Taxation Policy in Developing Countries: What is the IMF’s involvement?

The Bretton Woods Project
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Theory

- Significant differences between developed & developing countries:
  - Lower levels of economic development
  - Weaker institutions
  - Less accountability
  - Higher corruption
  - Higher inequality
  - Greater reliance on indirect taxation
  - Extensive informal sectors

Overview

What kind of domestic tax policy advice has the IMF given, and how has the distributional impact of this advice been addressed?

- Section I: Evaluation of theory on taxation in LDCs and specific characteristics of LDCs
- Section II: Analysis of IMF tax advice as provided in Article IV Consultations
- Section III: Recommendations and Conclusions

Theory

- Differences between developed and developing countries

![Bar graph showing tax take as a percent of GDP for OECD and Developing Countries.]

Overview

- Dependence of many LDCs on IMF for aid and loans
  - Obligation to comply with advice
- IMF push for lower trade taxes
  - Developing countries not able to regain lost revenue through VAT
Theory

The standard IMF recommendations:
- decrease in trade taxes
- lowering of PIT and CIT
- broadening tax base
- implementation of VAT at a standard rate between 11-19%
- simplification of tax system to decrease administrative costs

Theory

- Problems with VAT in LDCs
  - Administrative problems in LDCs
  - Exemptions narrow the tax base & create opportunities for tax evasion
  - Inability to cover informal sector

Theory: Conclusions

- Consider alternative forms of taxation
  - Ex: taxation of goods used by the informal sector
- Accountability Issues
  - IMF as a scapegoat for government accountability
  - LDC governments are accountable to elites instead of the masses

Article IV Consultation Analysis - Methodology

- 10 Low Income
  - Bangladesh
  - Benin
  - Haiti
  - India
  - South Korea
  - Lao PDR
  - Mongolia
  - Mozambique
  - Solomon Islands
  - Yemen
- 10 Lower-Middle Income
  - Albania
  - Armenia
  - Azerbaijan
  - Bosnia and Herzegovina
  - Cameroon
  - Moldova
  - Morocco
  - Namibia
  - Samoa
  - Vanuatu

Article IV Consultation Analysis – Overview of Results

- 3 cases of compensation to offset increased fuel prices as a result of reduced exemptions
- 2 cases of pro-poor advice
- Governments are aware of distributional consequences
**Article IV Consultations: Technical Assistance (TA)**

- Not enough detail
- IEO findings:
  - wider dissemination of TA reports needed
  - TA has "only a weak link" to priorities
  - TA is driven by internal IMF initiatives

**Recommendations: Article IV Consultation Analysis**

- Distributional consequences
  - Recommend more PSIA work on taxation
- Poverty and Social Impact Analysis
  - Integrate PSIA work into IMF policy advice
- Technical Assistance
  - Publish details of missions
  - Better identification of need and targeting
  - More evaluation of effectiveness

**Article IV Consultations: Poverty and Social Impact Analyses (PSIAs)**

- Only 3 related to taxation
- No cooperation between the IMF and World Bank
  - "IMF communications on aid and poverty reduction have contributed to the external impression that the IMF committed to do more on aid mobilization and poverty-reduction analysis"

**Recommendations: Article IV Consultation Analysis**

- External Transparency
  - Publication, publication, publication
- Internal Transparency
  - Educate staff about PSIA work
  - Publish guidelines to educate staff about actual IMF commitments

**Article IV Consultations: Limitations of Results**

- Being representative of IMF advice
  - Small sample size
  - By country rather than by population
- Only the most recent consultations – no knowledge of trends over time
- Transparency - IMF representative reticence and lack of institutional memory

**Conclusions**

- The IMF does not seem to have considered whether the VAT is an appropriate tax for developing countries
- Analysis of the distributional impacts of policy advice needs to be central to IMF operations in developing countries.
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