

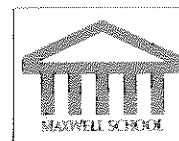
# REVENUES

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Research & Policy Notes Concerning Public Finance in Developing Countries



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## In This Issue

In this fourth issue of *Revenues*, we provide an abstract of a report written by James Wozny, doctoral candidate in economics and research associate in the Metropolitan Studies Program. The subject of the report is the personal tax as a local government revenue source in several African states. Wozny's research is based on both primary and secondary data on the subject and was supported by the Local Revenue

Administration Project. This careful study of the personal tax is an example of the kind of comparative research on government finance that LRAP sponsors in addition to its long-term field projects.

The following summary is from James Wozny, "Personal Taxes in African States," Occasional Paper No. 81, Metropolitan Studies Program, July 1984.

## Personal Taxes in African States

The poll or head tax was the earliest form of direct taxation introduced to colonized Africa and continues to be an important means by which many African governments derive financial contributions from a substantial portion of their population. The current use of personal taxes in a large number of African states is examined in the report and attention is given to variations across countries and over time. Included in this review are assessments of the rate structures of the tax, how it is administered, and the role it plays in both national and local revenue structures in a variety of settings. In addition, the paper provides an evaluation of these taxes on the basis of their revenue yield and elasticity, equity, and ease of administration.

For at least the next decade it is doubtful that broadly-based personal taxes could be supplanted completely as local government revenue sources either by modern fiscal instruments such as property taxes and user charges, or by less formalized "self-help" contributions. In conclusion, this report comments on the particular circumstances in which personal taxes are making positive contributions to local government finance and the situations in which they appear not worth retaining.

### The "Personal Tax" Defined

Economist John Due employs the term "personal tax" to refer to a hybrid between a poll tax and an elementary form of income tax (in his book, *Taxation and Economic Development in Tropical Africa*, MIT Press, 1963, pp. 61-62). A poll tax, at one extreme, is levied without any regard to the economic circumstances of each individual taxpayer, while an income tax is imposed at a set percentage of a taxpayer's assessed income, reduced by permissible deductions and allowances. The distinction between a graduated personal tax and an income tax, in some cases, becomes negligible. Common characteristics of a personal tax include: (a) the application of a minimum tax to all

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adults, frequently restricted to adult males, with no allowance or deductions and with exemptions limited to the disabled, elderly, or destitute; (b) a limited degree of graduation in the rate structure with rates fixed for a given income range; (c) tax liabilities are typically assessed directly by local committees rather than professional tax assessors in rural areas; and (d) presumptive rather than actual income is used as the basis for assessment, especially in the rural areas.

Given the diversity of economic and social conditions in different countries, there understandably have been a variety of procedures employed for the direct taxation of African populations. The procedure of personal taxation, nevertheless, has evolved in most areas through a well-marked cycle. Starting from a hut tax, the levy became a poll or capitation tax, usually graduated regionally to reflect differences in the scale of local resources or the extent of opportunities for earning a wage. Within each region all individuals paid the same amount of tax. In time, efforts were made to relate tax liabilities to the ostensible resources of individual taxpayers in order to improve the yield and equity of the levy. The term personal tax is used here to refer to both poll taxes and graduated personal taxes wherever a distinction between the two is not analytically relevant.

### **The Decline of the Personal Tax as a Central Government Revenue Source**

Once a major generator of budget receipts for African states, personal taxes since 1970 have become substantially less important as a revenue source for central governments. The share of personal taxes in central government revenues depends to a large extent on the structure of intergovernmental fiscal arrangements. In comparison with the fiscally centralized Francophone African states, the personal tax shares of former British territories were relatively low because of the more rapid development of conventional income taxes as well as the transfer of the responsibility for taxing low incomes to local authorities. In Kenya and Tanzania the shares of personal taxes in central government revenues declined from 8.9 percent and 16.7 percent in 1947 to 3.6 percent and 3.2 percent, respectively, in fiscal year 1962. In Uganda personal tax revenues had been completely transferred to local governments by 1962.

Since the late 1960s personal tax shares have declined substantially in Francophone Africa as well. In Chad, beginning in 1968, municipalities were allowed to retain the revenues of the *Taxe Civique* collected within their borders. Livestock taxes (often linked analytically with personal taxes) were eliminated in Chad after 1972 and in Senegal after 1973. All central government personal taxes were phased out in Rwanda (1976) and Burundi (1977).

### **The Rate Structure of Personal Taxes**

Traditionally, most personal taxes in Africa were levied at a flat rate which applied to all taxpayers. At the other extreme are more recent impositions that are graduated on the basis of some perception of the taxpayer's income level.

According to economic theory, a flat sum poll tax will generate a lower welfare cost per unit of revenue than any other impost because there are no substitution effects associated with the former. That is, an individual cannot influence the size of his tax payment by altering his economic behavior. A flat sum poll tax is also the simplest form of direct taxation to administer. A standard levy circumvents the difficulty of annual assessments of personal incomes, but at the expense of ignoring relative taxable capacity. The ease of administration argument in favor of a capitation tax is much stronger in the African context than is the efficiency

argument relating to labor disincentives.

There are, however, both equity and revenue-raising rationales for graduating the rate structures of taxes on individuals in accordance with people's ability to pay. The revenue of a poll tax will be very restricted if the individual payment is set with regard to the ability to pay of persons on the margin of subsistence since wealthier individuals are then being taxed too lightly. A strong incentive thus exists to introduce some graduation of rates according to personal or family incomes as soon as it becomes politically and administratively feasible. A rate schedule of this design would give the tax a built-in elasticity. As the economy's aggregate nominal income rises, due to inflation or growth, tax revenues will rise more than proportionately.

The rate structure of a graduated personal tax reflects an attempt to gain some of the yield and equity benefits derived from taxing individuals at the margin according to their abilities to pay while maintaining the simplicity necessitated by administrative constraints. The rate structure and its application to income brackets are what primarily distinguish a graduated personal tax from a standard income tax. The former utilizes a "slab" system; fixed tax liabilities are levied on each range or bracket of income. The wider is the income bracket subject to a given amount of tax, the smaller is the inequity associated with inaccurate income assessments but the greater is the intra-bracket regressivity and the lower is the growth in the tax yield associated with an increase in average income of the taxable population.

At one extreme, a poll tax requires no assessment of incomes. The danger of horizontal inequity is minimized since individuals of equal economic standing are taxed equally. But a poll tax is characterized by severe vertical inequity since individuals of different economic standing are not taxed differently. The yield, elasticity and vertical equity of the tax can all be improved by narrowing the widths and increasing the number of brackets. The extension of the upper cutoff in the rate structure is particularly important for the latter two purposes; otherwise, additional income earned by individuals already subject to the highest liability goes untaxed.

### **Tax Burdens**

No generalization can be made concerning the absolute burden of personal taxes in African states. Statutory rates vary significantly from country to country, and sometimes from district to district within a country. There is also great difficulty in estimating taxpayers' actual abilities to pay as opposed to their assessed annual incomes. Finally, the burden of a tax within a community can vary greatly from year to year as agricultural production rises and falls with rainfall patterns. This last consideration provides an argument for the personal tax as a local government revenue instrument and for imparting some flexibility into the imposition of personal taxes.

### **Conclusions**

National governments in Africa are finding themselves with fewer resources to share with local governments. Despite nearly universal policy pronouncements of intentions to expand the role of local institutions in financing public services, national policymakers have almost universally prevented local authorities from assuming greater fiscal responsibility by abolishing or severely restricting the bases of personal taxes without providing realistic alternatives to these traditional revenue sources.

Case studies of Kenya and Nigeria examined in the report suggest that a reliance on central government grants leaves

the fiscal position of local authorities uncertain at best. When grants are forthcoming they have generally been used to impose national priorities on local communities rather than to stimulate the latter into adopting self-help projects. Central ministry priorities commonly conflict with those of localities. While Nigerian central authorities were promoting projects that would generate revenue, such as markets or car parks, or projects that would increase agricultural production, the priorities of local communities were reliable water supplies and health services.

People will not willingly pay any tax or fee unless they can see a link between their contributions and public projects which they value. Local officials will not zealously enforce collection of a tax unless significant shares of the receipts accrue to their budgets. For these two reasons personal taxes are unlikely to be cost-effective revenue instruments unless they are given over to local control.

Local personal taxes have been recommended for the support of health services for low-income people. Local water supplies are being financed through user fees for private house connections and even for urban standpipes and wells, but in rural areas rate collection at communal water points is infeasible. The "Taxe Rurale" has been suggested as a means of financing village water supplies in Senegal. Collecting tolls on rural roads is not a practicable method of recovering road maintenance costs, but personal tax surcharges earmarked for road maintenance might be imposed on villages in the area. In all cases where reliance is placed on personal taxes the link between tax payments and service provision must be pronounced in order to enhance compliance on the part of the taxpayers and collection practices of the local officials.

## Conference on Jamaican Corporation Taxes

In October, Roy Bahi convened a conference in San Francisco devoted to the examination of policy reform for Jamaican corporation taxes. More than 20 people attended including several members of the Revenue Board of Jamaica, the Jamaican Committee on Tax Reform (composed of representatives from the private sector), and consulting economists on the Jamaica project from the US and Canada.

## The Ecuador Project

During December, four members of the LRAP Ecuador team — David Greytak, Jorge Martinez, Ken Stacey, and Hernando Garzon — traveled to Ecuador to consult with the AID mission and the Ministry of Finance. The discussions concerned the results of the analysis of the possibilities for income tax reform, evaluation of customs administration, and review of the intergovernmental grant system.

## LRAP Assignment in Haiti

In late November, Roy Bahl and sales tax expert Matt Bourgeois of Metro's Jamaica project office traveled to Haiti for nearly a week to assist the AID mission there. They conferred on how to set up a program to study and implement tax policy reform and to consider more carefully the relationship between the country's economic policy and tax policy.

## Visitors to Metro

In October, British expert on customs administration Ken Stacey spent time at Metro to work with the Ecuador tax project team.

In October, M.A. Choudhry, Director General of the Operations and Methods Division of the Cabinet Secretariat of the Government of Pakistan, visited Metro to discuss the subject of local government in Pakistan. His trip was sponsored by the United Nations Fellowship Program, Department of Technical Cooperation for Development.

In December, Jorge Martinez of Georgia State came to Metro to confer with other members of the Ecuador team.

In December, Doug Graham of Ohio State University visited the program and gave a seminar entitled "Rural Savings Mobilization in Developing Countries."

## Staff Publications

### Reforms in Bangladesh

Larry Schroeder published an article on "Decentralization in Rural Bangladesh" in *Asian Survey*, 1985, Vol. 25, pp. 1134-1147. The author discusses the policy and goals of the Ershad government's approach to decentralization. After a section describing local government structure in 1982, before Ershad came to power and declared martial law, a subsequent section explains the proposed revisions in the administration and local government structure. Progress since 1982 is then reviewed and the article closes with attention to the three major problems facing plans for decentralization in Bangladesh: personnel needs at local levels of government, political conflicts between officials of new units and old units, and the nature of financial allocations from the central government to the local bodies.

### Signs of Strain in Sri Lanka

Robert N. Kearney, professor of political science in the Maxwell School, and Barbara D. Miller wrote on "The Spiral of Suicide and Social Change in Sri Lanka," which appeared in the *Journal of Asian Studies*, 1985, Vol. 45, pp. 81-101. The suicide rate in Sri Lanka tripled between 1966 and 1974, with extremely sharp increases registered in districts of the northeast which have experienced rapid population growth due to heavy internal migration, much of which is sponsored by government colonization schemes.

## Staff News and Notes

Larry Schroeder participated in a workshop held in October at Bloomington, Indiana, on "Local Development and Local Resource Mobilization in Egypt."

In November, Steve Haggblade presented a paper on "Home vs. Factory Brewing: The Impact of Shifting Market Shares in Africa's Indigenous Beer Industry" at the annual meeting of the African Studies Association, held in New Orleans.

Jerry Miner traveled to Paris in November to attend the International Conference on Fiscal Policy and Development where he presented a paper on "Financing Communal and Rural Areas in Burkina Faso." The conference was jointly sponsored by the French Ministry of Economics, Finance and Business and the Ministry of Cooperation and Development.

In December, Roy Bahl gave a seminar on Metro's work on tax reform in Jamaica at the Agency for International Development in Washington, D.C.

Barbara Miller presented a paper on "Surveying the Anthropology of Gender Hierarchies" at the annual meeting of the American Anthropological Association, held in Washington, DC, in December.

Ranjana Madhusudhan received an award from the Roscoe Martin Fund to support research for her dissertation. The grant will allow her to go to Washington, DC, to interview economists at the World Bank and the IMF concerning fiscal decentralization in developing countries.

Richard Joseph received a grant from the Roscoe Martin fund which will allow him to obtain secondary sources relevant to his doctoral dissertation on "The Fiscal Impact of Tourism in Jamaica."

Barbara Miller has been appointed for a two-year term as consulting editor to the *Journal of Voluntary Action Research*.

## Next Issue: The Jamaica Project

In 1983, the Metropolitan Studies Program agreed to undertake a several-year project which would lead to comprehensive reform of the entire tax system of Jamaica.

Funded by the United States Agency for International Development, the Jamaica Tax Structure Examination Project is headed by Roy Bahl, Maxwell Professor of Political Economy. The project personnel comprises 25 faculty consultants from Syracuse University and other universities internationally, as well as several senior technical consultants with long experience in such areas as income tax and customs administration.

The project maintains an office in Kingston with four fulltime resident advisors who are responsible for key aspects of the reform process, as well as research assistants working on various topics including financial institutions, the corporate tax, and the taxation of tourism. Over the past two years a significant amount of research has resulted in the production of nearly 30 staff papers prepared for the use of the Jamaican Revenue Board, the counterpart institution of the Syracuse team. Since the project's beginning a little over two years ago, substantial progress has been made in working toward policy reform in all aspects of the work: income taxes, property taxes, corporate taxes, indirect taxes, and administration.

The next issue of *Revenews* will provide a detailed description of the accomplishments of the Jamaica Tax Structure Examination Project.

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