by subsistence agriculture and a large informal sector which are difficult and uneconomical to tax. The agriculture share of employment stands at 45 percent, while two-thirds of Kenyans work in lower-tier informal employment (2023c). There are considerable overlaps between the two sectors with much of agriculture being informal. The informal sector accounts for a third of all economic activities (Murunga et al., 2021) and is home to some 95 percent of enterprises and businesses (World Bank, 2016). Hard-to-trace cash transactions dominate agriculture and the informal sector. Taxing agricultural and informal sector incomes has proved to be profoundly difficult with workers seldom in receipt of regular, fixed wages, and when paid, through off-the-books cash. This diminishes DRM efforts as key taxes such as income taxes and consumer taxes often end up not being imposed.

Second, low tax compliance. In 2022, the VAT compliance rate stood at 28 percent less than half the global average of 63 percent (Figure 14). The technical and complex nature of tax laws and procedures, low fiscal returns, high compliance costs, insufficient sharing of taxpayer information among National and County Government agencies, limited and overstretched manpower in tax administration, and insufficient taxpayer education have long confounded compliance levels in Kenya.

Third, complexity in taxing the emerging digital economy. Notwithstanding accelerated reforms in recent years, the Kenyan tax system has not kept pace with emerging technological business models, especially those related to digital transactions and easy-to-shift base e-commerce (Ndaka, 2017, Nyanumba, 2023). This has led to some business activities being left out of the tax net especially the activities carried out through the internet on a digital platform. These business activities can be carried out in a tax jurisdiction without having a physical presence in that jurisdiction.

Fourth, inadequate customs administration. Dynamics in international trade including, emerging business models, new trading partners, increased security threats, organized crimes, and an increasing number of regional free trade areas that Kenya is a member of present challenges in customs administration. Customs administration, in particular, faces the following key challenges:

- Limited adoption of modern technological equipment at entry/exit border points to address under-declaration and misclassification of goods,
- Weak customs border administration that fails to safeguard against the importation of counterfeits, smuggling, and diversion of goods;
- Insufficient Human Resource capacities and low morale;
- Poor cooperation, coordination, and collaboration among Government agencies on customs and border management matters; and
- Inadequate customs-to-customs regional cooperation to curb abuse of rules of origin.

Fifth, distortionary tax exemptions. A World Bank assessment in 2017 found that an absence of tax exemptions could increase corporate income tax yields by some 24 percent, equivalent to some 1.9 percent of GDP. The proliferation of exemptions has affected Kenya's average tax buoyancy with the effects being particularly acute in taxes such as corporate and personal income taxes, both of which have inelastic responses to GDP. DRM challenges in Kenya have long been underpinned by a significant negative tax buoyancy (-0.38), limited tax effort (0.43 against a regional average of 0.50), weak administration efficiency (VAT C-efficiency ratio of 0.24) roughly half the global average), and limited compliance at 0.28 less than half the global average of 0.63 and other low middle-income countries (0.49). Collectively, these challenges have led to a tax gap of 11.5 percent of GDP (2023e) and thus insufficient to finance the country's pursuit of sustainable development goals.

The bulk of tax exemptions are concentrated in the few subsectors of financial services, information and communication technology, health, and manufacturing. Collectively, these account for about three-quarters of the losses in corporate income tax. This reflects

the relatively large size of these subsectors in GDP. Indeed, reflecting higher levels of formalization, the actual contributions of the financial and banking sectors to the total corporate income tax revenues is disproportionately higher.

Further, the occasionally tumultuous domestic politics, characterized by political demonstrations and election-related violence, have also contributed to DRM challenges through the disruption of business and trade, leading to poor performance of key revenue sources like VAT, income tax, and excise duty during election cycles. The recent outbreak of violent protest over tax hikes in the 2024/25 finance bill, a case in point. Consequently, Kenya has repeatedly found itself in a tight fiscal space occasioned by emerging expenditure pressures arising from drought-related expenditures and external shocks.

3.3 Contribution of IDA To Kenya's DRM

The scale of the country's fiscal challenges has historically been underprioritized by Multilateral Development Banks (MDBs) with many opting to focus on public expenditure management and social service delivery. For example, the World Bank's country partnership strategy (FY14–21) failed to recognize early signs of sliding revenue performance and did not have explicit DRM-focused objectives, pillars, interventions, or associated results indicators. A recent review of the World Bank's DRM efforts associates the re-prioritisation with the need to support a transition from the public sector-driven growth toward private sector-driven growth, and that fiscal consolidation should be driven by rationalizing public expenditure(2023f).

Notwithstanding limited MDB's financial support for DRM between 2014 and 2021, both the Government of Kenya and MDB still pursued small incremental DRM reforms aimed at consolidating earlier Public Financial Management reforms through the modernization of tax administration, strengthening taxpayer identification, reviewing the efficacy of existing tax structure, and building extensive analytical and advisory work on DRM. Collaborative efforts involving the MDBs subsequently began to inform lending operations and government reform regarding revenue forecasting and reduction of income tax and VAT exemptions. In 2017, the 16th edition of the World Bank's Economic Update for Kenya provided a comprehensive assessment offering

recommendations for tackling tax and efficiency gaps in Kenya's value-added and corporate income taxes (2017). The knowledge product was effective in driving discussion on tax exemptions and their cost in foregone revenue collection. However, it did not result in increased revenue collection. The reason behind the limited success of advocated DRM reforms in Kenya between 2014 and 2018, was the lack of significant financing of said reforms which rendered the reforms a mere narrative. Despite concerns for DRM featuring in the World Bank's systematic country diagnostic (SCD), Country Economic Memorandum (2016-2023), and Country Partnership Frameworks, the diverted focus of reforms in support of facilitating the private sector transition hindered the specificity of support and related financial flows.

Further, there were limited joint efforts between the World Bank, International Monetary Fund (IMF), and the African Development Bank on DRM in Kenya, exemplified by a lack of IMF's input into the World Bank's Country Partnership Framework for Kenya. This denied Kenya and the World Bank invaluable insights into the evolving financial structure of the economy which may have triggered a redress much earlier. Only modest progress was made, despite the World Bank's extensive production of 13 DRM-relevant ASA, to inform operations supporting DRM. The Kenya Petroleum Technical Assistance Project (FY15), which provided training for staff at the Kenya Treasury and the Kenya Revenue Authority in forecasting, collecting, and managing oil revenues, had limited relevance to the DRM agenda. However, according to government officials, capacity-building activities enhanced revenue collection through withholding taxes from subcontractors working on associated projects. Over the long run, these small incremental steps have been key to maintaining the reform momentum, providing targeted support to a few but specific components of DRM, and building up a support base and appetite for additional reforms.

The momentum was further maintained with the 2018 launch of the World Bank-supported Governance for Enabling Service Delivery and Public Investment Project (GESDeK I), a Program-for-Results (PforR), which provided training to 11 staff of the Kenya Revenue Authority on revenue modelling and forecasting. The project aimed to reach a target of 94 percent of domestic revenue collection as a percent of the annual budget, but it fell short, partly because of the COVID-19 pandemic. Notwithstanding the mitigating external environment, GESDeK I served as a testing platform for PforR interventions in DRM which tied disbursements to performance, thus helping to institutionalise reform ownership and accountability. Perhaps, the biggest DRM achievement by

GESDeK I has been the reengineering of an eCitizen portal that enables citizens and businesses to conduct and pay for 600-plus types of transactions with the public sector online(2023d).

These prior actions paved the way for the IDA 18 US\$750 million Kenya Inclusive Growth and Fiscal Management Development Policy Financing (DPF) in 2019. The DPF included prior actions to enact the Finance Act 2018 to remove VAT exemptions on petroleum products and adopt a governance framework for granting tax exemptions to avoid the creep in tax exemptions and arrest the decline in tax revenues(2019b). The Act introduced an 8 percent VAT on petroleum products that yielded additional revenue estimated at 0.15 percent of GDP over the first seven months of implementation. Given these efforts, according to the IMF, while tax revenues as a percentage of GDP have managed to recover from 11.8%, it has not attained the golden benchmark of 15 percent. It managed to recover from 12.7 percent in FY20/21 to 13.2 percent in FY22/23 and looks set to meet the IDA 20 target by FY23/24.

The Inclusive Growth and Fiscal Management DPF further supported the 2023 launch of a Medium-Term Revenue Strategy (Strategy) for the period FY 2024/25 to FY 2026/27 aimed at raising sufficient resources for the implementation of the Government's Bottom-Up Economic Transformation Agenda through the Fourth Medium Term Plan of the Kenya Vision 2030. The Strategy provides a comprehensive approach to undertaking effective tax system reforms to boost tax revenues and improve the tax system over the medium term.

3.4 Conclusions and Lessons

Cumulatively, the combined effects of the change in MDB focus on DRM and recent targeted reforms have been instrumental in enabling the growing institutionalization of those reforms. In 2023, the World Bank approved the second phase of the US\$250 million Strengthening Governance for Enabling Service Delivery and Public Investment (GESDeK II) Program for Results (PforR). Among others, GESDeK II targets additional improvements to revenue mobilisation, strengthened accountability and transparency

in public finance management, improved coordination of priority programs, and promoted external audit and oversight at the national government level.

Overall, Kenya is illustrative of the cumulative power of sequencing incremental DRM reforms which adopt a holistic approach to DRM, unpack its various components, and design a series of complementing solutions over time. The support for DRM reforms in Kenya demonstrates the power of MDBs in enabling or hindering progress. Developing countries that face acute fiscal consolidation challenges often struggle to reform their DRM in the absence of committed support from powerful external actors like the MDBs. Where such support is sparse or divided as it was prior to IDA 18 in Kenya, experiences with reforms tend to be mixed and often subject to interference by competing domestic powers, the recent outbreak of violent protests over proposed tax hikes to address the country's burgeoning debt distress³¹, a case in point. MDBs have the capability of committing countries to long-term reforms even in light of domestic competition. Coupling access to long term concessional credit with regular analytical support on public finance can help avert short term recourse to high interest credit that contributes to debt distress and subsequent stringent reforms. Further, provision of aforesaid support can help cushion against shock-therapy reforms by allowing countries time and space to sequence and learn from reforms, which can contribute to the mobilisation of popular legitimacy for the reforms. Further, prescriptions on DRM need to be complemented with support to reduce waste and strengthen the efficiency of public expenditures against which DRM targets are anchored. Nonetheless, the MDBs themselves are not infallible, initial reform results can disappoint. Thus, MDBs need to work with recipient countries in identifying concrete targets and adopting longer-term, problem-driven iterative strategies. This can only happen where there are already inherent analytical and policy capacities within IDA countries and demonstrated willingness to implement the very reforms themselves.

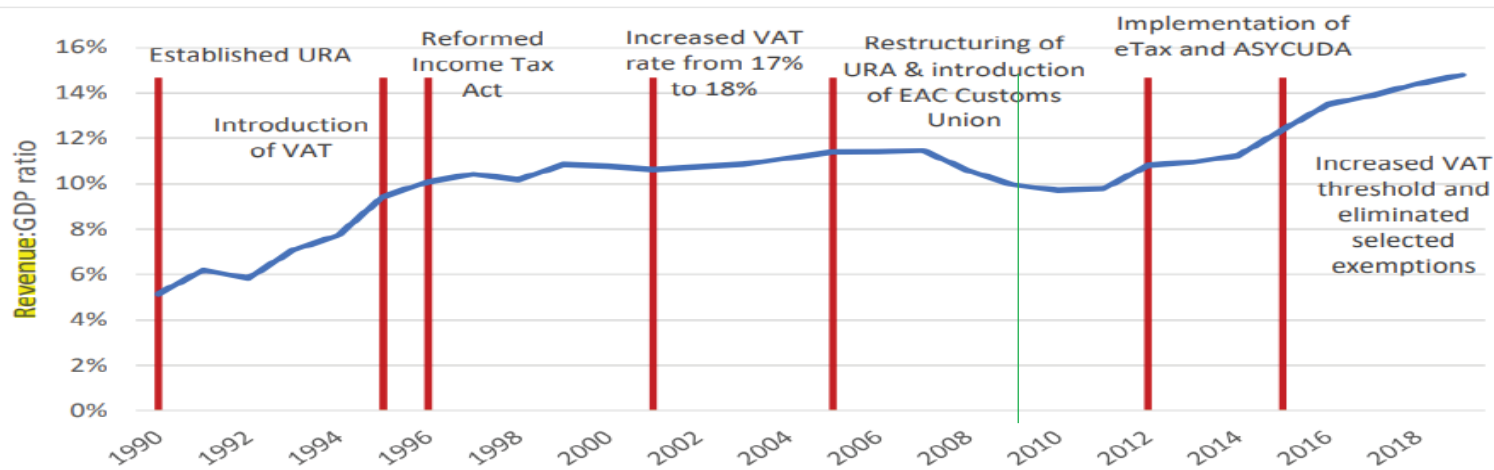
³¹ Kenya's public debt currently stands at US\$79 billion, equivalent to 65.2 percent of GDP (RoK, 2024)

4.0 DOMESTIC RESOURCE MOBILISATION (DRM) IN UGANDA

4.1 Introduction

Uganda is a low-income country with an estimated GDP per capita of US\$ 1,139 in 2023. It has implemented a wide range of DRM reforms over the last three decades, famously pioneering the establishment of a semi-autonomous revenue agency in Sub-Saharan Africa in 1991. Other major DRM reforms include the introduction of VAT in 1996, reforms to the income tax regime, establishment of large and medium taxpayer offices, increased adoption of Information and Communications Technology (ICT) solutions to facilitate tax administration, the elimination of selected VAT exemptions, and increases in selected excise tax rates. The reform process is summarized in Figure 16. Results-wise, reforms have contributed to an increase in the tax-to-GDP ratio from 6 percent in 1990 to 13.8 percent in 2022 (IMF, 2024).

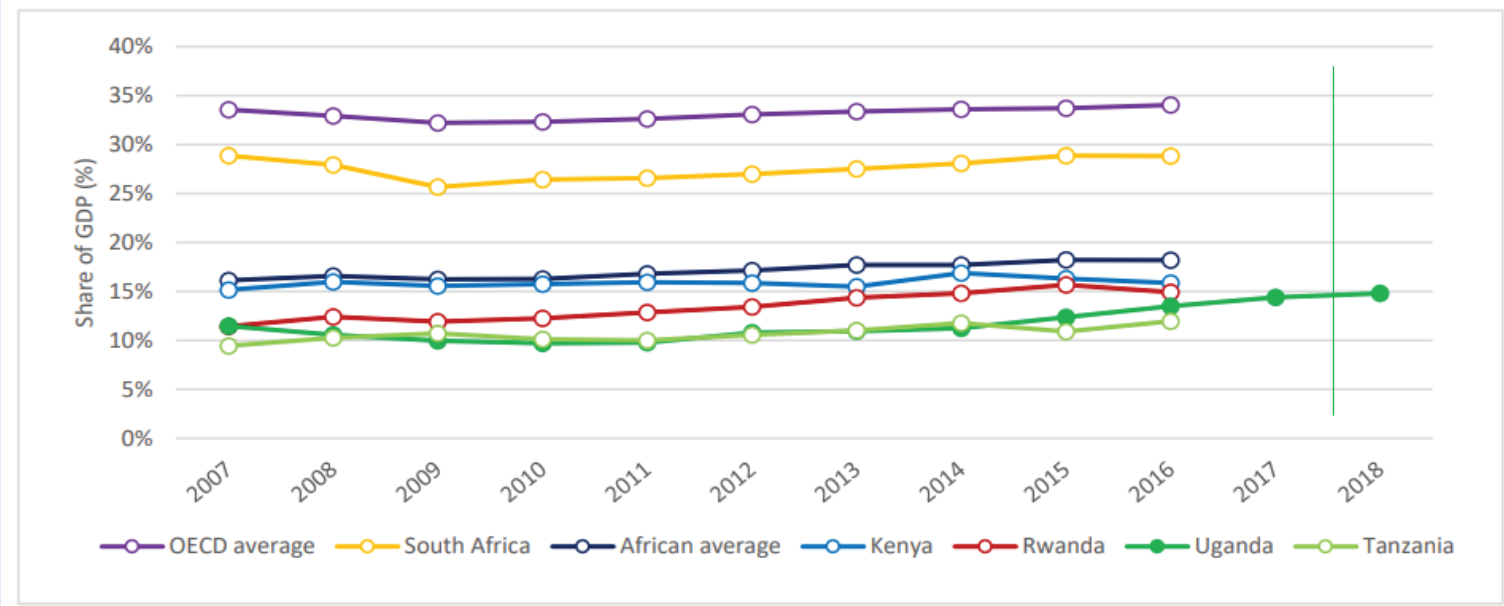
Figure 16: Chronically reforms with changes in revenue to GDP ratio in Uganda



Sources: IMF Country Reports (2018) and (2019a)

DRM reforms have led to steady improvements in revenue collections, and between 2015 and 2021 revenue collection consistently improved to a historical high of 14 percent of GDP, after a period of stagnation between 10 and 12 percent of GDP since 2000. However, despite yielding results, Uganda has struggled to sustain reforms with revenue collection declining to 13.7 percent of GDP in 2023(2023a). Further, Uganda has yet to meet the IDA 20 target of 15 percent tax-to-GDP and revenue collection has historically lagged that of regional peers, although over the past four years, Uganda’s performance has increasingly converged as shown in Figure 17.

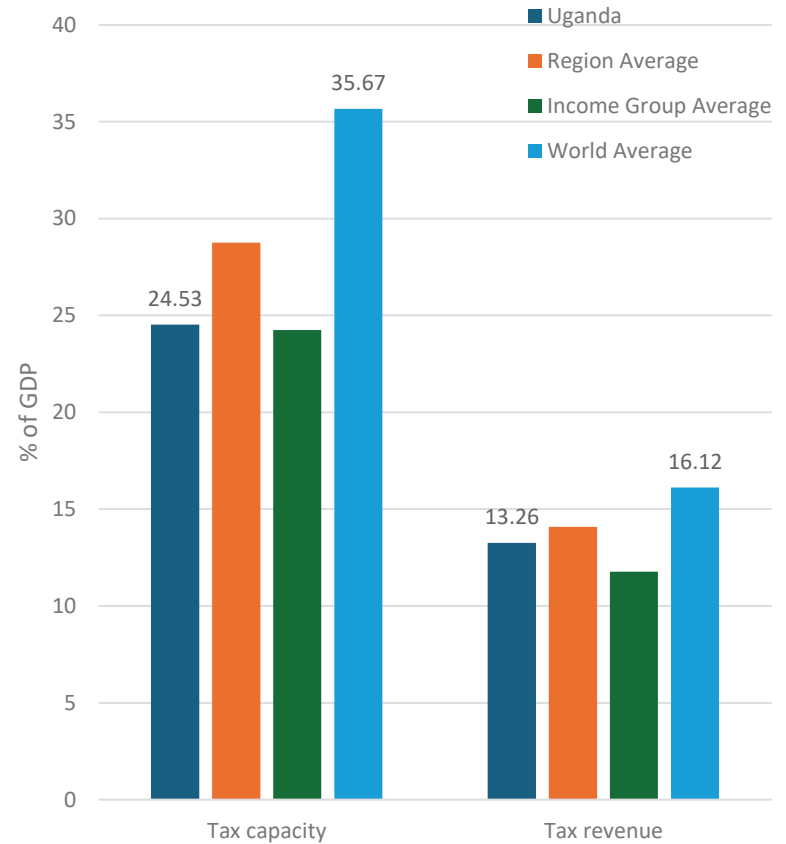
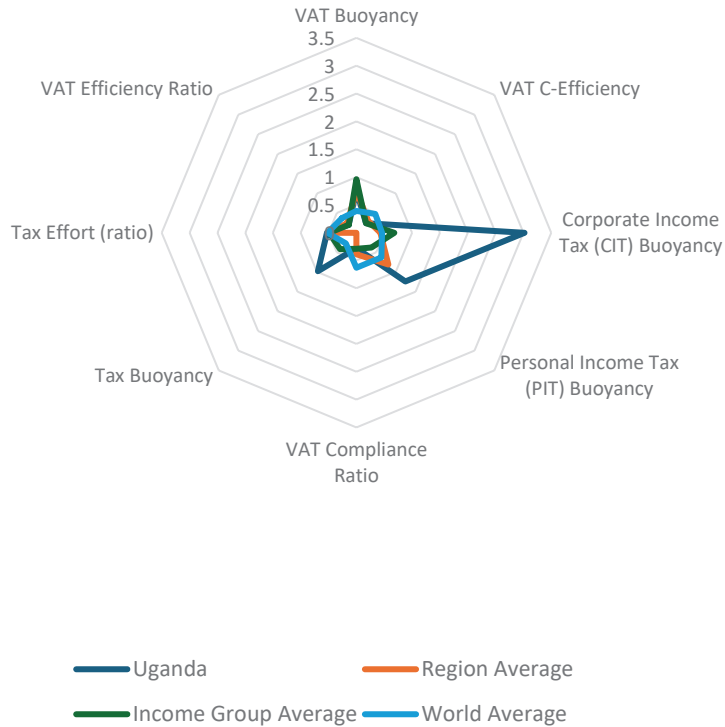
Figure 17: Regional Comparison of Revenue Performance, 2007 - 2018



Sources: RoU (2019)

In FY2018/19, Uganda implemented additional DRM reforms with support from MDBs under the aegis of its medium-term Domestic Revenue Mobilisation Strategy (DRMS), 2019/20 – 2023/24. These include the harmonisation of excise duties applied to telecommunication services, strengthening the effectiveness of the limitation on excessive interest deductions, clarifying the obligation of foreign providers to account for VAT on online services consumed in Uganda, and administrative measures to enhance compliance, including strengthening risk management, dedicating more staff to arrears enforcement, and deploying scanners at all major border points. Revenue collections have subsequently increased relative to domestic targets, with the exception of COVID-19 affected 2019/20 and 2020/21. Driven by high tax efforts and an increasingly buoyant tax structure (Figure 18, below), Uganda had a tax gap of 11.27 percent of GDP which is lower than the average for Sub-Saharan Africa, low-income countries, and the world at large.

Figure 18: Comparative tax collections, Uganda vs. Neighbours, 2022



Sources: WEO (2024), IMF

4.2 DRM Challenges in Uganda

DRM challenges in Uganda include the following:

First, a challenging political economy enumerated by weak service delivery and efficiency of spending, reported Government corruption, weak democratic systems, and politically linked allocation of tax expenditures (RoU, 2019). Perceptions surveys suggest that Ugandans are dissatisfied with the social contract from paying taxes. The availability and quality of public services are often not commensurate to taxes paid, thus discouraging tax morale and compliance. Unsurprisingly, VAT compliance at 0.28 is lower than the Sub-Saharan Africa average of 0.39 as well the global ratio of 0.63 (Figure 18, above). In addition, tax administration is rife with perceptions of limited integrity among tax and wider government officials further discouraging compliance with tax laws. Finally, the lack of positive political messaging on the value of paying taxes, and the historical tendency to prioritise investment over revenue generation, has further damaged morale. A fundamental shift in attitudes towards taxation, in Government and society, is needed to establish a culture of compliance and improve the productivity of Uganda's tax system.

Second, approximately 45 percent of the Ugandan economy resides in the informal sector, beyond the purview of formal tax measures. Globally, taxation of the informal sector has often proved highly political because of the inherent nuances of the sector which often acts as a refuge for the masses of unemployed but politically influential youth. At 3.6 percent per annum and 1 million youth entering the labour market every year, Uganda's high population growth, limited labour market absorption capabilities render its youth a highly relevant political force (as witnessed at its last general elections in 2022), thus capable of influencing DRM.

Third, inadequate tax policies. There has historically been limited public consultation and limited use of detailed analysis in the design of Uganda's tax policies. This has often been caused by severely under-resourced and overly pressured tax staff tasked with meeting overly ambitious revenue targets irrespective of mitigating circumstances. The result has been poor forecasting and the introduction of ill-thought tax measures that have failed to endure, succumbing to popular pressure and predatory politics. In recent years, revisions to Uganda's tax laws have taken place with alarming regularity impacting the stability and predictability of the tax code. This has further undermined trust in the authorities increased the compliance

burden for taxpayers and introduced unnecessary complications to revenue administration. In return, businesses have increasingly lobbied the Government to review such changes leading to increases in the number of tax exemptions and incentives.

The lack of systemization of reforms has undermined fairness in the tax system contributing to a high aggregate tax gap of 11.27 percent. The size of the tax gap reflects the divergence between the nominal tax rates and the low effective tax rates on net chargeable incomes, products, and services. Uganda's tax expenditures have helped increase much-needed foreign direct investment with an adverse impact on the overall tax yield. According to its DRMS (RoU, 2019), this is particularly reflected in the CIT performance. For instance, capital allowances, including depreciation allowance, initial allowances, and industrial building allowance, are more generous than economic depreciation, ultimately contributing to the large tax losses claimed by businesses. In addition, the ability to carry forward losses indefinitely may incentivise companies to remain artificially in a tax-loss-making position, over-claiming losses. Tax losses carried forward within the CIT system are currently substantial and distort the yield from CIT.

Further with proven recoverable reserves of 1.5 billion barrels of crude oil, enough for an expected 30 years of production at a rate of 230,000 barrels per day, Uganda sits on considerable sources of DRM that in light of the recent drive for renewable fuels, are likely to be of even greater diminishing returns. Uganda has expected earnings from oil of about \$1.5 billion a year, or 4 percent of FY20 GDP, however, eighteen years on since discovery not a drop of oil has been pumped. However, with a renewed push to commence oil production by 2025, oil has the potential to accelerate the attainment of the IDA 20 DRM target in Uganda. For this to materialise, an effective fiscal regime needs to be developed to balance the country's short-term needs for foreign direct investment and its medium to longer-term ones of diversifying the tax base and transforming the economy for more inclusive and sustainable DRM.

Fourth, weaknesses in tax administration. The Uganda Revenue Authority (URA) has a cost-of-collection ratio is around 1.74%, higher than the average of around 1% for OECD and selected non-OECD countries (World Bank, 2018). This compares the administration's costs with net tax revenue collected, an indication of efficiency, although reductions in this ratio can be driven by

a number of factors beyond the effectiveness of collection, such as tax policy changes, increased levels of expenditure, or economic changes, and thus should be complemented with other indicators of effectiveness. The poor efficiency of tax administration is caused by among, others, the following:

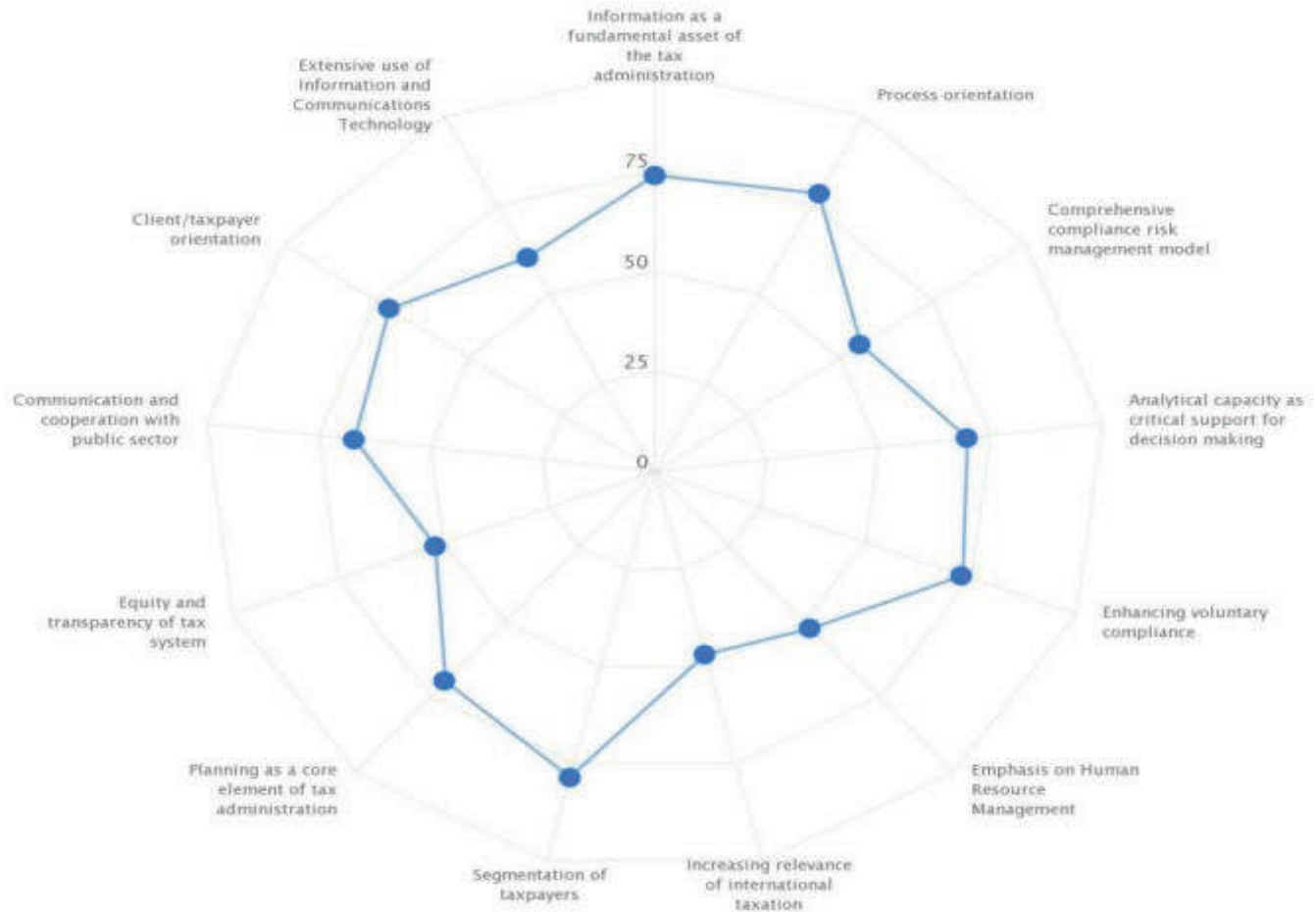
- Multiple governance challenges within the national revenue agency, including weak coordination and reporting framework between the URA and Uganda's Ministry of Finance. Both URA and the line Ministry are also severely hamstrung by a narrow performance monitoring framework, focusing almost exclusively on revenue targets.
- Inadequate human resources at all levels and across revenue and policy-related agencies, with gaps in both staff numbers and staff capacities, particularly on data analysis, specialized areas of taxation such as international tax, and audit and enforcement.
- Slow pace of modernizing ICT infrastructure due to insufficient allocation of funds that affects the interoperability and stability of critical components. Further revenue ICT infrastructure suffers from poor third-party data access and internal data management that constrain taxpayer identification, registration, filing of returns, and validation of declarations.
- Limited taxpayer education drive has excluded high proportions of businesses and individuals. Uganda needs to improve tax literacy and strengthen trust between its taxpayers and authorities. A more comprehensive and extensive education programme could go a long way towards improving engagement, and taxpayer registration, and addressing chronic under- and non-declaration. A successful education programme is key to strengthening the effectiveness of tax audits and lowering collection costs through improved voluntary compliance.

4.3 Contribution of IDA to Uganda's DRM

Uganda's effective tax gap of 11.27 percent of GDP impacts the country's pursuit of sustainable development goals. Consequently, Uganda has been under tight fiscal space occasioned by emerging expenditure pressures arising from increasing climate change and external shocks. The scale of the country's fiscal challenges has historically been underprioritized by Multilateral Development Banks (MDBs) with many opting to focus on public expenditure management and social service delivery. For example, notwithstanding the current World Bank's portfolio of IDA-financed credits and grants of \$4.86 billion in commitments, none of the 19 supported national projects exclusively target DRM in Uganda. A recent implementation monitoring report of the country's DRMS found limited year-on-year progress despite Uganda's increasing revenue collections (2023b). While Uganda has made considerable progress in tax administration through, efforts to digitalise revenue collection, limited support from MDBs has exacerbated challenges with the integration of data from third-party sources – to the e-Tax system, including the Integrated Financial Management System (IFMS) that pays government suppliers. Overall, Uganda has made decent progress in only 12 of 51 intended reform areas. The progress in some 18 reform areas was rated as fair while 21 were poor.

The DIAMOND22 assessment undertaken in 2018 by the World Bank evaluated URA's strengths against 14 strategic dimensions, reflecting the key features and trends of modern tax administrations. These place a strong emphasis on encouraging voluntary compliance and broadening the tax base, as well as client orientation, equity, and certainty in the application of tax laws. The assessment shows that the URA has implemented basic good practices and has been able to provide key taxpayer services and compliance strategies.

Figure 19: DIAMOND assessment results by strategic dimensions



Sources: RoU (2019)

However, there is room for improvement in terms of extending the coverage of existing taxpayer services, overcoming constraints to accessing relevant third-party information, especially from the financial sector, strengthening the performance management system, and the tax audit business model (World Bank, 2018). The figure 19 above indicates that URA needs to pay special attention to increasing the relevance of international taxation, and human resource management, developing a comprehensive compliance risk management model, using ICT more extensively, improving cooperation with the public sector, and enhancing transparency.

4.4 Conclusions and Lessons

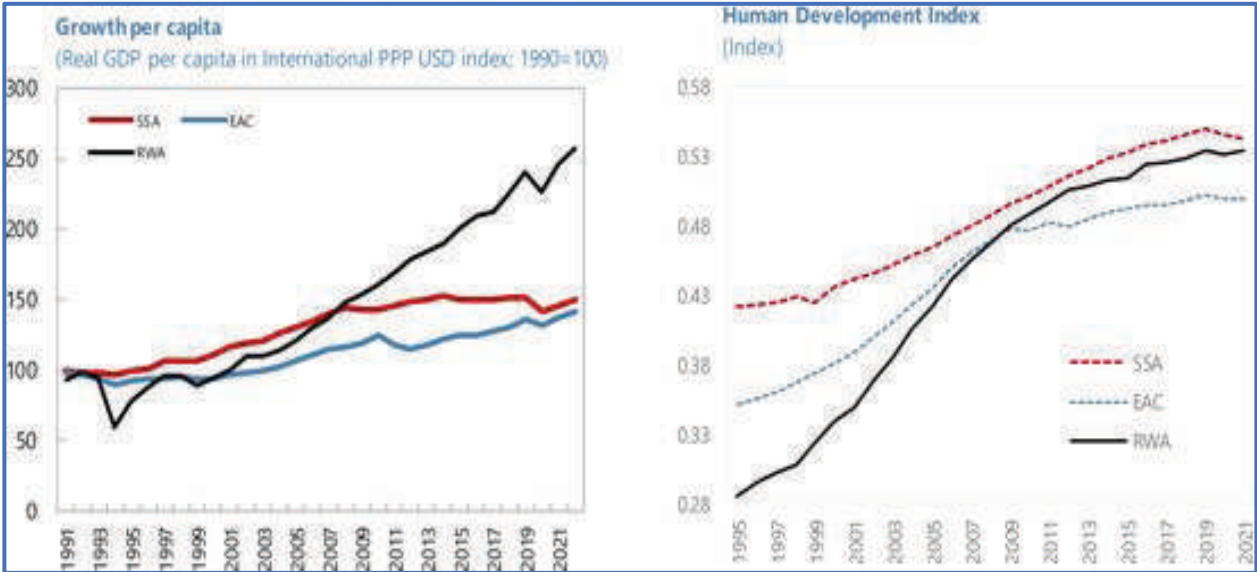
Overall, the limited support for DRM reforms in Uganda in recent years is asymptomatic of reliance on externally driven reforms, and the price that countries pay when donor fatigue sets in. Developing countries that face acute fiscal consolidation challenges often struggle to reform their DRM in the absence of committed support from the MDBs. Where such support is sparse or divided as it has recently been since IDA 18 in Uganda, experiences with reforms tend to be staggered and more so in countries with democratic deficiencies. However, as Uganda continues to demonstrate, support for DRM need not necessarily be anchored on large financially supported DPOs or PforR projects. Successful harnessing of earlier support can go a long way toward effective reforms of DRM systems. In addition, knowledge partnerships with MDBs such as those that transpire through the DRMS are useful to co-creating lasting solutions to DRM challenges.

5.0 DOMESTIC RESOURCE MOBILISATION (DRM) IN RWANDA

5.1 Introduction

Over the past three decades, the economy of Rwanda has experienced a steady growth rate averaging 8.5%. This has been the result of economic reform measures that the country has been taking. Figure 20 below provides the average growth rate of Rwanda, EAC and SSA for the past three decades, as well as the Human Development Index for the three categories.

Figure 20: Growth Rate per Capita and Human Development Index (HDI)



Source: World Economic Outlook, UNDP, and IMF staff calculations

From the above figure, the per capita GDP for Rwanda was almost at the same level as that of EAC and Sub-Saharan Africa (SSA) before the 1990s. In the 1990s, its per capita GDP actually went down to below EAC and SSA. It started to pick up from 2000s, surpassing that of EAC, and by 2007, it had even surpassed that of SSA.

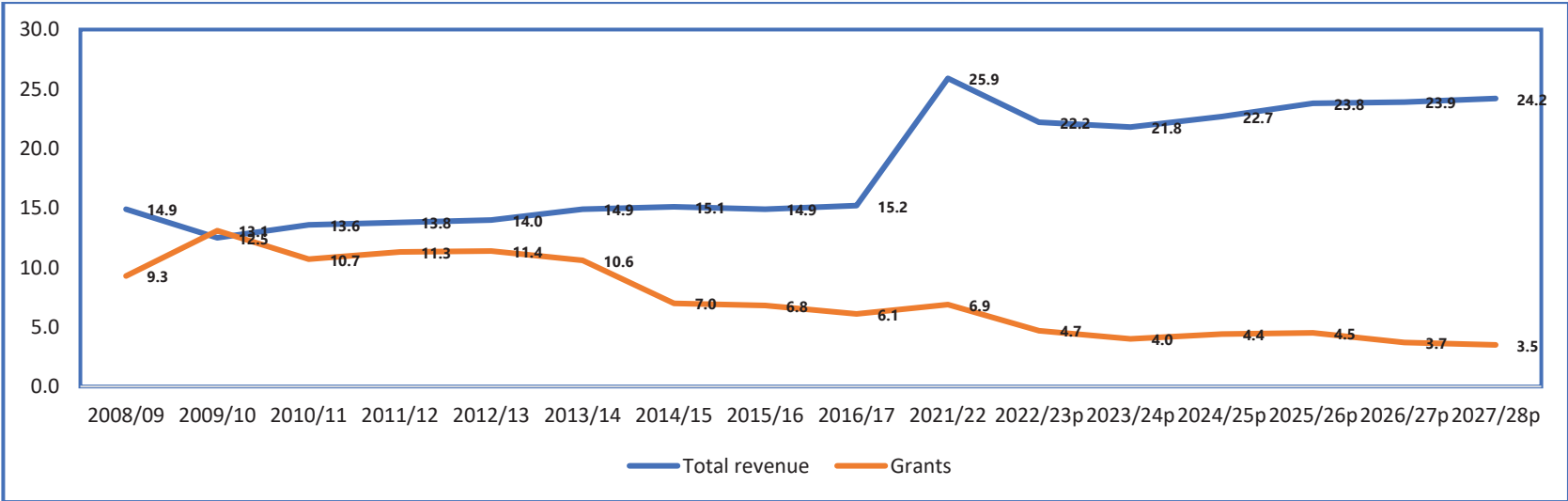
The recent growth rate is also reflected in the social development as indicated by the HDI, which has consistently increased since the mid-1990s. An interesting feature in the growth rate of the HDI in relation to that of per capita GDP is that, while the latter surpassed both EAC and SSA, the former (HDI) surpassed only that of EAC and continued to be below SSA. This signals that the seemingly growth rate of per capita GDP has not been able to provide equivalent revenues to fund social services. This means that, despite remarkable growth, a gap exists in financing Rwanda's long-term development goals.

Just like other developing countries, the main sources of financing Rwanda's development initiatives have been grants and local revenues, in the form of taxes and non-taxes. The World Economic Outlook statistics show that, while demand for financing development has been increasing over time, grants have been declining over time. This leaves domestic revenue to be the main source of financing development. Against this background, the importance of domestic revenue mobilisation cannot be over-emphasized as an important instrument for financing both, short- and long-term development goals.

5.2 Sources of Financing Development in Rwanda

As noted earlier in this section, the main sources for financing the development agenda for Rwanda are grants and domestic revenues. Figure 21 below provides a summary of these two sources and the level of their contribution to financing development agenda over time.

Figure 21: Total Revenue and grants as a percentage of GDP (p=projections)



Note: Data was not available in this source from 2017/18 to 2020/21
 Source: IMF-Rwanda Article IV Consultation, 2023. Data from 2023/24 to 2027/28 are Projections.

From the above figure, the share of total domestic revenue in financing development agenda in Rwanda increased from 15% of GDP in 2008/09 to 26% of GDP in 2021/22. While estimates of 2022/23 show a decline to 22% of GDP mainly due to the impact of the COVID-19 lockdowns in the country and in key trading partners, projections show that it will pick up from 2024/25 and reach the ratio of 24% of GDP in 2027/28. On the other hand, the share of grants in financing the development agenda in Rwanda has consistently declined from 9.3% of GDP in 2008/09 to 6.9% of GDP in 2021/22. The available estimates as informed by the current trend show that this share will further consistently decline to 3.5% of GDP in 2027/28.

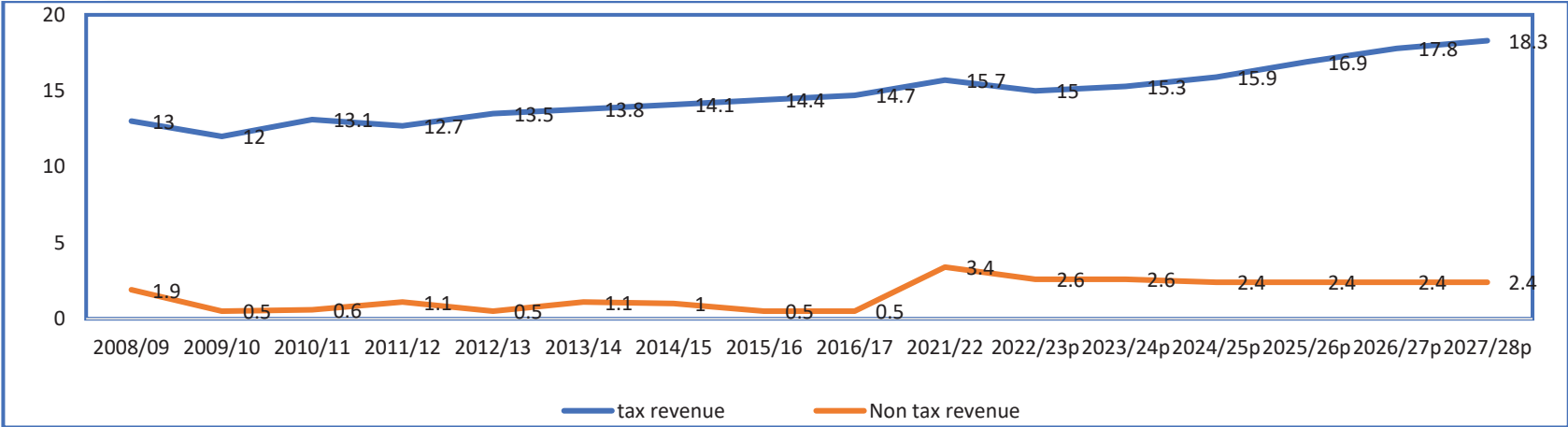
The clear message from this trend is the increasing importance of domestic revenue mobilisation in financing development in Rwanda. Up to 2015/2016, the gap between the two sources existed but was relatively narrow. Even the trend shows that they were

moving together, and the speed of the widening gap was rather slow. After that period, the gap has been widening faster, and in 2021/22, the gap was 19% of GDP. Projections show that in 2027/28 the gap between the two sources will be over 20% of GDP. Considering earlier discussions on the financing gap to attain social development at least similar to the average of SSA, more resources are needed. This puts more pressure on increasing efforts of domestic resource mobilisation through tax and non-tax revenues.

5.3 Tax and Non-Tax Revenues in Rwanda

As discussed earlier, the importance of domestic revenue mobilisation is a matter of urgency given the shrinkage of grants and other external sources of financing local development. Tax and non-tax revenues are the main sources of domestic revenues. Figure 22 below provides the share of each of the two sources as well as the overtime trend of their contribution as a share of GDP.

Figure 22: Tax and non-tax revenue as a percentage of GDP (p=projections)

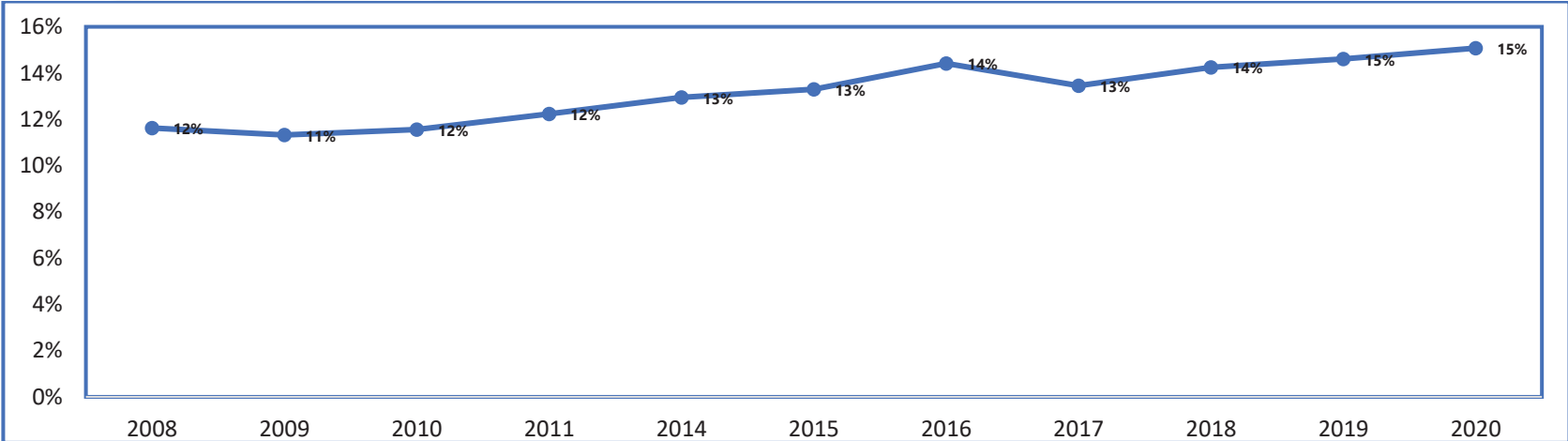


Note: Data was not available in this source from 2017/18 to 2020/21
 Source : IMF-Rwanda Article IV 2023. Data from 2023/24 to 2027/28 are projections.

As we see, tax revenues provide a bigger share of domestic revenues than non-tax. Looking at the trend over time of the two sources, we notice that more efforts have been put into tax revenues than nontax revenues. The trend in the share of tax revenue to GDP has been fairly increasing over time, whereas that of non-tax revenue has, at best, remained stable at the lower level over time. Because of the importance of tax revenues in local resource mobilisation. Let us look at it closely to understand what has happened and the measures that the country has taken to ensure that it improves collection from this source.

Figure 23 below provides time series data for tax to GDP in Rwanda for the last decade. We see that tax revenue growth in Rwanda has improved significantly in recent years, jumping from 12% of GDP in 2008 to 15% of GDP in 2020, driven by tax reforms during that period. Data from the World Economic Outlook by the IMF shows that in 1992 the level of Tax to GDP was 8%, a fact that suggests devotion of high efforts in recent years to drive domestic revenue collection to the current level.

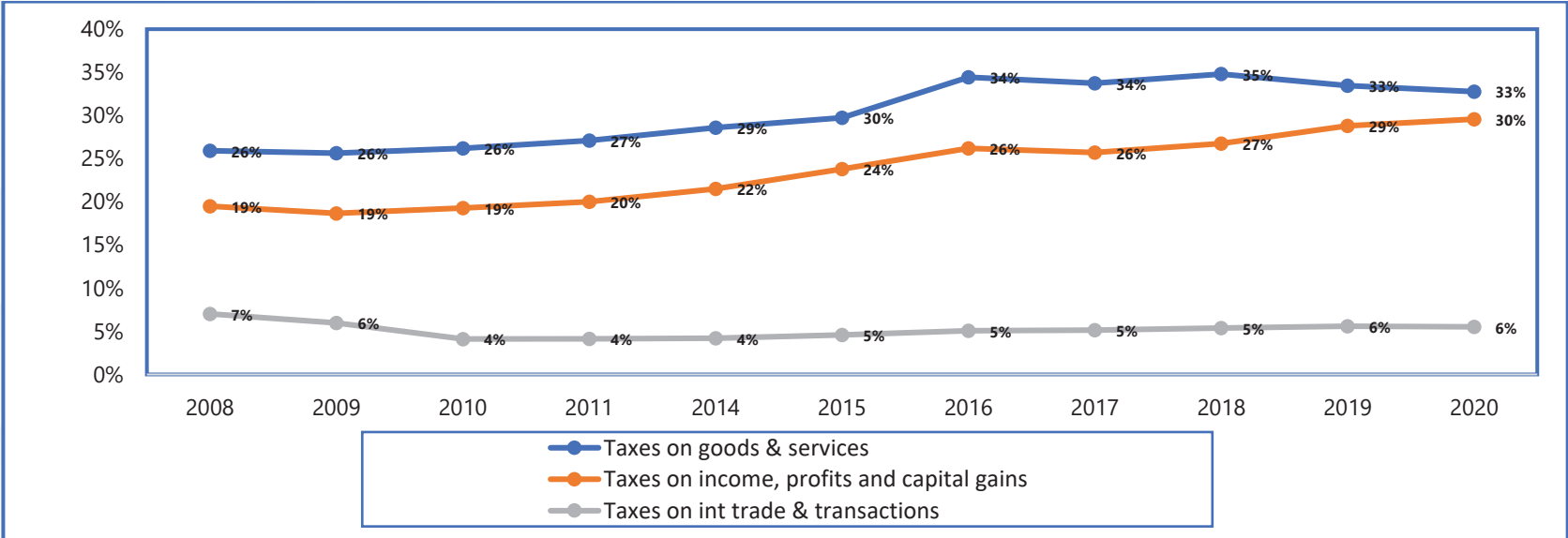
Figure 23 Tax to GDP ratio overtime



Source: Republic of Rwanda, 2021, *Medium Term Revenue Strategy 2021 – 2024*, Ministry of Finance and Economic Planning, August 2021; and IMF 2023, *Tax Reforms in Rwanda-Comprehensiveness Over Selectivity*

The observed achievement in domestic revenue mobilisation is a result of reforms that Rwanda made. The government made reforms in tax collection through significant improvements in collection efforts, auditing procedures, and scrutiny of large taxpayers. In the last 10 years, the tax-to-GDP ratio has increased by 3.75%, mainly due to sustained reforms to improve DRM by widening the tax base. The biggest contribution of tax revenues has been from three sources as shown in Figure 24 below:


Figure 24: Different tax as a percentage of total tax revenue



Source: Republic of Rwanda, 2021, *Medium Term Revenue Strategy 2021 – 2024*, Ministry of Finance and Economic Planning, August 2021; and IMF 2023, *Tax Reforms in Rwanda-Comprehensiveness Over Selectivity*

The biggest share of tax has been from tax on goods and services, whose share increased from 26% of total tax revenue in 2008 to 33% of total tax revenues in 2020.

This source reached a pick of 35% of total tax revenue in 2018 below slowing down in subsequent years.



The second contribution in the total tax revenues came from taxes on income, profits, and capital gains.

This source increased from 19% of total tax revenues in 2008 to 30% of total tax revenues in 2020.

The good feature of this source is its consistent trend of increasing, almost closing its gap with taxes on goods and services.

The gap between the two sources has shrunk from 7% in 2008 to 3% in 2020, signifying its increasing importance to domestic revenue mobilisation. Another important feature of tax on incomes, profits, and capital gain is its stability. While other sources declined or remained unchanged in recent years, it has consistently increased in recent years.

The last biggest contributor is taxes on international trade and transactions. Over time, this source has remained stable, declining from 7% of total tax revenues in 2008 to 6% of tax revenues in 2020. The lowest level of the contribution of this source was 4%, which was recorded in three years consecutively from 2010, then picking up slowly to 5% from 2019 before picking up again slowly to 6% in 2020. One key feature of this source is that, while its contribution is less than 10% of total tax revenue, it is not growing over time and has almost remained, at best, stable at a lower level throughout the whole of the last decade.

5.4 Reforms to Improve Domestic Resource Mobilisation in Rwanda

As discussed earlier, overall, the trend of tax to GDP in Rwanda has increased consistently in the last decade. This is attributed to tax reforms that the country has embarked on, aiming at improving domestic revenue mobilisation as discussed briefly below.

5.4.1 Formation of Rwanda Revenue Authority (RRA)

The RRA was formed in 1997 as an autonomy agency with the responsibility to foresee tax reforms as well as manage tax collection. Since it was formed, the RRA has made several reforms that have improved revenue collection. In the direct taxes, for instance:

Initial focus after forming the RRA targeted big companies to ensure that they comply with tax payments that are in line with the income they get.

They improved documentation and filing system, which in a way improved tax compliance.

The RRA rationalized personal income tax setting nominal income brackets in a way that increased progressivity.

These tax reforms were accompanied by imposing strict tax penalties that enhanced voluntary tax compliance.

For the indirect taxes, before the formation of RRA tax base was very narrow from this source. Thus, the focus had been to broaden the tax base, in which VAT was introduced in 2021. The introduction of VAT did not have a high tax yield as there were a lot of exemptions of VAT on investment. In 2010/11 incentives on VAT that had been granted to holders of certificates for investment were removed. Import certificates for investment were removed. In addition, quarterly reporting was introduced as well as the introduction of electronic payments of tax liabilities. All these improved systems of identifying taxpayers as well as their tax liabilities.

5.4.2 Use of ICT In Revenue Collection

An electronic tax payment system in which tax-payers were registered electronically, automating revenue estimates, and making payments through bank accounts reduced direct interactions between tax-payers and tax collectors. This significantly improved revenue collection because there were no negotiations that could provide loopholes for tax leakages.

5.4.3 Improving Governance in the Revenue Collection System

Reforms had been made to the staff of the RRA to improve their benefits but also to undertake training on better ways of collecting revenues but also better ways of handling taxpayers. While improvement of staff benefits aimed at improving their efficiency, penalties to misconduct in tax collection were made stricter. With improvements in staff welfare, the government was very strict on any RRA staff identified to be associated with corrupt practices. This improved trust in the authority of taxpayers, which in a way had a very positive bearing on voluntary tax compliance.

5.5 IDA In Rwanda's Domestic Resource Mobilisation (DRM)

Rwanda is one of the 39 African Countries receiving IDA support. Table 4 shows tax reform areas that Rwanda has undergone with support from the IDA to enhance domestic resource mobilisation:

Table 4: Direct IDA support to Rwanda to enhance DRM

Policy Reforms needed	IDA support	Current achievements
<p>Increase progressivity of Personal Income Tax:</p> <ul style="list-style-type: none"> a. Develop a new PAYE schedule b. Periodically align thresholds with inf 	<p>Support for strengthening enforced collections</p>	<p>IN 2005, simplified PIT rates were introduced, with nominal income brackets set, and remained unchanged contributing to progressivity.</p>
<p>Review Corporate Income Tax to support competitiveness:</p> <ul style="list-style-type: none"> a. Reduce the CIT rate to enhance global competitiveness b. Phase out tax holidays and incentives in favour of more effective tools c. Introduce a turnover-based minimum alternative tax (MAT) d. Include income from digital services in the tax regime. 	<p>Capacity building on enhancing compliance in the telecommunications sector</p>	<p>Immediately after the formation of RRA, the initial target was large companies, then legislative changes were later introduced to support personal income Taxation. The RRA revised the investment tax code to streamline several tax exemptions. Incentives granting VAT exemptions on imports for investment certificate holders were also removed, which broadened the existing narrow tax base.</p>
<p>Introduce VAT reforms, including:</p> <ul style="list-style-type: none"> a. Incentives to increase the effectiveness of the EBM system. b. Introduction of a Digital Services VAT c. Temporary VAT exemptions under the MBRP. 	<p>Measures to improve quality assurance for electronic taxpayer services.</p>	<p>VAT Exemptions were removed in 2010/11. The quarterly filing was introduced to improve Compliance. The RRA enforced VAT compliance by introducing electronic transaction devices (ETD) and withholding VAT at source by government departments and increasing the collection of tax arrears.</p>
<p>Reform Excise and Environmental Taxes:</p>	<p>The Investment Climate Facility for Africa (ICF) provided a grant of over US\$2</p>	<p>Rwanda is an environmental threat like many other countries in the world, but also its</p>

<p>a. Periodically align the Excise rate with inflation</p> <p>b. Replace AV taxes on harmful goods with a specific tax</p> <p>c. Increase Excise tax on older vehicles to incentivize the upgrading of Rwanda's fleet.</p>	<p>million to the RRA to streamline processes for domestic tax administration and raise taxpayer awareness of RRA services and procedures.</p>	<p>sensitivity to the impacts of the hazard is higher than EAC peers as the ecosystem depends more on natural capital</p>
<p>Support voluntary compliance with improved taxpayer services:</p> <p>a) Digitize Tax Administration to offer a wider range of services and channels</p> <p>b) Use data science to develop effective and timely services and interventions.</p> <p>c) Leverage stakeholder engagement in the design and delivery of taxpayer services.</p>	<p>Support on improving quality assurance for electronic taxpayer services, hence increasing voluntary tax compliance among tax payers.</p>	<p>New electronic filing and payment systems were introduced during 2010–11, with the implementation of electronic tax registration. Also, basic risk management approaches and direct bank payment of tax were introduced to reduce leakages.</p> <p>The tax and business registration processes were integrated to ease the cost of doing business.</p>
<p>Modernize RRA's business operations, capacity, and productivity:</p> <p>a) Deploy a new business operating model.</p> <p>b) Improve human resource management with targeted development.</p> <p>c) Strengthen RRA governance.</p>	<p>Training among RRA staff on measures that enhance voluntary compliance and the use of the digital system in curbing evasions.</p>	<p>Capacity building of RRA workers and serious penalties for staff who were accused of corruption increased voluntary compliance and trust among taxpayers.</p>

From table 4, we see that the role of IDA 20 DRM in Rwanda cannot be overemphasized. The support has been both technical and financial. Technical support has been through the increased capacity of RRA to its staff to be able to increase productivity in modern

methods of revenue collection. But also, IDA has provided financial support in that regard. For instance, the provision of a grant of over US\$2 million to the RRA to streamline processes for domestic tax administration and raising taxpayer awareness of RRA services and procedures was very useful to increase the fiscal space, advancing reforms under the Resilience and Sustainability Facility (RSF), more fully utilizing synergies between development objectives, and further efforts to mobilise private climate financing to help advancing development objectives and safeguarding macroeconomic balances,

In addition to the direct support to domestic resource mobilisation, Rwanda has benefited from IDA, through financing projects that aim to improve growth, thereby increasing tax capacity. The notable more recent IDA support to Rwanda is a \$100 million credit to support private sector development. This support is aimed at increasing private sector access to finance following the downturn of the sector propelled by COVID-19 and the recent Russian invasion of Ukraine. This financing has provided support to an innovative Sustainability-Linked Bond (SLB) instrument which was issued by the Development Bank of Rwanda (BRD) in local currency, thereby facilitating the mobilisation of private capital in the Rwandan private sector.

“The additional financing will expand the pool of innovative blended finance instruments under the project which brings World Bank financing together with funding from the Asian Infrastructure Investment Bank and the Global Facility for Disaster Reduction and Recovery. Through this operation, Rwanda is setting an example for other countries in the region on how to enable private capital mobilization while promoting sustainable economic development at a time when the need for resources globally is acute.” said **Rolande Pryce, World Bank Country Manager for Rwanda.**

While efforts for domestic revenue mobilisation are vivid in Rwanda, still there exists a gap between potential and actual collection. The potential gap is the difference between the amount that the country would collect given economic conditions and what the country actually collects. The IMF statistics show that the performance of Rwanda in domestic resource mobilisation is consistently

below its potential, leading to a significant tax gap. For instance, the recent estimates show that the tax gap for 2019 was 9.7% of GDP. If this potential had been collected, Rwanda's tax to GDP would have been as high as 25%. One of the highest in the continent, and about close to many countries in the OECD. It is further estimated that the gap in 2022/2023 has increased above the one recorded in 2019. This means more and more efforts are needed to arrive at the optimal domestic revenue mobilisation.

Most of the recipient countries have experienced an increasing trend in their tax-to-GDP ratio over time. Generally, IDA assistance in Rwanda has yielded considerable value for money. The total value of this assistance, despite being one of the largest donor tax assistance programs in Africa over the past two decades, has not exceeded US\$40 million—an amount that is less than the amount the RRA collects in any three weeks, according to several documents, including DFID 2021. As a result, looking at the trend in relation to potential, a big gap continues to exist. This means the support is not enough, suggesting scaling up of the IDA support if these countries should realize their potential.

5.6 Conclusions and Recommendations

5.6.1 Conclusions

This section has analysed the trend of domestic revenue performance of Rwanda over time and possible reasons for the trend. The performance for domestic revenue mobilisation as defined by the tax to GDP ratio has increased from lower than 10% in the 1990s to above around 16% recently. While the trend has been positive over time, it has been subjected to fluctuations, partly explained by economic shocks. The positive trend has been associated with reforms that the government of Rwanda has implemented, the notable one being the formation of the Rwanda Revenue Authority (RRA).

Following the formation of RRA, a number of tax reforms were implemented including the removal of exemptions, introduction of electronic means in tax assessment and payment, payment through banks, improvement of working conditions for tax officials, and

strengthened penalties among tax evaders and workers with misconduct in tax collection. All these did improve tax collection by broadening tax bases but also by the increased trust among tax officials by the taxpayers. We also note the role of IDA in supporting domestic revenue mobilisation in the country, especially the recent support to promote private sector development, which in turn broadens the tax base.

Despite all these reform efforts and the IDA support, the country is still far from its potential, suggesting not only the need for more reform efforts but also the need for more proper use of the IDA support in a way that promotes domestic revenue mobilisation.

5.6.2 Recommendations

Rwanda has generally shown improvements in domestic revenue mobilisation over time. Despite the seemingly prosperity in tax collection, it still lags behind its potential, a fact suggesting that a small effort could make big difference. Within this context, building the capacity of tax officials to undertake proper records of production and sales is necessary. Also, increased tax revenue has been contributed by the revenue authority's capacity to deal with tax exemption, an area which needs to be further strengthened so that they do not jeopardize investment.

For IDA, it might be useful to reconsider additional support because the amount provided so far seems far below from helping these countries meet their potential domestic revenue mobilisation. On the other hand, recipient countries should reconsider how they spend the support from IDA because regardless of the increase, if the spend is not directed to targeted reforms that are potential to promote domestic resource mobilisation, outcomes may seem negligible.

Finally, strengthening tax reforms to broaden tax bases is warranted. Rwanda, like other countries in the EAC, has a large size of informal sector but also the agriculture sector is largely smallholder driven, making it difficult to tax without appropriate mechanisms. Capacity building to reforms as part of IDA support, taking experiences of countries that had big informality and managed to transform them into formal sector is necessary. Political will of the IDA support recipient country is also very important for successful of this transformation.

6.0 CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

This Policy Paper has analysed the trends and features of domestic resource mobilisation in Tanzania, Kenya, Uganda, and Rwanda. The paper has established that in all four countries, tax yields, a key component of domestic revenue mobilisation, have shown significant improvements overtime. The improvements have been accounted for by tax reform measures that these countries have undertaken to improve domestic revenue mobilisation. The main reform was the formation of Tax Revenue Authorities from early to mid-1990s in all the four countries. These tax authorities addressed challenges that tax collection was facing. They have improved governance structure by addressing corruption challenges, removed unnecessary exemptions and introduced ICT in tax collection, a measure which improved detection of tax evasion. These achievements were attained with IDA support, which provided not only financial support to such reforms but also capacity building on analysis that enhanced domestic revenue mobilisation. In partnership with other MDBs—in particular, the IMF and AfDB—and other development partners, the IDA 20 has made valuable contributions to enhance DRM in the four countries. Key areas of IDA 20 contribution to the four countries' DRM include:

- Continued support for the development of a medium-term revenue mobilisation and a public financial management strategy aimed at improving forecasting and aligning revenues with expenditure;
- Promotion of voluntary compliance through the adoption of behavioral science approaches to tax administration and research;
- Support for DRM anchored on large financially supported DPOs or PforR projects;

- Support towards effective reforms of DRM systems including measures to improve the efficiency of public spending, often the cause of demand for more revenues;
- Creation of fiscal space to support long term programming and phasing of PFM reforms to condition against sharp short-term impacts and mobilise popular support for reforms;
- Knowledge partnerships with MDBs such as those that transpire through the DRM thus enabling the growing institutionalization of reforms and being useful to co-creating lasting solutions to DRM challenges through, *inter alia*, strengthening accountability and transparency in public finance management, improving coordination of priority programs, and promoting external audit and oversight at the national government level; and
- The continued support for DRM reforms in these countries demonstrate the power of MDBs in enabling or hindering progress.

Despite these seeming achievements in DRM performance for the four countries overtime, they all have not attained their full DRM potentials. It is shown that by early 2020s, tax gaps in all four countries remained at roughly half of their potential. Tax yields in the last two decades suggests that none of these countries look likely to reach their respective tax potentials in the medium term. But also, in the achievements that we see over time, they vary significantly between countries. For instance, Tanzania's tax-to-GDP ratio is lagging behind the three countries (Kenya, Uganda, and Rwanda) despite having almost the same socio-economic characteristics. Comparing these EAC countries to Sub-Saharan Africa, we note that Tanzania and Uganda have lower tax-to-GDP ratios than the average Sub-Saharan Africa, while Rwanda and Kenya have ratios above that of the average SSA countries. As clearly indicated in this Policy Paper, these trends are explained by a number of factors:

One, large informal sectors in all four case countries contributing to a high of about 50% of GDP in Tanzania. The sector is hardly taxed because it is too expansive and the players in the sector are not organized and difficult to locate administratively. Bringing the key economic players into the formal sector has been difficult because of cumbersome procedures within the revenue authorities that require taxpayers to fill multiple forms, making compliance costs high as they hardly keep daily transaction records.

As a result, Tanzania (and partly Uganda) has a very narrow tax base, leaving many potential taxpayers out of the country's tax system. This is different for Kenya and Rwanda, which have relatively less informality, explained by large urban sector, hence, they both have broader tax base compared to Tanzania and Uganda.

Two, sequenced success of revenue and tax reforms successfully implemented by all countries with Rwanda as an aggregate standout. Among successful tax reforms in Rwanda include the removal of exemptions, the introduction of electronic means in tax assessment and payment, payment through banks, improvement of working conditions for tax officials and strengthened penalties among tax evaders and tax workers involved in corruption. All these reforms improved the country's tax collection by broadening tax bases and also increased trust among tax officials by taxpayers than the case of the other three countries in the region.

Three, the failure to effectively make use of respective country's comparative advantage. Countries like Kenya and Rwanda were able to take advantage of having a large urban sector (relatively small informal sector) to increase their respective tax bases. While Tanzania has a relatively large informal sector which is difficult to tax, it is among the resource-intensive countries in SSA, with abundant mineral and natural gas resources. Despite the endowment of huge natural resources, the country has not been able to collect high tax revenues from natural resources. The lower contribution of this sector to tax revenue is partly due to its nature of investment, in which initial capital is so high that it takes time before investors start to realize profit for tax purposes. This has provided loopholes for investors to provide documents that underestimate potential profit. Coupled with the limited capacity for sector experts within the country's revenue authority to undertake proper audits, this has significantly reduced the tax contribution from this sector. Kenya, Uganda, and Rwanda are not among the SSA's resource-intensive countries.

6.2 Recommendations

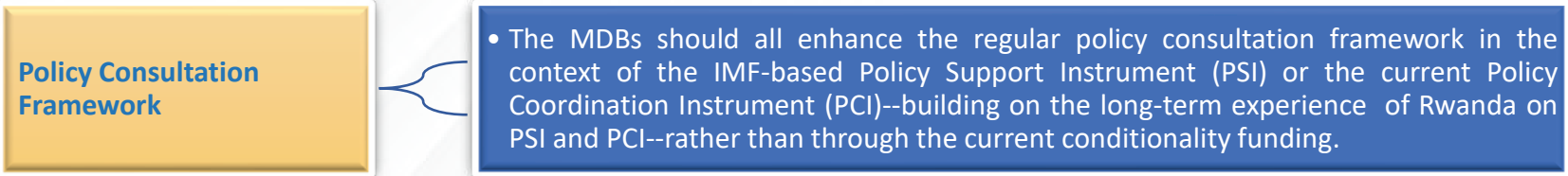
While the four countries are lagging in various aspects of domestic revenue mobilisation, they have a lot of potentials to increase their DRM. They are among the countries with the highest GDP growth over the past decades. This implies that these countries have a strong base that needs to be appropriately mobilised through, *inter alia*, proper tax assessment and collection mechanisms

to enhance their respective DRM. Tanzania, Kenya, and Uganda are also among the countries with large populations. This also gives them a comparative advantage for increasing respective market sizes with the respective populations comprised of a large middle-income category. While the middle-income group stimulates local demand, its contribution to money circulation is high, hence increasing a country's tax base.

In the context of the ongoing reforms at the MDBs, two very targeted recommendations are henceforth made for MDBs to consider:



The increase in the number of representations at the MDBs will (a) enable these countries and those of SSA to effectively and timely align their policy frameworks—including the DRM policy frameworks—with those developed by the MDBs; and (b) appropriately mobilise resources from the MDBs that enhances the DRM targets in particular the grants and technical assistance resources. Availability of the high concessional resources from the MDBs would also be beneficial for these countries.



Enhanced and regular policy consultation framework by the MDBs will strongly benefit these countries in the key macroeconomic and policy areas that will progressively and continuously support the enhancement of their respective DRM.

While these are general measures that all counties need to take, there are country specific issues to address.

Tanzania

Over the longer term, the government can strengthen tax administration to improve the tax system's equity while increasing revenue mobilisation and reinforcing the social contracts. This will improve fairness and make tax system more efficient. Adjusting rates, rationalizing exemptions, expanding the tax base, leveraging digital technologies to enhance tax administration, and improving compliance management are among measures that need to be done.

Over the short term, and also as recommended by IDA 20³², measures to address challenges of specific tax source can be implemented. Within this context, the government can prioritize increasing productivity of value-added tax (VAT), personal income tax (PIT), and corporate income tax (CIT) by adjusting rates and rationalizing tax exemptions. The current set-up tend to disproportionately benefit wealthier households while diminishing the overall equity of fiscal policy. Strengthening taxation at the top of the income distribution would improve the tax system's equity, as wealthier taxpayers often pay relatively little in taxes.

Over the medium term, systemic reforms that promote voluntary compliance and narrow compliance gaps could bolster revenue mobilisation while strengthening the social contract. Building the capacity of the revenue administration—the Tanzania Revenue Authority—will be essential to expand tax collection efficiently and equitably. Capacity-building efforts could also lay the groundwork for additional reforms, such as lowering the VAT registration threshold to broaden the tax net. Hiring and training more auditors could help ensure that all registered taxpayers report and pay their true tax liabilities.

Kenya

The government needs to improve compliance given the low rate of voluntary compliance that is far below the global average. This should be done through relaxing the technical and complexity nature of tax laws and procedures in the country. Ensuring sufficient

³² **TANZANIA Economic Update**--The Efficiency and Effectiveness of Fiscal Policy in Tanzania. Issue 19, 2023; World Bank Group.

sharing of taxpayer information among National and County Government agencies, increasing manpower in tax administration, and providing sufficient taxpayer education will improve compliance levels in Kenya.

The Kenyan tax system should increase the pace with emerging technological business models, especially those related to digital transactions and easy-to-shift base e-commerce. This will broaden tax base by bringing some business activities being left out of the tax net especially the activities carried out through the internet on a digital platform. These business activities can be carried out in a tax jurisdiction without having a physical presence in that jurisdiction.

Improvement of customs administration by increase adoption of modern technological equipment at entry/exit border points to address under-declaration and misclassification of goods, strengthen customs border administration that fails to safeguard against the importation of counterfeits, smuggling, and diversion of goods, improve Human Resource capacities as well as their morale, improve coordination and collaborations among Government agencies on customs and border management matters, improve customs-to-customs regional cooperation to curb abuse of rules of origin.

Address the challenge of tax exemptions, which has potential to increase corporate income tax yields by some 24 percent, equivalent to some 1.9 percent of GDP. Exemptions are mostly in the subsectors of financial services, information and communication technology, health, and manufacturing. Collectively, these account for about three-quarters of the losses in corporate income tax. This reflects the relatively large size of these subsectors in GDP. Apparently, there is a big gap between the current performance and the potentials. By addressing tax exemptions this gap would partly be bridged.

Finally, addressing domestic politics, characterized by political demonstrations and election-related violence, are likely to improve tax performance because such violence have contributed to DRM challenges through the disruption of business and trade, leading to poor performance of key revenue sources like VAT, income tax, and excise duty during election cycles. Consequently, Kenya has repeatedly found itself in a tight fiscal space occasioned by emerging expenditure pressures arising from drought-related expenditures and external shocks.

Uganda

The government of Uganda should improve accessibility of relevant third-party information, especially from the financial sector, strengthen the performance management system, and the tax audit business model. The government needs to pay special attention to increasing the relevance of international taxation, and human resource management, developing a comprehensive compliance risk management model, using ICT more extensively, improving cooperation with the public sector, and enhance transparency. Specifically, the government needs to:

- Address the multiple governance challenges within the national revenue agency by strengthening coordination and reporting framework between the URA and Uganda's Ministry of Finance. Both URA and the line Ministry have weak performance monitoring frameworks, focusing almost exclusively on revenue targets.
- Address the problem of inadequate human resources at all levels and across revenue and policy-related agencies, with gaps in both staff numbers and staff capacities, particularly on data analysis, specialized areas of taxation such as international tax, and audit and enforcement.
- Speed up the pace of modernizing ICT infrastructure, which is facing insufficient allocation of funds that affects the interoperability and stability of critical components. Further revenue ICT infrastructure suffers from poor third-party data access and internal data management that constrain taxpayer identification, registration, filing of returns, and validation of declarations.
- Lastly, the government should consider increasing taxpayer education to include high proportions of businesses and individuals. Uganda needs to improve tax literacy and strengthen trust between its taxpayers and authorities. A more comprehensive and extensive education programme could go a long way towards improving engagement, and taxpayer

registration, and addressing chronic under- and non-declaration. A successful education programme is key to strengthening the effectiveness of tax audits and lowering collection costs through improved voluntary compliance.

Rwanda

Rwanda has generally shown improvements in domestic revenue mobilisation over time. This has been accounted for by reforms that its revenue authority has undertaken. Despite all the achievements, it still lags its potential. This potential can be realized if the country focuses on tax education to strengthen citizens understanding of their role in revenue mobilisation.

The authority is also facing the problem of human resources as the current staff is slim in relation to the demand of the labour force. Inadequate human resources at all levels and across revenue and policy-related agencies, with gaps in both staff numbers and staff capacities are likely to create loopholes for tax evasion as companies may take advantage of fewer staff in the authority to evade tax.

The country should also improve its customs capacity given its location as a landlocked country. While Rwanda has significantly improved in the use of ICT, improvement of customs administration by, *inter alia*, increasing the adoption of modern technological equipment at entry/exit border points could help to deal with potential problems of address under-declaration and misclassification of goods. Because of its location, customs border administration is very important to help against the importation of counterfeits, smuggling, and diversion of goods,

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