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No PB 09/2024 September 2024

REPOA Brief

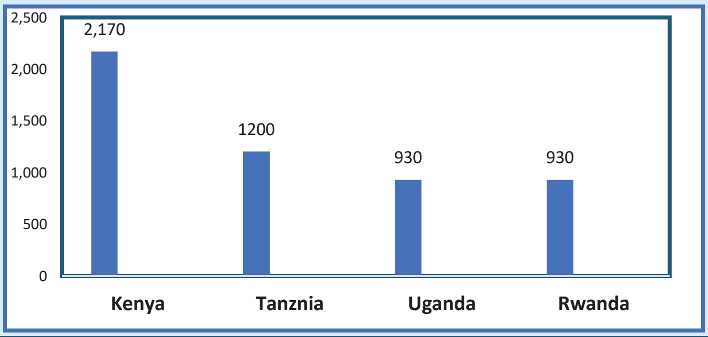
Domestic Revenue Mobilisation for Sustainable Development in the Four East African Countries

By REPOA

Significance of DRM

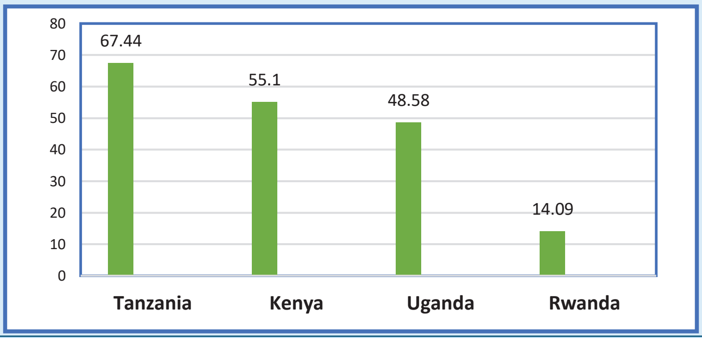
Domestic resource mobilisation (DRM) is essential in allowing countries to own and flexibly chart policies that address their specific development challenges while mitigating the risks of debt distress. East Africa Community (EAC) Countries have put attention on enhancing domestic revenues. While these countries have made progress in their economy growth, only Kenya and Tanzania have reached the lower middle-income category, whereas Uganda and Rwanda are still in the low-income category. Figure 1 shows per-capita income of the four countries and Figure 2 shows population.

Figure 1: Per capita income of the selected four EAC countries, 2024



Source: World Bank—SSA, 2024

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



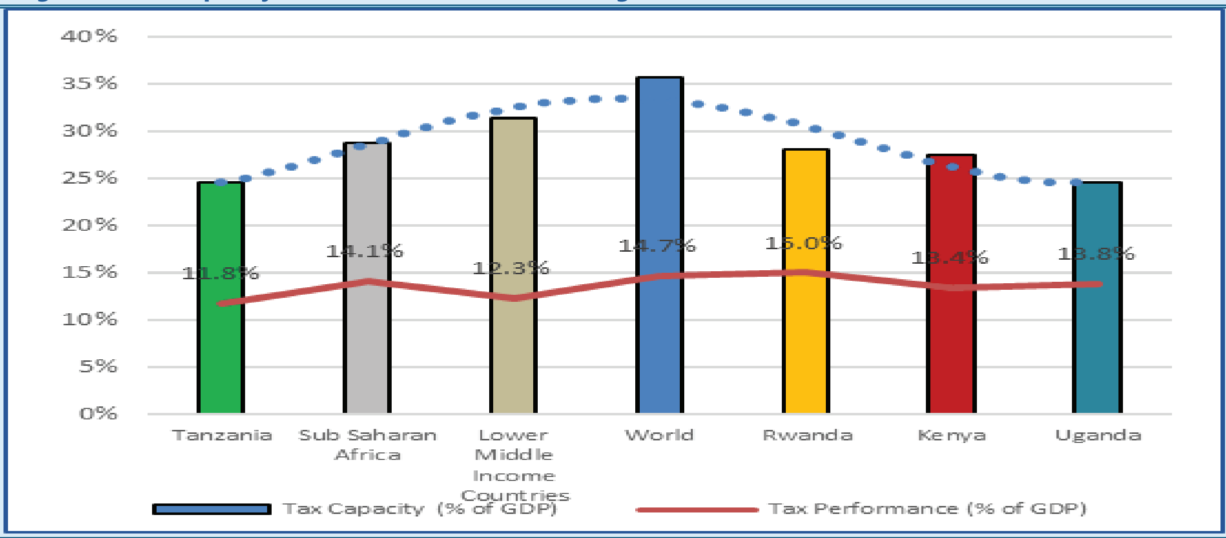
Source: WORLDOMETER, April 2024

These countries have varying achievements in their growth in relation to population, but they face a common challenge: their growth is not sufficient to mobilise domestic resources to meet their demand for service delivery given their large population.

Trends of DRM In Tanzania, Kenya, Uganda and Rwanda

The challenges facing the EAC countries—both Low and Lower-Middle Income—include the urgency to mobilise domestic revenue for effective and sustainable reduction of economic inequality, unemployment, poverty, inadequate service provision, and external indebtedness. The four countries have recently experienced growth in revenues as a percentage of GDP.

Figure 3: Tax Capacity vs. Performance as Percentage of GDP for the selected EAC economies in 2022



Source: USAID Respective Country Dashboards for DRM, 2024

These achievements are the result of several developments in domestic revenue mobilisation attained by these countries. The most notable is the formation of (semi) autonomous revenue authorities in early to mid-1990s. Other reforms include:

In Tanzania

- Digital transformation, including redesigning core functions and the organisational structure have significantly improved revenue collection.
- This has helped to reduce physical contact between taxpayers and tax collectors, thereby reducing the risk of temptations and negotiations on levels and rates of tax payments.
- The authority has also invested in taxpayers' education in particular the use of the new technologies and this had a clear taxpayer-oriented vision in place.

In Uganda

- Major DRM reforms that have enhanced revenue mobilisation including 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.

In Rwanda

- Immediately after the formation of the autonomous Rwanda Revenue Authority (RRA), the target was on large companies to ensure that they comply with tax payments that commensurate with their incomes.
- The use of ICT improved documentation and filing system, and improved tax compliance through increased integrity of tax collectors.
- The RRA rationalized personal income tax, setting nominal income brackets that increased progressivity.
- Exemption on investments were removed and high penalties imposed to tax evaders, an action that increased voluntary compliance.

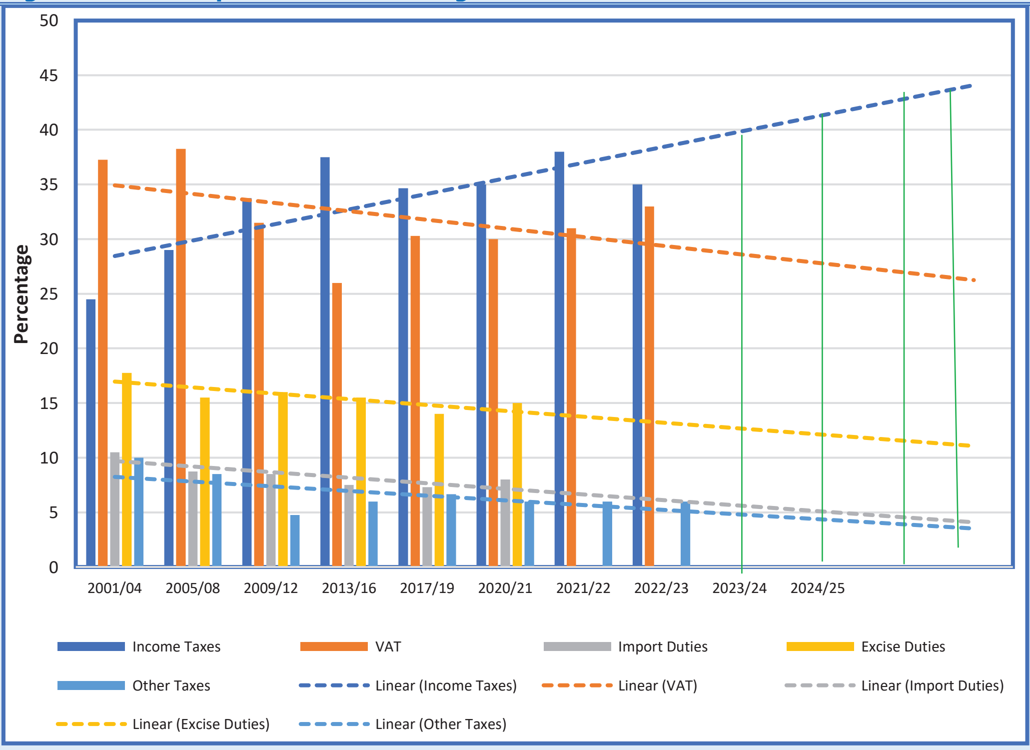
In Kenya

- Embarked in the reforms to improve DRM after formation of Kenya Revenue Authority in the mid-1990.
- Despite the reforms, the performance of its DRM expressed as tax to GDP has declined in recent years.
- Despite this recent decline, the country has the highest tax to GDP ratio among the EAC countries.
- Kenya has the largest formal economy than other countries in the region, thus a relatively broad tax base.

Challenges of DRM in the Four EAC Countries

While notable progress in DRM has been made in the EAC countries, there are gaps between revenue realisation and potential (see Figure 3, above). Key among the many challenges inhibiting the maximization of tax potential among EAC countries is the presence of a large informal sector, mainly agriculture and non-business services, which have proved difficult to tax. Despite their similarities, there exist specific challenges in DRM as outlined below:

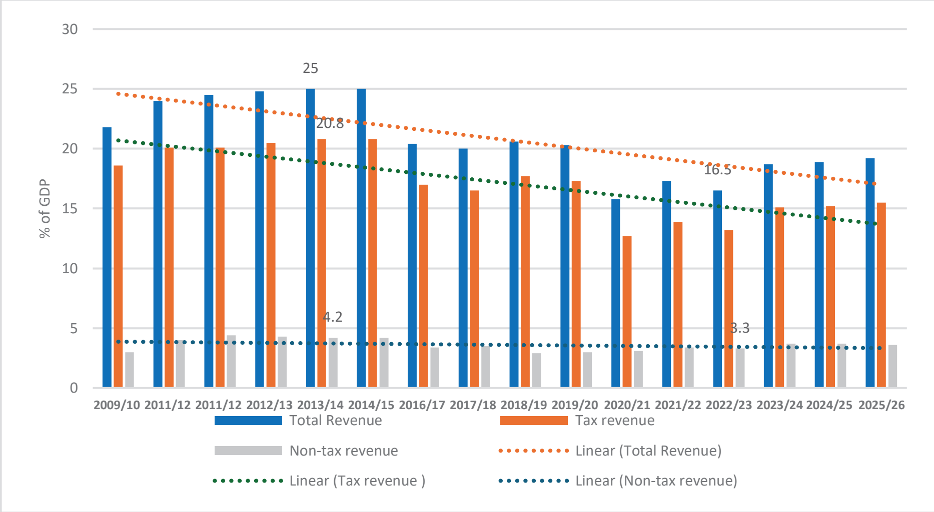
Figure 4: Tax Components as Percentage of Tax Revenues in Tanzania



Sources: Ministry of Finance, Tanzania

- **Tanzania** is among the 15 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 has not been able to maximize tax revenue from this source, despite the fact that the turnover and exports from this source are high.
- Also, there are concerns over administrative capacity as well as weaknesses in controlling corruption have been cited as among factors that has affected negatively revenue mobilisation in the country.

Figure 5: Tax and Non-Tax Revenues in Kenya



Sources: IMF (Various)

- **Kenyan** tax system has not been able to move at the same pace with emerging technology-driven business models, especially those related to digital transactions and easy-to-shift base e-commerce, leaving some businesses out of tax system.
- Issues of custom administration related to border control have also limited Kenyan capacity to optimize tax collection.
- Tax 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.

In Uganda, 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 have been cited as constraints to DRM growth. Secondly, historically the country has limited public consultation and limited use of detailed analysis in the design of its tax policies. Finally, Uganda has been facing a problem of general weaknesses in tax administration. The Uganda Revenue Authority (URA) has a cost-of-collection ratio of around 1.74%, higher than the average of around 1% for OECD and selected non-OECD countries.

For Rwanda, the country is facing the problem of policy decisions that revolve around exemptions. Several policies were introduced during the COVID-19 pandemic to support the economic recovery, at the expense of tax revenues. Second, DRM performance is partly explained by the narrow tax base as the growing agriculture and food manufacturing remained generally untaxed. Finally, Rwanda has not been able to undertake comprehensive tax reforms that would yield high revenues. Since mid-2022 the cabinet approved comprehensive reforms, but to date, only loss-making tax measures have been adopted by the authorities, while core revenue enhancements have not yet been adopted as planned.

Contribution and Influence of IDA-20 on DRM in the Four EAC Countries

There have been several DRM interventions in all EAC countries. In **Tanzania,** IDA 20 has contributed to 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). In **Kenya**, IDA 18 includes the US$750 million Kenya Inclusive Growth and Fiscal Management Development Policy Financing (DPF) in 2019. In **Uganda,** fiscal challenges have 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. In **Rwanda,** financial support includes 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, increasing the fiscal space, and advancing reforms under the Resilience and Sustainability Facility (RSF).

Conclusions

a. Revenue mobilisation	➢ While there are noticeable improvements in revenue mobilisation, all four countries have not been able to realise their potentials.
b. Informal Sector	➢ All four countries face the challenge of large size of informality, which is difficult to tax.
c. DRM challenges	➢ All countries face a problem of collecting optimal tax from certain growing sectors.
d. Capacity gaps	➢ All countries have capacity gaps, reflected in insufficient manpower and limited technical know-how, creating loopholes for potential tax evaders.
e. High DRM potential	➢ Given that these countries have experienced high growth rate of GDP in the last decade, they have high potential to increase their revenues.

Recommendations

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

Representation at the MDB Executive Boards

Enhancing representation of Tanzania, Kenya, Uganda, Rwanda and the SSA countries at the MDB Executive Boards—IMF, World Bank and the African Development Bank---well beyond the three Executive Board Members for the entire SSA. This may serve to raise their collective voices for additional support for DRM.

Policy Consultation Framework

The MDBs should all enhance the regular policy consultation framework in the context of the IMF-based Policy Support Instrument (PSI) or the current Policy Coordination Instrument (PCI)--building on the long-term experience of Rwanda on PSI and PCI--rather than through the current conditionality funding.

Specifically, on the DRM front:

- Tanzania should strengthen its tax administration as well as tax reforms that will enhance voluntary tax payment.
- Kenya should reduce complex nature of tax laws and procedures and improve sharing of tax information to improve compliance.
- For Uganda, addressing governance challenges in tax administration and improving taxpayer education is important.
- In Rwanda, strenthening tax administration as well as addressing human capital challenges will improve revenue mobilisation.

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