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# The Reform of Revenue Administration

## A Study for the Department for International Development

by


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# Summary

## Purpose

This study reviews the experience of DFID-funded projects to support revenue administration in Africa against wider international experiences to determine lessons for future work in this field.

## Policy and Context

Revenue Administration reform projects should normally be run alongside projects to reform underlying tax policy because of the mutual benefits that result.

Prior to committing funds analysis of the adequacy of expenditure planning systems in the relevant country is necessary. Conditionality attached to the use of revenue may be appropriate but can overload projects unrealistically. Alternatively the development of complementary projects on the expenditure side may be sensible.

Revenue agencies have multiple objectives in addition to simple revenue collection:-

- maximising revenue collected
- minimising the costs of collection
- minimising the cost of compliance for tax payers
- enforcing limitations on imports and exports
- administering the tax law and policies appropriately
- administering the law equitably.

Projects need to resolve the relative importance of these and any conflicts between them in advance.

A particular problem is the potential conflict between immediate revenue collection activities and capacity building to promote long term performance. In larger projects careful identification of the relationship between particular inputs and particular objectives will be required to avoid this conflict manifesting itself. Normally capacity building should dominate over short term collection but a policy of gaining “quick wins,” if carefully designed and implemented, is consistent with this and is positively desirable to secure political support.

Projects directed solely at immediate revenue collection will rarely be appropriate for donor financial support but where a country has severe current difficulties a (self-financing) project might well be supported in the form specifically of project management drawing on donor expertise in that field.

## Generic Technical Assistance Issues

Tax administration suffers from a number of common problems encountered in TA projects.

**Political commitment** is a crucial determinant of the success of projects. Both contractor and donor resources need to be devoted to gaining and nurturing this support. Whilst such involvement can bring risks it is consistent with the partnership model now being promoted for DFID.

**Effective Management** was another key determinant of success. Where revenue agencies do not possess sufficient capacity it may be appropriate for donors to finance it although this will need a careful succession strategy where it involves the use of expatriate staff.

**Adequate counterparts** were vital to projects and efforts to ensure the supply of counterparts form an integral part of the partnership approach espoused. Again financial support may be appropriate in some cases to ensure the effectiveness of projects.

## Making Management more Effective

A range of management initiatives that are not tax-specific are critical in putting this into practice. Often these will be more effective than technical tax innovations.

**Targeting resources and better planning and monitoring** address a critical weakness in many civil service organisations. A strong manager can introduce these changes without the need for fundamental civil service reform. These can have a rapid effect on performance if resources can thereby be targeted on the activities critical to agencies' missions.

**Human Resource Management** is rather more difficult to address in many countries bound up as it is in many cases with the overall civil service structures. (For this reason such reforms are easier in a revenue authority approach (see below). However better management of staff within these constraints is possible.

There was limited experience of **performance related pay** and tax collection poses particular problems of over eager enforcement in this respect. More realistically the use of performance appraisal did appear achievable even within conventional structures.

**Deploying staff** well to meet real needs showed potential for improvement with the rotation of staff and accelerated promotion amongst possible strategies.

**Corruption** remains a major problem. Some analysts have argued that corruption in some countries is so severe as to make reform attempts futile. We did observe some successful attempts to confront corruption. In some cases these were in the context of a revenue authority where senior managers gained greater power. It appeared easier for expatriate managers to confront these issues for understandable reasons. Some experience even outside of revenue authorities in raising wages did appear to hold out hope for playing a part in reducing corruption. Corruption, especially at the political level, remains an issue which can only be dealt with by reforms beyond the scope of a revenue administration project.

**Contracting-out of support services** had begun in minor ways with services such as building security. In Kenya some tax auditing has been outsourced. This represents a potential area for expansion but will be limited in the near-future by lack of competition and fairly undeveloped markets for such services in many countries.

Overall strong managers can perhaps contribute most by inculcating a **change of attitudes**. The literature and officers ion the field continually speak of the need for "professionalism" as a means of combating corruption and promoting good performance. A clear example from the top down backed by actions with middle and junior mangers can support this.

## Tax-Specific Innovations in Revenue Collection

A large number of reforms that are specific to tax administration have been attempted. A common theme is that these require considerable management effort and cultural change to introduce successfully in a sustainable way. Thus attention to these generic issues becomes important. There is a clear danger of overloading managers with too many specific initiatives, especially early on in a project to the detriment of overall performance.

**Flexible Anti Smuggling Teams (**or FAST teams) have been effective in forming a highly visible threat to smugglers allowing for improved deterrence. To sustain the benefits requires good human resource development of local staff. FAST teams are a good example of the potential for the use of publicity in broadening the impact of what may be quite a small-scale input.

Moving resources in favour of more **audit and investigation** can widen the scope of taxpayers limiting evasion and enforcing higher tax settlements. This is an area like FAST teams where the work could be done by expatriate staff but sustainability requires skill transfer.

A more proactive response to **risk management** with resources targeted on activities where risk of abuse is high can produce quick benefits. This can be assisted by computer systems but the most important factor is the change in attitude if staff needed - away from routine checking towards selective and targeted checking. Where an agency has particularly low calibre staff this may need more than just training.

**Large taxpayer units** take advantage of the fact that a high proportion of tax due will be payable by a small number of taxpayers. Focusing efforts, at least initially, on getting these right is a particularly effective way of getting quick wins where these taxpayers have not been targeted in the past.

In Customs various forms of mis-declaration or under-declaration are now widely thought to be more important than pure smuggling. **Valuation indices** can assist officers in checking values and querying suspicious declarations.

**Improving Enforcement** is rather harder to tackle where it involve outside agencies such as prosecution bodies and the courts. This is frequently a bottleneck in tax enforcement. Some success has been gained in setting up special courts, in clarifying tax agency powers and in giving prosecution rights to tax agencies.

**Computer systems** are a common feature of reform projects. They can be over-emphasised however. Normally it is best to get existing systems right first before attempting rapid computerisation. Human Resource constraints and lack of local involvement can also impede successful installation. One approach that has had some success is a modular approach that takes developments on a step-by-step basis. An exception to this norm is where a new tax is being introduced (typically VAT) where the project deadlines and the lack of a manual systems to confuse developments means that reform may be more successful.

Allied to computers **Taxpayer Identification Numbers** can assist in sharing data between tax functions and assist in investigation. Introducing them has proved difficult and again they may best represent an option for a fairly sophisticated agency.

**Taxpayer education and taxpayer service** represent important developments offering cheap cost-effective ways of improving collection across a broad range of taxpayers. Again cultural change represents a potential barrier to success and improvements here take some time.

## The Revenue Authority Model

The Revenue Authority model (known by various names) has been adopted in, amongst others, Ghana, Uganda, Zambia, Kenya, Tanzania, South Africa, Zimbabwe and Rwanda. It follows the Executive Agency model which gives a high degree of autonomy to a single-purpose agency. The primary objective in most cases has been to increase revenues, but in some (Kenya, South Africa) it has been to increase efficiency and tax compliance, thereby improving equity without increasing the overall tax burden. This represents the strongest body of UK-supported experience. Many of the lessons discussed here are relevant in less dramatic cases of reform especially in the fields of governance.

The Revenue Authority potentially enables the tax organisation to:

- pay higher, more competitive salaries in order to attract and retain staff
- have flexibility over pay structures, particularly for senior management and scarce skills
- have freedom to hire and fire, in order to tackle both incompetence and corruption
- have autonomy to manage their operations and their budget in a businesslike manner

- take legal action against defaulters directly rather than waiting for the state prosecutors
- integrate tax operations and organise them along functional lines where appropriate
- have a degree of protection from political interference and from budget cuts.

The relative importance of these advantages varies between countries.

However:
- there may be higher costs associated with the RA structure which may not necessarily be justified in order to increase tax effectiveness
- some changes can be achieved without an autonomous RA; sometime the move to an RA may be driven by those who stand to gain from higher salaries
- an autonomous RA does not guarantee an end to political interference, and there are often both legal and political constraints to hiring and firing
- pay differentials from the rest of the civil service may create problems in inter-agency co-operation, and may be eroded over time
- it can contribute to fragmentation of the civil service when what may be required is structural reform
- there needs to be a proper supervisory framework, properly monitored, to ensure that autonomy is not abused.

**Governance framework**
- Boards have often created problems by interfering in day-to-day management
- Boards tend to be dominated by government nominees; tax-payer confidence is enhanced where Boards include genuine representatives from the private sector
- Ministries of Finance need to maintain a degree of independence from the Boards to enable them to regulate the RAs
- supervision by government needs to ensure that performance standards are achieved but prevent interference with operational decisions
- a clear division of responsibility is needed with the Ministry of Finance over tax policy.

**Internal organisation**: RAs usually have a Commissioner-General or Chief Executive to manage the organisation and oversee all tax administration. It is more important that such a person is a good corporate manager than a tax expert. Below that, internal structures range from retention of existing tax departmental structures to reorganisation along functional lines. There may be practical limits to functional integration, but there are certain elements where there are clear benefits:
- tax-payer identification and records, including tax-payer numbers
- computerisation/IT
- cross-checking liabilities between taxes
- accounting and auditing
- legal services
- flexibility to re-deploy staff.

Integrating tax departments can be a difficult process, especially where they have evolved their own cultures and systems, and takes time. Where “common service units” are developed, e.g. IT, legal, auditing, etc., their role and position needs to be clearly defined. They also need to be accountable for their performance, otherwise the divisions responsible for collecting particular taxes may seek to set up (or retain) separate systems.

**Decentralisation**: Where decentralised structures are adopted, the roles and functions of the decentralised units needs to be clear, as does their relationship to the centre.

**Appointment of staff:** One model is to start afresh, requiring all former staff to apply. The other is to take on everyone formerly employed, but allow the greater flexibility over firing (or generous redundancy packages) to get rid of incompetent and/or corrupt staff. Clearly, the former offers a greater chance of effectiveness, but can only be done where there is strong political will. However, even such a radical approach requires firm monitoring to ensure that poor working practices and corruption do not re-emerge.

**Funding:** Autonomy over managing the organisation's budget is essential, but there is a question about how that budget should be fixed. One model is to give the RA a share of tax collected. Another is for the Ministry of Finance to fix the budget annually. The former gives a greater incentive to performance, and offers greater protection from budget cuts, but raises a problem about how the percentage should be fixed. A compromise is to provide a basic annual allocation plus a percentage of tax collected above a target as an incentive. This still leaves the question about how to fix the amounts, especially since the funding required will, almost inevitably, be significantly higher than previously.

**Making Revenue Authorities work**: experience suggests:

- it takes time to establish and consolidate such organisations
- too many organisational changes (autonomy, integration, systems modernisation, decentralisation) at the same time can create management overload
- the benefits in terms of human resource management flexibility (pay rates, hiring and firing) appear to flow more rapidly than those from integration
- autonomy from the public service requires an appropriate framework for regulation and accountability
- the need for a clearly defined and co-operative relationship between the RA (including the Board) and the Ministry of Finance
- dynamic and honest leadership from the Commissioner-General/Chief Executive is crucial
- proper HR management policies are essential, rewarding performance and dealing with poor performance

## Contracting Out

Contracting out of the revenue collection function itself has been tried in one case - Customs in Mozambique. There are fundamental difficulties with establishing a conventional contract for this type of service since it is not possible to fully specify in advance the appropriate level of performance on revenue collection.

This puts the emphasis on a trust-based or relational contract where the future reputation of the contractor (and the client) is the best guarantor of good service. This can be hard to reconcile however with a need in the public sector to re-tender contracts periodically

The role of donors on such contracts is not clear-cut. On the surface they are eminently suitable for funding from proceeds on a self-financing basis and conventional theory might suggest that a commission basis (if performance could be monitored effectively) would be most approriate. The most obvious role for donors is in supporting government contract management.

More experience of such contracts is needed and there is considerable scope for experimentation in this field.

## Project Design and Management

A range of issues in project design, implementation and monitoring are identified.

The clear conclusion is that **process rather than blueprint** approaches to project design are appropriate for revenue administration projects. However this imposes added responsibility on project managers on the donor side to take part in continuing revision and oversight of projects.

Use of **log frames** was not always effective with problems especially over the identification of OVIs.

**Donor relationships** were generally satisfactory but there were some claims of a tendency of UK based assistance to want to have the field to itself. This perception (whether accurate or not) needs to be dealt with.

**UK practitioners** had proved generally effective in the field but exceptions remained. Initiatives to improves selection and monitoring were beginning.

A critical issue is the organisations from which DFID draws for its expertise. Currently **two main contractors** are involved plus Her Majesty's Customs and Excise. This represents a limited pool and efforts to widen it are needed. HMCE do not bid for large projects in competition with the private sector and this further limits available expertise or requires it to be filtered through contractors.

A lack of clarity over **management responsibilities** between different DFID (and other UK government) offices was remarked on by many counterparts and by contractors. These roles are confusing and there may be scope for simplifying or at least explaining better these respective roles.

## Measuring Performance

The particular difficulties of measuring tax collected in a way that indicates performance has already been mentioned. Other aspects of performance are more easily measured. This suggest that the trust-based approach appropriate for contracting out also needs to be adopted widely in technical assistance projects.

Where there are **long term aims** of capacity building there are particular problems of measuring these either than by input based approaches. This is unsatisfactory and can result in inappropriate delivery of inputs or in the neglect of capacity building in favour of the performance that is being measured more precisely. Project management needs to address this by according different priorities their appropriate place.

Post project review appear to have been relatively neglected and need to be carried out systematically.

## Overall Strategy for DFID

**DFID's special niche** in tax administration reform is widely recognised and is capable of wider exploitation. However this may be limited by resources on the contractor side and by a limited capacity with DFID to take on the burden of contract monitoring described here.

The successful reforms promoted by DFID have tended to **involve longer term projects** (at least 3 years say) on a fairly large scale. Focusing on these may make the best use of resources.

Selective **choice of countries** to focus on those that have appropriate overall governance mechanisms (in respect of expenditure planning and anti-corruption initiatives) will give tax administration reform a chance. Integrating administration projects with tax policy projects gives a chance to focus resources on poorer countries with beneficial impacts on the distribution of income and on funding overall government programmes aimed at the poor. A partnership approach with a small number of countries along these lines offers an exciting future for significant advances in tax administration.

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# Introduction

### Background and Purpose

The collection of tax represents a major government function:-

- it is large in scope being a major employer of civil servants
- it enables the funding of expenditure programmes and hence is crucial to the sustainability of any developments in government expenditure
- it is the means by which much policy on interpersonal equity, poverty and gender is implemented
- it implements the government's monopoly power on the coercive taking of assets from individuals and companies

This report highlights lessons for future tax administration projects of recent DFID experience in promoting tax administration reform. This is done against a background of wider international experience in the field. The report is not an evaluation of past or current projects. Instead it seeks to draw out common experiences and highlight relevant exceptions. The emphasis is on comparative experience where this can feed into future project design, implementation, management and evaluation.

### Scope

The focus is on **administration** rather than underlying **tax policy**. Whilst the distinction is blurred and there are important relationships between the two this is designed to make the study manageable and to focus an area where DFID has been especially active. Some of the key links between policy and administration are considered in chapter 1.

Regionally the main focus is on Africa where DFID has undertaken a number of tax administration projects although examples from other regions are considered where appropriate.

The study was restricted to tax rather than other types of revenue such as charges. Only central government taxes were considered

### Sources and Methods

The study was originally conceived as a desk study of relevant project and academic materials. This has remained the main methodology but this has been supplemented by visits to a number of projects in the field and to DFID Development Divisions in Harare, Nairobi and Pretoria. This was further supplemented with discussions with World Bank and IMF staff in Washington, with staff of the Harvard Institute for International Development and its associated International Tax Program in Cambridge, Mass. and with UK based staff of consultancy organisations.

In some cases comments were made on a non-attributable basis and this has been respected in the report which follows. A number of matters of commercial sensitivity are omitted form this study whilst in a few cases specific details are omitted to protect confidentiality.

Comparative study of projects is difficult because of the heterogeneous nature of the reforms, the countries and organisations in which they were attempted, the economic conditions within which they were attempted, differing objectives and so on. Basu and Gammell (1997) point out that “inter-country comparisons of this sort are difficult to make and improvements over time in some aspect of administration often lead to other administrative constraints being highlighted”. The relatively weak information systems of many administrations (especially but not exclusively prior to reform initiatives) means that reliable and comparable quantitative data is surprisingly limited.

The adoption of multiple initiatives in projects, the changing external environment and the relatively short time-scales during which initiatives are implemented means that dis-aggregating the impact of individual measures and attributing causality is difficult.

The combined effect of this is that a case-study approach is the main tool of analysis in this type of evaluation (see also Casley and Kumar, 1987) and this is adopted here.

**The literature on tax administration reform**

The report refers throughout to a range of published and grey literature on tax administration reform which is summarised in the References section at the end of the report.

Surprisingly there is comparatively little formal comparative material in this field. Instead there is a lot of project-based material (although mostly descriptive and relating to projects in operation at the time of writing) and a lot of material which discusses “tax administration” but which is really about how to change tax **policy** (i.e. the underlying tax instruments) to make administration easier. The emphasis on tax policy reform may reflect the predominance in written studies of economists more interested in tax instrument design than in more practical issues of administration. The lack of comparative studies of what has been attempted in administration reform may similarly reflect the incentives and interests of consultants who, in the administration field are much more likely to be practitioners or full-time consultants with little pressure to publish. As Tanzi and Pellechio (1997) point out there are relatively few people outside the IMF who have extensive experience in different countries.

The leading recent study that does focus on Tax Administration is Silvani and Baer (1997) summarising IMF experience and prescriptions. Their summary of guiding principles is:-

- political commitment to and the sustainability of the reform are crucial
- simplify the tax system to facilitate administration and reduce compliance costs
- encourage voluntary compliance
- formulate a clear strategy

- identify the tax and Accounting laws that require change
- take an integrated approach to the collection process
- differentiate the treatment of taxpayers by size
- ensure the effective management of the reform process
- set priorities and establish a timetable
- begin fundamental reform with pilot projects

This list is broadly consistent with the experience described in this study although we tend to place a higher emphasis on strong management than do Silvani and Baer. (They do identify the lack of a strong management team as a key bottleneck however.)

Other broad studies include Casanegra et al (1992) also reflecting IMF experience but emphasising transitional countries; various articles in Bird and Oldman (eds.) (1990); Datta-Mitra (1997) summarising World Bank experience in the field and Kant Patel (ed.) (1997) reporting an UNCTAD sponsored study focusing on reforms in least developed countries. Again the overall experiences discussed within these studies is consistent with the approach adopted here.

**Structure**

Chapter 1 considers the context to tax administration including the relationship with tax policy especially issues of sequencing. The role of tax within an overall context of managing expenditures as well as income is also considered.

Chapter 2 highlights "generic" issues associated with technical assistance that have impacted upon tax administration projects including political commitment and the role of counterparts.

Chapter 3 continues this theme by focusing on how effective managers can improve tax collection performance through measures that are not tax-specific such as human resource management. The issue of corruption is addressed here.

Chapter 4 examines a range of tax-specific initiatives that have been attempted such as improving investigation and tax audit or the use of computers in tax administration.

Chapters 5 and 6 examine two specific institutional or organisational reforms that have been attempted in this field. (Only the organisational aspects of reforms within these projects are considered in these chapters - where they have adopted more conventional techniques these are discussed in the relevant chapter elsewhere in the report.) Chapter 5 looks at the specific reform of introducing a unified, quasi-autonomous revenue authority. Chapter 6 looks at contracting out revenue collection.

Chapter 7 examines issues of project design, management and monitoring. This includes issues of the choice of contractor  and individual consultant/TCO selection.

Chapter 8 focuses on the particular management task of project evaluation examining how this can be done for a tax administration project.

Chapter 9 brings together some overall themes by way of conclusion including the implications this may have for future DFID strategy in this field.

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# 1. Objectives of Revenue Administration Projects

### 1.1 Tax Administration and Tax Policy

The relationship between administration and policy in tax is complex. There are few projects that are pure attempts to change policy without some impact on administration. Projects that are focused on administration rather than policy do exist but even there, there are impacts on tax policy. This makes the question of whether reforming policy or reforming administration is more effective hard to answer in a pure way. However experience suggests that projects which integrate both policy and administration elements are always likely to be superior over projects which tackle only one of those issues. There are a number of reasons for this:-

- in practice most countries involved have deficiencies in both their policy and their existing administration
- development of new policy requires adequate statistical information that in turn originates from the tax administration
- changing policy will almost always need some changes in administration and support will be needed for that
- administration expertise can help in “cleaning up” draft legislation to make it workable (see Witte, 1993)
- reforming administration is likely to reveal weaknesses in policy which should be acted upon.

**Policy and Administration in the first South African project**
Where activities have focused on administration, such as during the early part of the SARS project, consultants did attempt to flag up failings in the underlying tax legislation they encountered as they pursued enforcement strategies. For example weaknesses in the legislation for stopping and searching consignments were identified. Unfortunately neither the project itself nor the overall revenue agencies had the resources to pursue these. .

If quick results are called for then hypothetically an administration-led project aimed at producing immediate collection performance increases would probably produce results more quickly that any project aimed at policy. However, as discussed below, there are doubts over whether such a pure collection strategy is ever appropriate and over whether donors ever need to fund such a strategy.

For projects that involve some underlying reform that is sustainable it is tempting to argue that certain types of policy reform can produce rapid benefits. These would be reforms that simplify tax systems, remove inappropriate exemptions, raise thresholds and, possibly, lower tariffs. This can simplify the process of tax administration, remove discretion (and hence some of the potential for corruption) and limit tax avoidance and evasion. Without clear examples of a project which attempted this without reforming administration it is difficult to be certain. However our conclusion was that in the countries we studied problems with the tax administration were so fundamental that few sustainable gains would have been realised from policy reform without accompanying efforts devoted to supporting the improvement of tax administration systems, structures and processes. Kant Patel et al (1997) echo this finding when they state:

> One of the most pertinent findings of our four country study [Bangladesh, Malawi, The Gambia and Tanzania] is that the effective implementation of many of the fiscal reforms and reforms to the tax structure in particular has been impeded by administrative constraints.

However this combination of tax policy reform and tax administration reform is not, in itself, easy to achieve. Different forms of expertise are needed, different counterparts are involved and different working methods are needed. Such a combination could be done within a single project or between several projects (either donor funded or domestically funded). This raises issues of co-ordination and control. There is clearly potential for conflict and avoidance of responsibility here. Thus this “ideal” model heightens the need for effective management and monitoring of the project.

There is some empirical evidence (see Tanzi, 1987) that administration is more of a constraint for low-income countries. Tanzi surveyed 82 countries and found that the countries with the lowest per capita incomes were characterised by a high dependence on import taxes. The harder-to-collect direct taxes represented a lower proportion of income. Thus a poverty-oriented focus might suggest that an administration-led project was especially relevant in lower income countries. Mansfield (1988) also points out that typical tax administrations tend to unintentionally discriminate against the “modern sector” of an economy which tends to be larger-scale, more centralised and to keep better accounts. Improving administration may reduce this and assist in more widespread growth although some collection led strategies might emphasise the easy gains from targeting just such large organisations.

### 1.2 Is Improving Tax Administration Always Appropriate?

Donor action to support revenue collection will frequently be beneficial given the underlying importance of revenues to government operation. It is conceivable however that raising revenues collected might be counter-productive. This would arise in a situation where:-

- systems for planning or implementing expenditure were weak
- large-scale abuse of public revenues existed
- the underlying tax legislation was taking too high a proportion of income given overall economic conditions and broad public policy

Clearly, as a minimum, donors would need to take a view on all of this before embarking on a programme of support to tax collection.

It would be possible to include conditionality related to some of these aspects in a project. The most likely field for this appears to be in relation to overall government expenditure planning and control systems. Whilst in theory this may be entirely appropriate, our feeling was that this would overload projects with conditions. In general revenue projects suffer from failure by recipient governments to deliver on conditions directly related to the revenue function (e.g. on the supply of counterparts in South Africa initially or in human resource policy changes in Mozambique). At a detailed level it did not seem practical to attempt to use a tax project to leverage changes in distinct policy fields. However donors may wish to retain this conditionality in cases where there is a large risk of failure to use resources wisely so as to allow an exit route in extremis.

An alternative approach is the pursuance of complementary projects within a country. Thus a tax collection project might be accompanied by projects specifically aimed at expenditure management. This might be funded by a single donor or be the result of co-operation between donors. In Ghana a number of projects in the financial management field are proceeding in this way.

### 1.3 Improving Performance or Improving Capacity?

A fundamental distinction can be made between projects that emphasise direct immediate improvements in the performance of revenue collection agencies and those that emphasise improvements in the capacity of the agencies. In practice this distinction is of course blurred since most projects are able to achieve progress in both types of objective and any improvement in capacity will be directed towards (eventual) improvements in performance. The distinction is useful however since it affects the way projects are conceived, specified, delivered and monitored. Any emphasis that does exist for one or the other of these objectives will have consequences for the interventions that are adopted and for the way success is perceived. The following sections explore these objectives in some detail to clarify these issues and to explore to what extent the two sets of objectives are complementary or in conflict.

### 1.4 Improving Performance

This section explores the nature of the performance objectives of revenue agencies and the implications this has for projects in this field.

A project that had the aim of improving the immediate performance of revenue agencies would in effect have the same aims (or a subset of them) as revenue agencies themselves. These can be summarised as:-

- maximising revenue collected
- minimising the costs of collection
- minimising the cost of compliance for tax payers
- enforcing limitations on imports and exports
- administering the tax law and policies appropriately
- administering the law equitably.

These aims will vary in their importance depending on the exact circumstances of the country, the particular agency concerned, policy on taxes etc. For example the role of UK Customs and Excise with respect to revenue collection has declined in relative terms with the development of the single European market. This has allowed more effort to be directed to other objectives including the enforcement of anti-drugs laws.

In South Africa recent history during the sanctions-busting period gave Customs only a limited role in enforcing import rules whilst border security became predominantly the responsibility of other agencies.

Typically the revenue collection function is seen as the prime responsibility of revenue agencies. This is more obviously true for those agencies dealing with “inland” or domestic revenues. Whilst taxes can themselves have many objectives (promoting particular activities, discouraging others, influencing family structures etc.) these are generally seen as policy functions and the responsibility of the tax revenue agencies is to administer the tax laws as they exist maximising revenue within the terms of those laws. This function clearly has fundamental importance in the context of an overall programme of sustainable development. “Sustainable” must mean sustainable in terms of finance as well as of government technical and policy capacity. An effective revenue collection function thus forms a cornerstone of public sector reform. Revenue collected must reflect the needs of the country and its resources but this remains an issue of tax policy rather than administration.

Constraints on maximising revenue have traditionally been seen in terms of the costs of collection. In part this is a matter of policy - some taxes may never be cost effective to collect. However there is a large range of issues where the performance of the revenue agency will influence the costs of collection and hence the net receipts of a tax policy. In some cases this implies a degree of discretion by the revenue authorities - pursuing some tax may be counterproductive in terms of net receipts. This is of course a difficult issue - the use of discretion can be abused for corrupt or political reasons, discretion may reduce the perceived credibility of the tax system.

More recent studies have additionally emphasised the costs to taxpayers (and possibly other economic agents) of tax collection. This can be seen in a number of ways:-

- cash costs e.g. in employing specialists to complete tax returns
- time costs e.g. in waiting for goods to be cleared by customs
- flexibility costs e.g. in only being allowed to import goods through certain border crossings.

These costs have an impact on the economy by affecting the profitability of different forms of enterprise. In South Africa for example there was clear pressure from the business community to cut down on time taken to clear customs and the project was successful in addressing this. In general such costs should be minimised although a Machiavellian strategy might identify these costs as a way of reducing undesirable activities. In the past for example some countries in Europe have been accused of deliberately imposing these sorts of costs to discourage imports especially from the Far East.

More widely transfers of costs from revenue agencies to taxpayers or to businesses have sometimes been seen as cost effective. Initiatives such as self-assessment or the collection of airport passenger taxes by airlines may reflect examples where public sector costs are reduced but at an increased cost to taxpayers.

For customs the role of tax authorities is crucial in enforcing limitations on the import and (to a lesser extent) the export of certain sorts of goods and, occasionally, services. This can be seen principally in terms of prohibited goods such as drugs, pornography or firearms. In export goods it is typically cultural goods that are affected but there are others including animal products and strategic raw materials where the government wishes to protect a domestic processing industry. Customs can get involved usually in association with other agencies in the enforcement of immigration rules.

In the case of domestic trade the role of revenue authorities tends to be more limited and to be less easily separable from the revenue collection function. The enforcement of domestic rules against prohibited goods tends to be the preserve of police forces rather than revenue agencies. For example in the UK the involvement of Customs and Excise in enforcing rules against illegal distilleries or misuse of agricultural fuel subsidies is essentially a revenue protection activity.

Clearly it is not true that tax authorities only exist to maximise revenue. The most obvious example of this is the role in enforcing prohibitions against goods. More widely however tax policy, as already noted, can be directed to non-financial aims and the tax authorities should be enforcing these even where there is a cost. (It is of course arguable to what extent tax is an appropriate policy for achieving such ends - the claim here is simply that, if the government has such a policy then the revenue agencies should implement it.) For example it is conceivable that a government might introduce a tax on say, smoking, at a level that was sub-optimal in terms of revenue maximisation for health promotion reasons. Selective enforcement of such a tax might increase net revenues but would not be an appropriate choice for the revenue agency itself to take.

A final aspect of policy which is really a special case of the last point is that revenue authorities should be administering the law equitably. Issues of practicality in maximising net revenues or limited capacity may mean that taxes are selectively enforced. A risk exists that this is done inequitably. One common perception is that richer people by using expert tax advisers can cut their tax bills in ways which are not available to poorer people. It could conceivably be cost-effective for a revenue authority to tolerate this since the time it uses in fighting such cases could be directed towards taking on easier cases. Thus potentially tax administration has a negative impact on poverty. This role is limited in most countries that we examined because of relatively high thresholds for the application of main taxes like income tax or corporate taxes. This leaves the most potential for such activities as being the administration of taxes that affect small traders.

Similarly it is conceivable that gender issues might influence tax administration. The primary impact of tax on gender is clearly through the underlying tax policy e.g. the policy on family allowances, treatment of child care costs etc plus the policy on taxes that particularly affect sectors where women are economically active such as, say, market taxes.

In summary, the widely perceived simplicity of the aims of revenue authorities actually masks a rather complicated set of objectives. A revenue authority has to balance a number of objectives. Where resources are limited or where the agency is going through rapid change, this balancing is perhaps particularly difficult to get right. Effective donor interventions will need to be clear about which of these aims matter most and about the impact that projects may have on aims other than the ones adopted. In the past some criticism has been levelled at donors such as the IMF for focusing exclusively on the revenue raising functions.

### 1.5 Improving Capacity

Improving capacity implies a range of activities in, for example, human resource development and institutional development. Most typically training interventions and organisational reform have been attempted. These will not be explored in detail at this stage and are pursued in chapters 2 to 6. However clearly the intention of a capacity-building project in this area will normally be to improve subsequent revenue collection capacity. This might be related to existing tax instruments or to the capacity requirements of a new tax instrument (most typically VAT) which is being introduced for other policy reasons.

Conceivably a capacity based project in revenue might have as an additional aim the piloting of particular approaches for subsequent application elsewhere in the public sector. We did not find this to be the case in any of the projects we studied although there certainly was discussion about whether this might prove to be a side-benefit.

### 1.6 Improving Performance and Capacity?

In practice all the projects we looked at had some element of capacity building in their objectives. This reflects the desire for sustainable development that was discussed earlier and few would query this as a norm for donor intervention. Two questions arise:-

- can current performance be improved alongside capacity building initiatives?
- Is a project directed exclusively towards current performance ever justified?

The clear answer to the first question is that an effective capacity building programme will almost inevitably improve current collection. By this we mean that effective capacity building will involve practical hands-on learning that is applied to real cases (as opposed to purely classroom learning say). If the capacity building itself is correctly formulated then some improvement in performance must follow.

A stronger answer to this question would be that improvements in current performance are necessary for a capacity-building project to be successful. A number of reasons can be cited for this:-

- senior politicians in the country concerned are likely to need extra income to achieve their objectives for their country. Their support for a long-term capacity building project will diminish if they cannot deliver rapid improvements.
- The motivation of counterpart staff will be difficult to sustain without perceived success
- possibly the interventions needed may be hard to realise after consultants have departed so effective demonstration of potential success is a necessary (but not sufficient) precondition for subsequent reform

An emerging consensus therefore holds that “quick wins” are necessary for a capacity-based project. The problem with such an approach is that the two differing sets of aims are hard to reconcile when both are not being achieved. In Uganda for example there was a clear conflict between simultaneously set objectives of short term revenue gains and long term system improvements. A carefully designed strategy that clarifies which activities contribute to such objectives is one way to diminish this conflict. In Zambia managers consciously devoted two weeks of each month to collection activities as opposed to development or capacity building reflecting the urgent need to collect income. That project is a large-scale one where the DFID support effectively is to the organisation as a whole by funding top managers in addition to short term consultants. A smaller-scale project could conceivably be more wholly devoted to long-term issues without the need for quick wins.

The potential for conflict between long and short term objectives suggests that a fully trust-based relationship between donor and contractor and counterpart is necessary where the balance between these objectives can be discussed and inputs adjusted accordingly. These issues are discussed more fully in chapters 7 and 8..

**Conflicts between Short and Long Term Objectives in Malawi**

A Joint Project Review by DFID, the IMF and the Government of Malawi in June 1997 noted that:-

> With hindsight it was clear that there was a tension in the project between revenue raising on the one hand (requiring line officers) and building institutional capacity (requiring an advisory, facilitatory role on the other. To date, there has been a clear trade-off between the two.

At a detailed level this discussion suggests that careful project design is needed to establish which elements of the project contribute to eventual capacity building and which generate quick wins with effective management to secure the planned results.

It should be noted that the co-existence of short and long term objectives has important implications for how projects are monitored. By definition the short-term objectives are the ones that can be best measured (in output as opposed to process terms) during the project. This can skew the impact of monitoring and hence of implementation. This issue is discussed further in chapter 8.

The second question of whether a purely performance-oriented project is ever justified is interesting. The only strong candidate for such a project would appear to be an economy where there is a major shortfall in current revenue that is so serious it is interfering with the basic functions of government. Even here it is arguable that a capacity-building element should be added alongside an immediate revenue collection objective given that eventually some degree of local capacity will be needed. Additionally there is a question over what the donor role in a pure performance-related project is since a revenue collection project would be such a clear contender for being self-financing. Donors might add some experience in project design and management but their funds would not be critical to such a project if the contractors were sure of their success.

### 1.7 Conclusions

In summary:-

- tax administration projects should be integrated with policy reform initiatives and proceed in parallel
- prior to committing funds to revenue projects there should be an analysis of whether expenditure planning and control systems are adequate to ensure reasonable usage of funds collected but generally this should not be part of the conditionality of projects
- projects need to clarify the relative importance of differing underlying objectives of tax administration
- generally capacity building issues should dominate over immediate issues of tax collection performance but usually a worked-out strategy for achieving "quick wins" is necessary
- pure current collection projects will rarely be appropriate for donor financial support but may, in limited cases, be appropriate for donor management and design assistance.

# 2. Generic Technical Assistance Issues

## 2.1 Introduction

Tax administration projects suffer from a range of problems that affect technical assistance projects generally. The World Bank's Operations Evaluation Department concluded in its study of Technical Assistance (1996a) that "outcomes have varied widely, but overall the efficacy and cost-effectiveness of TA has been disappointing, especially in Sub-Saharan Africa". These problems have been widely studied (e.g. Berg, 1993) and thus here only the features that specifically affect tax administration are examined.

## 2.2 Political Commitment and Political Interference

It is widely recognised that strong political commitment is necessary to achieve reform in government. This is to combat *inter alia* entrenched opinions, to deal with the resistance of special interest groups and to push through reforms that challenge inappropriate access to power or public resources. Tax administration suffers potentially from all of these:-

- a strong established civil service with standard conditions of pay
- possibly a legacy of corrupt practices by tax administration staff
- powerful voices on the taxpayer side resisting effective implementation of tax laws

On the other hand there is a risk of political interference. This might be motivated by personal interest, by adherence to the interests of some group in society or merely be the result of incompetence. Tax administration's role in enforcing the state's monopoly on taking resources by force gives interfering politicians scope for abuse of power.

**Political Commitment in the South African Revenue Service**

Support for the South African Revenue Service comes from a senior level. A Deputy Minister of Finance has the lead political responsibility for the agency. She is committed to the principle of a unified and quasi-autonomous institution and has a strong hand in setting SARS' mission and overall strategy. She has however remained apart from issues of detailed operational matters like individual tax assessments and appears to have given the top management reasonably free rein in implementing SARS' strategy. Unusually in South Africa there is not only strong commitment from politicians but the underlying ideas on improving revenue collection appear to emanate from them rather than from donors or consultants.

Similarly Morrissey (1995) identifies political commitment as a major determinant of the success of tax reform in Tanzania.

Issues of the relationship between political commitment, interference and governance are discussed more fully in chapter 5 which reviews explicit attempts to move away from conventional governance structures.

## 2.3 Sustaining Commitment: A Partnership Model

Commitment needs to exist not only at the outset of a project but throughout its life. Generally the projects we examined identified the need for such commitment and labelled possible decline in commitment as a risk. Projects were initiated where this risk was considered to be sufficiently small.

A more radical strategy would be to regard the sustenance of this commitment as an integral element of the project. This would be in line with DFID's commitment to partnership approaches. The question then arises of who should sustain the commitment - DFID or the contractors? The obvious answer is both though this will depend on the project. A large-scale project at the centre of a country's tax collection efforts may give the scope for contractors to deal directly with senior politicians. In Zambia for example the DFID supported Chief Executive of the Revenue Authority was able to have regular meetings with the President. This example illustrates the difficulty however of suggesting blueprints for governance arrangements. Access to a President can weaken the legitimate role of the Ministry of Finance. In practice a view needs to be taken over the potential sources of effective senior support and over where it is most likely to be achieved.

For smaller-scale projects this level of contact may be impossible to achieve at the contractor level. In project design and in setting up counterpart relationships it would be sensible to seek formal access rights for contractors wherever possible at both a senior level in the revenue organisation and in its sponsoring Ministry. Specifications of contractors roles could then emphasise this activity.

For any project, DFID potentially has access to politicians and its role as the supplier of finance as well as of expertise gives it legitimacy. Such access can encourage politicians to take difficult decisions which might otherwise be neglected. This already happens to some extent - in one country we were told that the biggest achievement of DFID had been in persuading politicians to sack a particular under-performing senior manager. Scope for more of this exists but it obviously brings risks of being accused of meddling or of getting involved in factional fights within government. The partnership role thus has risks if it is proactive.

## 2.4 Effective Management

Another generic weakness of many technical assistance projects is the lack of effective management in the organisation. Effective management includes a range of leadership skills. In the context of tax administration our impression was that this factor was often the single most important determinant of tax agency performance. The detail of some of these actions is discussed in chapter 3.

**Strong Management in the Zambian Revenue Authority**

In Zambia a strong Chief executive was brought in. He took firm action on corrupt staff, prioritised areas for management action, established a programme of recruiting qualified and experienced staff to take on senior management roles and backed a programme of generous remuneration to support his staff.

In the context of tax administration the willingness to confront staff corruption is especially crucial since this can frustrate a wide range of other reform activities. More widely however there is enormous scope for simple, straightforward management reviewing systems and procedures to see if they do what they are meant to, and for managing the performance of staff.

It has been suggested that some of these changes are easier for expatriate managers to achieve perhaps because they come from a different management culture, because they lack particular ties to existing individuals or groups of staff or because they are only to be in post temporarily. In the long terms sustainability and domestic political needs are likely to make it difficult to employ expatriate managers on a permanent basis. In Uganda for example there was clear political opposition to the employment of expatriate managers although this seems to have recently receded to some extent. In the west this is becoming commoner with e.g. American managers of UK companies. Conceivably the political objections to the employment of expatriate managers in e.g. Africa will diminish but in most countries in the near future it will remain hard to persuade politicians to appoint long term expatriate managers. This opposition will be harder still in the case of western, white managers. There is some mixed experience with the use of expatriate managers from other African countries.

Where domestic managers with the right abilities do not immediately exist the employment of expatriate managers on a temporary basis may be appropriate to achieve a one-off change in systems and attitudes. In this case actions to recruit and develop successors will be especially crucial.

A related question in tax administration is how far do senior mangers need to be technical tax experts. Our conclusion here was clearly that a strong manager capable of leading a large organisation is more important than a strong tax expert at the very top of an organisation. This is however subject to the proviso that a top manager who is not himself or herself a tax specialist must have access to expert tax advice. This reflects our overall conclusion that generic management skills were the most important determinant of success.

### 2.5 Adequate Counterparts

Another generic failing of technical assistance projects is weakness in counterpart arrangements for providing local staff with whom contractors or TCOs can work. Where counterparts are insufficient in number or quality they threaten both the short term achievement of activities and the longer term sustainability of results. In some countries this is an endemic problem reflecting existing weaknesses in staff recruitment, retention and development allied to a burden of ongoing routine work that cannot slip.

In tax administration this was clearly a problem. Issues of detailed tax administration need intelligent and resourceful staff. In some cases they will need formal professional training in taxation, accountancy or support skills such as computing. Civil service systems of selection, remuneration and training often do not facilitate this. At the same time general retrenchment policies or market demands by the private sector may have encouraged the able to already pursue careers outside the civil service.

Solutions to these problems generally relate to other aspects of administration discussed elsewhere:-

- political commitment to taking staff with potential out of routine posts and deploying them as counterparts probably as a condition of the project
- effective collaboration between consultants and senior managers to persuade them of the benefits of deploying strong counterparts
- improving overall remuneration arrangements
- paying for counterpart costs (or the costs of staff covering for counterparts' routine tasks) through the project where these represent a one-off additional cost on development activities
- recruiting additional staff for high level or expert positions.

The familiarity of this issue tends to downgrade the attention given to it. Our conclusion was that this was critical. The importance of good links between operational management and consultants was particularly important for projects where middle and junior ranking counterparts were needed. In one project we observed activities at two different centres. In one, progress was being frustrated by a lack of counterparts; in the other there was considerable progress and reasonably effective counterparting. The explanation for the difference appeared to be in the skills of the consultants - one had established good relations with the local managers who were willing to deploy their staff accordingly; the other, whilst he had cordial relationships, had not been able to convince local managers of the priority for deploying staff.

In Zambia considerable efforts had been devoted to recruiting senior local managers from outside organisations aided by improvements in remuneration and freeing up of selection procedures (as discussed in chapter 5). This appeared to be providing the foundations for an effective local management cadre and for successful succession to the positions being filled by expatriate staff.

## 2.6 Conclusions

In summary:-

- political commitment is crucial and must be prioritised
- a partnership role both for DFID and for contractors in nurturing commitment throughout the project is desirable despite the risks
- strong management is essential and the project should provide it if it cannot be sourced domestically
- counterparting arrangements need to be secured as a critical precondition and projects should assist in financing this if necessary
- at the top of organisations leadership and generic management skills are more important than technical tax experience

# 3. Making Management More Effective

### 3.1. Introduction

The preceding chapter indicated that the factor perceived to be most crucial in achieving success was effective management. This chapter briefly discusses some of the elements of that in the context of tax administration. There are close links to the discussion of political commitment in the preceding chapter and to the discussion of governance issues in chapter 5 on revenue authorities.

Grindle (1997) identifies organisational culture as a key determinant of organisational success and as a reason for explaining the divergent performance of public organisations in developing countries. In this context the role of an effective senior manager can be seen in overall terms as creating a sustaining a culture that is supportive of high performance.

The World Bank OED (1996a) study mentioned earlier also supports this focus on personnel rather than specific technical initiatives:-

> "what matters most is the combination of the institutional environment and the qualities of the TA personnel. When the right experts are placed in settings conducive to training and skill transfer, as has happened in numerous countries from Botswana to China they have a significant impact. When these conditions are not met TA fails, no matter what the instrument used."

### 3.2 Targeting Resources, Planning and Monitoring

Effective managers devoted their resources to activities closely related to the mission of their organisation. In Zambia for example staff were switched from ensuring the completeness of tax returns to acting on the ones that were being submitted. (In the long term obviously a process of extensification would be needed to deal with non-filers but in the meantime collecting revenue mattered most.) By contrast in one South African customs office we were told the majority of staff were engaged in making tax reimbursements of various kinds leaving a minority to collect taxes.

**Planning, Monitoring and Supervision in Ghana**

Terkper (1995) reports on the central role of planning, monitoring and supervision in the Ghana National Revenue Secretariat. Research Planning and Monitoring Units were set up to monitor projections of both revenue and expenditure. Revenue collections for each collecting unit are monitored monthly within 2-3 weeks of the end of the month allowing rapid action to correct problems.

This cluster of activities represent a significant set of skills for an effective manager seeking to turn around an under-performing organisation.

### 3.3 Implementing Procedures and Systems

We were frequently told anecdotes about staff who were following systems to the letter with little understanding of why they were doing it. Clearer guidance about the underlying reasons for procedures such as inspections allows more sensible use of resources.

Similarly, often systems existed but were simply not being pursued. Failures to complete requirements by taxpayers were simply not acted upon. Much effective work in South Africa for example was done on improving basic record-keeping procedures.

These types of shortcomings give any experienced manager an opportunity to tighten up business processes and improve performance with only a most basic understanding of the technical aspects of taxation.

### 3.4. Human Resource Management

A fundamental weakness in many organisations lies in the human resource systems. To a large extent these were derived from general civil service rules and an individual manager in a conventional agency would have little scope for changing overall systems such as levels of pay.

However within these constraints there did appear to be some scope for improving performance. In South Africa variations between customs posts we observed sometimes appeared to depend on these factors. In one post, trade union resistance was cited as the source of problems whereas in another post it was said that an effective manager could avoid such limitations. Use of discretion over bonuses, promotion, rotation and other elements did seem to give power to some managers.

A particularly challenging area to deal with is the issue of performance management and performance-related pay. Conventional management thinking would suggest that this is one route to take within public organisations including tax authorities. To date it has tended to be of limited application with most developments being in revenue authorities because of their increased discretion over such matters. This reflects a wider lack of experience in introducing such changes in African Civil Services (see (Lienert and Modi, 1997). The limited experience to date means clear lessons are hard to draw. Coady (1997) identifies the payment of performance bonuses in Ghana as one of a package of measures that collectively led to increases of revenue in the order of 7-8% of GDP. The limited experience means that it is difficult to dis-aggregate the effect of individual measures so convincing empirical evidence is hard to come by.

There are obvious problems in an area involving enforcement and detection of encouraging over-eager activities. In South Africa performance bonuses tied to inspections had been tried but they encouraged numerous poorly targeted inspections. This is a good example of where bad incentive design can bring revenue collection into conflict with trade facilitation. Incentives tied to results rather than activities are clearly superior but many factors affect the ability to, say increase revenue collected, so equity issues within organisations can interfere with effective incentives. On the whole incentives tied to performance at team level may be more successful that individual incentives provided individual free-riding is not thereby encouraged. The ZRA had attempted this with some success although opinions on this within ZRA were mixed.

Trying out performance related pay in more projects clearly has some potential although careful monitoring is needed to avoid undesired consequences. Rather more promising may be the idea of performance appraisal without a necessary link with remuneration. We saw encouraging adoption of many of the principles of performance appraisal in the ZRA with systematic discussions between managers and subordinates over annual targets for example. It would appear possible to introduce at least some of the features of this in a conventional revenue agency that still lay within civil service structures.

### 3.5 Maximising productivity

The deployment of staff was clearly a factor in success. Whilst frequently limited by poor capacity in existing staff, imaginative deployment of staff did seem to offer potential for success. Rotation of staff between functions and areas had benefits for introducing new thinking and as, a side effect, limiting the development of collusion.

### 3.6 Confronting Corruption

This has already been mentioned as a key issue. Effective managers were willing to investigate corrupt staff, confront them and fire them. This often involved being willing to take on organised groups within organisations. Failure to do this will often mean that other reforms (e.g. to boost remuneration) will not realise their potential. Often civil service arrangements do not facilitate this and the revenue authority route (discussed in chapter 5) attempts to address this issue. One particular effective technique which was adopted (which may be possible within existing Civil Service rules although we observed it in the context of the ZRA) is the frequent rotation of staff between teams and between locations. Corruption by officers within the revenue agency may also be addressed, at least in part, through policy reforms that limit administrative discretion and thus reduce the scope for corruption (as described in chapter 1).

Corruption also sometimes involved attempts by politicians to intervene in individual cases. This type of corruption is not easily addressable by reforms wholly within a revenue organisation - even the fundamental institutional reform of the revenue authority does not really address it. Again a strong manager may be needed to resist these attempts. It was suggested to us that this was particularly difficult for domestic managers in some countries where a culture of corruption was widespread. Kant Patel et al (1997) confirm this from their study of reforms in least developed countries:

> It is almost always more difficult to introduce reforms in highly controlled regimes such as existed in pre-reform Bangladesh, where large influential interest groups have secured individually or collectively, property rights to rents derived from import protection or have managed to secure ‘special treatment’ with respect certain taxes. The reform process in a country such as the Gambia, on the other hand, was much smoother because there were no such major interest groups.

Some research (e.g. Van Rijckegehem and Weder, 1997) suggests that the wage levels needed to reduce corruption may be lower than has usually been assumed. This however depends on a number of factors and empirical evidence is inconclusive. However attempts to introduce improvements in wages may be especially worthwhile in revenue agencies either in conventional civil service structures or in revenue authorities. To date this has only be seriously tried in revenue authorities although Liniert and Modi

(1997) report some limited developments in introducing “scarcity” or “retention” allowances.

Chand and Moene (1997) report some success in the use of incentive payments to tax officials in Ghana. They emphasise however the importance of containing corruption at higher levels to allow such incentives to become effective

Overall experience in combating corruption is patchy with some signs of optimism but clear evidence that only a sustained attack on corruption has any chance of success. Cohen (1993) writing in the context of Kenya argues that in some cases corruption may be too deeply embedded to address.

Whilst an expatriate manager might be more willing to confront corruption (sometimes at some personal risk) this raises clear problems of sustainability. In the longer term, or where there is reliance on domestic managers from the outset a choice needs to be made. Tax administration efforts should be focused on countries where corruption is already at a manageably low level or where there is a credible effort at dealing with corruption across the public sector.

### 3.7 Administrative Structures

A number of administrative issues arise which are not really specific to tax matters. For example the relative roles of centralised versus decentralised offices or the role of support services. These provide potential for strong managers to make cost savings or to increase performance.

In Zambia there were plans to increase the outsourcing of support services like building security to reduce costs. In Kenya some moves had been made to introduce outsourcing of the audit of tax returns (by private sector accounting firms). Such outsourcing is a recognised part of the armoury of new public management techniques. It may well be appropriate to encourage this in projects but successful outsourcing requires considerable management effort and can founder on a lack of effective competition in the private sector or on the difficulties of specifying services. It would be unwise to make this an absolute requirement in projects without some prior study of the individual potential in a particular setting. Where, as in Kenya, there are particular staff skill shortages, contracting can (at a cost) allow an escape from civil service remuneration restrictions if the private sector has developed enough to be able to supply a credible alternative. It is however only one option for so doing and others, including the introduction of more flexible terms or the creation of a quasi-autonomous agency (see chapter 5) may be more appropriate. Terkper (1992) supports the use of outside tax auditors but points out that this is not a substitute for the improved profesionalisation of tax officials themselves.

The issue of decentralised offices was only a major issue in South Africa where a regional structure of offices had been set up but where the relationship with the Customs posts seemed awkward and unclear. In that case decentralisation was associated with the integration of different tax functions under a revenue authority. In the absence of this a decentralisation is relatively untested in tax administration and the well-known administrative difficulties in

One large-scale area for potential improvement is in the integration of administration for different forms of tax. This is discussed in chapter 5.

### 3.8 Changing Staff Attitudes

In line with the changes in procedures discussed above a number of changes in staff attitude at the point of contact with taxpayers were widely held to be desirable:-

- making staff more proactive
- encouraging initiative and discretion in the use of procedures
- encouraging professionalism
- moving from an obstructive bureaucratic mode to a customer care model (albeit one prepared to challenge taxpayers assertively where appropriate)

This cluster of skills probably requires intervention in the form of training and this was happening in a number of countries. Effective managers supplemented this by ensuring a consistent message came from the top and by supporting officers who had followed this approach (often requiring them to speak up forcefully in private or in public if their staff were criticised inappropriately).

### 3.9 Conclusions

In summary:-

- Projects need to recognise that substantial gains are likely to derive from non tax-specific improvements
- projects should recognise this by empowering strong managers to engage in these activities
- corruption needs careful consideration at the outset of a project since deeply embedded corruption, especially at the political level, may not be easily confronted
- where corruption is at a lower level, and especially at the officer level, a strong manager may be able to take it on especially if supported by flexible remuneration systems
- a range of activities by effective mangers should be considered including:-
  - the adoption of performance appraisal systems
  - systematic planning for staff deployment
  - contracting out of support functions
- projects should not be overloaded with tax specific techniques at the expense of fundamental management improvements

## 4. Innovation in Revenue Collection/IT systems

A large number of specific innovations in tax collection and in the use of IT have been adopted. This chapter reviews experience of the most significant approaches.

### 4.1 FAST Teams

Flexible Anti-Smuggling Teams have become a common approach in the customs field implying a small highly mobile team of high calibre officers with the organisational freedom and logistical support to enable them to roam freely to react to problems. Where there is widespread evasion e.g. because of a lack of customs coverage at borders or because of corruption within customs they can significantly raise the threat of detection and of seizure and other penalties. In South Africa the early use of this approach was successful in generating seizures. Strong use of publicity by the South African customs spread this effect and even some time later official business groups in South Africa spoke positively of the results of this exercise.

The clear problem with FAST teams is that they require high calibre staff who are honest and difficult to intimidate. In the short term expatriate staff can fill this role (as happened in South Africa). In the long-term sustainability may be a problem without complementary measures to improve staff recruitment and confront corruption.

FAST teams thus form a useful tool - they can contribute well to a quick wins strategy and demonstrate the potential that exists. With broader HR development strategies they can be part of a sustainable improvement but this is somewhat harder.

**Publicising Successes in South Africa**

The use of FAST style teams was very effectively publicised in South Africa, apparently at the initiative of SARS itself resulting in a large amount of positive high-profile coverage in newspapers and in other media. The attractiveness to the news media of stories about detecting smuggling undeniably assisted on this. Even some time after this initiative had largely ended local businessmen still spoke positively of the impact and regarded it as having a continued deterrent effect. Interestingly they tended to explicitly recognise the UK involvement as a positive benefit regarding seconded UK staff as being of high integrity and highly effective. The South African counterparts we met did not seem to see any negative side to the highlighting of expatriate involvement.

The South African experience with publicity (mirrored in some other countries like Zambia) is instructive. Whilst there is a danger of losing the support of local staff by highlighting expatriate involvement this seems to be manageable. The impression sometimes exists that there is a reluctance by DFID to promote their involvement in tax programmes. This may be justified for political reasons. However building in a publicity activity for such enforcement measures can be useful although wherever possible local staff should be fully credited for their involvement in the success.

### 4.2 An Emphasis on Audit and Investigation

More generally a move away from devoting resources to routine collection and towards investigation can prove beneficial. If targeted at large non-payers (or at groups of large non-payers) this could be an effective use of resources providing enough resources remain to keep routine functions at a satisfactory level.

Efforts at investigation focused on non-filers can be a key way of moving away from the "hunting inside the zoo" syndrome of enforcing higher assessments on existing tax payers whilst allowing those completely outside the system to remain unhindered.

In investigation there is again the possibility for expatriate operational staff to undertake functions directly with immediate results possible. Longer term approaches imply the delivery of training and the use of expatriates as advisers. South Africa again illustrates this approach. The second project has moved explicitly in the direction of these capacity building measures. They appear to be being successful in those areas where sufficient local counterparts have been assigned. However effective investigation requires high calibre staff with appropriate attitudes. This cultural change requires considerable effort to achieve and this would suggest that time scales need to be appropriately long to reflect this.

### 4.3 Risk Management

A related issue is the use of risk as a guide to the deployment of resources. In customs this is now widely understood - particular types of good are more likely to involve under-declaration, particular exporting countries are higher risk, particular exporters have bad records and so on. Formal computer systems exist to analyse this (see later) but this approach implies another cultural shift away from routine checking towards selective and targeted checking.

This may require higher calibre staff; it certainly requires new attitudes. Achieving this again requires strong management (at senior, operational and supervisory levels) plus training (perhaps on-the-job rather than in a classroom). This type of change was described to us in South Africa as the hardest to achieve. There we saw some evidence of effective local middle managers who had taken these changes on board and were operating in this new way with at least some of their staff. Their success indicated good working relationships between consultants and local managers and the selection of consultants with strong inter-personal skills.

### 4.4 Large Taxpayer Units

The use of large taxpayer units is now common in many developed countries and has been adopted in a number of countries in Africa. It forms a tax-specific example of the general technique of focusing resources where they can have the greatest impact. Since a small number of taxpayers will pay (or should pay) a large proportion of taxes due this can yield rapid benefits in tax collection. The best staff can then be focused on these cases in terms of processing returns but also in more proactive audits and investigations.

One parameter that is difficult to set is how wide the net is drawn. South Africa had started with a unit covering the largest 10,000 businesses which, although South Africa has a large commercial sector, seems to draw the net rather too widely. Experience suggests that an evolutionary strategy with quite small numbers is appropriate at the outset with possible extension as successful implementation comes.

This area is one where it could be easy for expatriate staff to take on operational functions and achieve quick returns with limited sustainability. Assuming that capacity building is an explicit objective it will be crucial to set up appropriate training, supervision and monitoring systems to support an effective unit. This is likely to require some degree of cultural change to be fully successful. There may also be opposition from existing offices who see some of their more substantial, possibly more interesting and possibly more remunerative (in unofficial income) cases being taken away from them.

### 4.5 Valuation Indices

In customs it is now widely believed that a major source (perhaps the major source) of revenue loss is not pure smuggling but under valuation of goods that are presented to customs. This includes both mis-declaration of the amount of goods, the category of goods or directly their monetary value. In some cases where existing systems have focused on bureaucratic approaches to completing forms there has been little effort to challenge importers' valuations. This forms a parallel in customs to efforts at audit in direct taxes.

There are similar HR issues here as with the closely-related issue of risk management - both imply a more thoughtful approach to processing imports with better trained and supervised staff needed. Success can be supported by computer systems and moves in Mozambique emphasised this as one approach with some success.

### 4.6 Tax Amnesties

Experience of tax amnesties is limited and the IMF has been sceptical of the effectiveness of such initiatives. The ZRA was considering such an initiative in particular sectors such as textile trading where substantial evasion was suspected.

Evidence on this is insufficient to form firm conclusions suggesting limited trials as in Zambia are worthwhile. Clearly the important issue is to ensure that more is gained from taxes collected than is lost by offering immunity. This requires the devotion of adequate staff resources to processing those who make declarations under an amnesty. An amnesty also needs backing up by a realistic chance of subsequent detection for those who do not declare and by effective penalties. There was a suggestion in Zambia that some of the defaulters in textiles were foreign nationals whose residence or work permits could be revoked. This appeared to be an effective

threat although it does perhaps raise equity issues if tax enforcement utilises such penalties.
Careful control of the messages that amnesties send is needed. The danger exists that if frequent amnesties are adopted then credibility of routine tax enforcement is lost. Tanzi and Pellechio (1997) report that earlier evidence on amnesties shows a tendency for them to become institutionalised.

### 4.7 Improving Enforcement

Difficulties in prosecution were frequently mentioned to us as a problem in revenue agencies. This usually reflected overall weaknesses in a country's prosecution and justice systems. Lengthy periods before cases were heard, inadequate legislation to support search and seizure and weak penalties were common whilst in some cases the basic honesty of the judicial system was in question.

Much of this is hard for a tax administration project to confront. One possibility, as in South Africa, is to give revenue agencies prosecutorial rights. More widely, improving specific legislation governing tax agency powers in investigation can help and has happened to a limited extent in South Africa. A more radical approach would be the setting up of special courts to deal with tax cases speedily. The revenue gains (in fines and goods seized) could easily make this self-financing even ignoring the increase in taxes collected via a deterrent effect. Thus far this does not seem to have been widely attempted presumably because it would require considerable political commitment cutting across government departments. Where courts have been willing to impose clear decisions and seize goods and take other sanctions, as in Lesotho this does seem to have had a positive effect on reducing evasion.

### 4.8 Computer Systems

DFID support has gone into developing computer systems in a number of countries including Zambia, Mozambique and South Africa. One general feature is that sometimes efforts to develop particular computer systems have been decided upon in advance of an overall IT strategy for the relevant organisation or a strategy for the use of Taxpayer Identification Numbers (see below). In Zambia this was said to be the case where systems for particular taxes were embarked on without an overall IT strategy for the ZRA.

This is clearly sub-optimal and reflects a more general issue of sometimes inadequate diagnostic stages to projects.

The benefits of computer systems are various and include:-

- allowing more flexible interpretation, analysis and reporting of data e.g. for risk analysis
- allowing faster and more flexible sharing of data between different tax units or functions
- saving costs e.g. in billing, accounting and filing

- reducing taxpayer compliance costs

The saving of costs is likely to be much less relevant in low wage economies leaving the other issues as the most significant. Peterson et al (1996) support this finding arguing that computers “promote effectiveness reforms by changing procedures rather than efficiency reforms by accelerating the throughput of data”.

The use of computers for data analysis relates closely to some of the initiatives discussed earlier. This has been most clearly developed in the customs field. The widely used ASYCUDA system in its most recent versions does provide information that would assist in risk management strategies and valuation. Earlier versions do not. Rather worryingly UNCTAD who control and install ASDYCUDA still install earlier versions of ASYCUDA in some countries. This is said to be for reasons of capacity in those countries but it would appear that UNCTAD’s own capacity is limited and the rate of upgrade to newer versions appears slow.

This raises questions about the desirability of UNCTAD continuing to control ASYCUDA. Whilst UNCTAD was successful in innovating with ASYCUDA and whilst it has a continuing legitimate interest in the trade statistics which are a prime output is arguable that ASYCUDA would be better managed and resourced in the private sector. This might free up competition for ASYCUYDA which is currently limited in terms of products which are designed for application in a variety or organisations (as opposed to systems developed for particular countries which are generally not being marketed internationally).

The perceived status of ASYCUDA as a world standard is clearly over-stated. Many developed countries do not use it and there has been some experience of countries adopting it and then subsequently abandoning it because of performance concerns. However there is relatively successful experience e.g. in Ghana (see Tettey, 1997) although Tettey criticises the relative lack of customisation in ASYCUDA arising from its nature as an off-the-shelf package.

The main competitor to ASYCUDA is Crown Agents system but this has limited experience to date in its full version. In terms of developing a market for such products continued support to Crown Agents products would be desirable from a strategic point of view to give more choice to countries seeking such a solution. However this needs to be accompanied by effective ongoing assessment of the usefulness of the data produced.

Outside of customs there is even less of a market for products with in-house developments being the norm. Some effort to further promote solutions which could be adopted in other developing countries would be desirable.

In-house developments have suffered from the classic problems of IT projects - insufficient local resource allied to weaknesses in original specification. This has led to delays in implementation of IT solutions and dissatisfaction amongst at least some local staff about their involvement in say Zambia. This suggest that where IT developments are attempted it needs to be with a well-designed human resource strategy for relevant

IT skills and with an emphasis on effective specification within an overall systems strategy. Tettey (1997) emphasises the need for involvement of staff affected since they may react adversely to what they perceive as a threat.

Generally IT solutions are perhaps emphasised too much reflecting a tendency for progress in IT to be attempted before the organisation is performing sufficiently well on manual systems to determine needs adequately. Lesotho had taken a conscious decision to not make use of computer systems until it had made more progress in improving the basic underlying manual systems. Peterson et al (1996) argue that a modular approach to computer systems can alleviate some of the problems of IT development by avoiding the need to await overall restructuring. Glenday's 1993 survey of experience in Sub-Saharan Africa whilst identifying a range of problems suggests a number of ways of addressing this issue:-

- a step-by-step approach (consistent with Peterson's modular approach)
- an experienced project manager or team
- reform within a revenue authority structure (to facilitate appropriate remuneration) - see chapter 5

In some cases communications infrastructure problems may limit the potential for using IT to the full. In Lesotho there were problems in linking between regions especially in the case of remote border posts. The development of communications means that these difficulties are likely to reduce rapidly which may make future project developments in this area more attainable.

This suggests that overall initial diagnosis is particularly crucial in the field of IT and that sequencing of projects should not put IT developments too early on. A distinction needs to be made here between the computerisation of existing tax collection systems and the computerisation of new taxes. There is considerable success in utilising computers for new taxes such as VAT in Zambia. This reflects a number of factors:-

- introducing a new system is easier when there is no manual system that must run in parallel
- the timetable for introducing a new tax (provided it is itself sensible and there is political support) can focus resources on effective systems development.

For existing systems the classical difficulties of introducing IT systems can mean that progress is terribly slow even for a relatively developed system like ASYCUDA (see Tettey, 1997).

Compliance costs for taxpayers did not figure as highly in IT projects relative to factors internal to the revenue agencies. In more developed countries considerable effort is being put into the electronic interchange of data to speed procedures. This is most noticeable in customs where, allied to the changes in trade brought by containerisation, there is considerable scope for such developments which have been exploited for example in Singapore. This can reduce compliance costs and make enforcement more effective (see Jenkins 1992). Some early moves towards electronic interchange have happened in South Africa but with local import agents rather than, as in Singapore involving the dispatch of information from exporting countries. In the longer term these developments along with electronic submission of tax returns (initially for businesses) are likely to form an accelerating priority as access to electronic communications spreads.

Overall computerisation offers potential but, as almost all writers on the subject have noted, it is not a “magic bullet” and requires overcoming the same obstacles that cause poor revenue performance in the first place.

### 4.9 Taxpayer Identification Numbers

The use of single taxpayer numbers is widely seen as a key measure in the sharing of data between different forms of tax collection. This could be between different tax organisations or within an integrated revenue authority.

In theory a single taxpayer number allows simple comparison of data and thereby the detection of inconsistencies between data submitted to different tax collectors. In practice this is hard to achieve because the point of tax collection may not be identical across taxes for all taxes. Some taxes for example are collected at factory level requiring a number specifying the factory whilst other taxes are collected at company level. This tends to suggest a dual number system with all entries capable of being cross referenced by a single number set at the level of the legal entity. Achieving this has proved hard where it involves working with systems designed for separate tax agencies. In Zambia for example progress on this has taken considerable time.

This approach needs to be considered along with overall IT strategy and sensitively timetabled into projects where it appears worthwhile so that efforts to get it working do not overwhelm more immediately beneficial activities.

### 4.10 Taxpayer Education, Taxpayer Service and Compliance Costs

Voluntary compliance by taxpayers with their legal obligations represents a cheap and effective route to revenue collection. This suggests efforts at improving taxpayer education may prove successful. Several countries had attempted this although it is hard to desegregate the empirical effects. Use of advertising in various forms better leaflets and other information, clearer form design all appeared to help and had been attempted in. e.g. Zimbabwe, Zambia and South Africa.

Terkper (1996) identifies taxpayer education as a major failing in the abortive attempt to introduce VAT to Ghana. This confirms the special nature of education in the case of a major policy change which brings with it major administrative change. In Zambia, for example, education was much more effective emphasising a simple message that costs would not rise.

More widely providing better service through telephone help lines, attractive reception areas, more friendly staff had been attempted. A current trend is to centralise such services in Taxpayer Service Centres - this has been tried in the Philippines for example (Jenkins and Terkper, u.d.). Jenkins and Forlemu (1993) argue strongly for these sorts of measures on the basis that they reduce compliance costs in themselves as well as increasing revenue collected. They acknowledge however that the costs of such programmes can be hard to meet up-front and that there is potential for abuse of data collected in the name of customer service. The cost problem suggests that this is particularly suitable for donor assistance representing a significant one-off cost followed by lower running costs.

### 4.11 Conclusions

This review of some of the innovations adopted clearly indicates that, whilst there is considerable potential for technical reforms in tax administration, they tend to depend on more fundamental development of staff, managers and organisations to achieve results.

Projects need to recognise this and devote sufficient time and resources to achieving the “soft” changes that this implies. Selection of personnel needs to reflect the fact that “state of the art” developments will rarely be appropriate in developing countries; rather simple focused reforms which target the key mission of the organisation.

# 5. The Revenue Authority Model[1]

## 5.1 Origins of the Revenue Authority Model

Revenue Authorities have their origins in the Executive Agency model, as developed in a number of countries, for functions which can be separated off into an arms-length unit. In developed countries there are numerous examples (e.g. in UK, the Benefits Agency, the Valuation Office Agency, the District Audit Service). In developing countries there are fewer examples, but the model is sometimes adopted for central banks.

The arguments for the Executive Agency relate primarily to effectiveness and efficiency

- as a single purpose agency, it can focus its efforts on the single task
- as an autonomous organisation it can manage its affairs in a businesslike way, free of political interference in day-to-day operations
- freed from the constraints of the civil service system, it can recruit, retain (or dismiss) and motivate staff to a higher level of performance.

Effective and efficient revenue collection is crucial to the success of the public sector, and indeed of the economy as a whole, particularly so in a poor country. In poor countries, public service systems often perform poorly. The model of the independent Revenue Authority is, therefore, an attractive one. In the case of the earliest examples,[2] Ghana (1985) and Uganda (1991), the dire financial position of the government required drastic action. Since then, at least in Africa, it seems to have become the "standard model", having been adopted in:

- Zambia (1994)
- Kenya (1995)[3]
- South Africa (1996)
- Tanzania (1996)
- Zimbabwe (1998)

Other countries e.g. Lesotho, are considering following suit.

In most countries, the driving force has been the need to increase tax revenues. But in some cases, notably Kenya and South Africa, the aim has not been to increase tax revenues (or at least, the tax/GDP ratio), but rather to improve effectiveness and efficiency of the tax administration system, potentially allowing reductions in taxes levied and thereby reducing the burden of the system on the economy and increasing equity between tax-payers and tax defaulters.

## 5.2 Arguments for a Revenue Authority Model

[1] Revenue Authorities have been known by a number of names: National Revenue Secretariat (Ghana), Revenue Board, Revenue Service; the term Revenue Authority is used here as a generic term to denote the independent, Executive Agency model.

[2] There were earlier examples, notably Jamaica (1981) (Jenkins, 1994)

[3] Of these cases, only Kenya did not have any significant external assistance with the introduction of a Revenue Authority.

Building on the general arguments noted above, there are a number of specific justifications for adopting the Revenue Authority model. These relate particularly to human resource management, and the constraints imposed by the civil service system. There are a number of aspects.

5.2.1. Remuneration

In most developing countries, particularly in Africa, civil service pay rates are extremely low compared to the private sector. It is therefore difficult for tax departments within the civil service to recruit and retain qualified staff, particularly key skills such as accountancy and IT. It is also difficult to motivate staff to devote their full attention to a job which does not offer them a living wage, and it is a common perception (although not entirely borne out by the evidence) that poorly paid staff are more likely to be open to corruption.

Nor is it simply a question of the level of pay but the narrow range between top and bottom grades which constrains the organisation's ability to attract and retain good managers. It may also be difficult, if not impossible, to pay staff an incentive bonus to reflect performance.[4]

By contrast, Revenue Authorities, established outside the civil service system, are able to pay rates which can attract quality staff, retain them once trained, and reward them for good performance. In some cases this has involved dramatic increases in pay rates. In Kenya, pay rates in KRA are about 60% higher than for civil servants, which may have been sufficient in most cases but insufficient for key skills such as IT. However, it is not always possible to sustain the higher levels of pay: in Uganda, the initial rates of pay have been eroded significantly by inflation, and there is a view within the Government that pay rates for URA staff should not be increased until the rest of the civil service has caught up.

The move to a Revenue Authority may also provide the opportunity to consolidate a range of allowances paid to staff, many of which may be non-monetised and tax free, and often given arbitrarily, into regular, taxable salaries, based on a logical categorisation of staff and performance appraisal (Coopers and Lybrand Inception Report on Tanzania, April 1996). Such an approach fits with wider civil service reform objectives.

5.2.2. Flexibility in Human Resources Management

In some countries, it is not so much a question of levels of remuneration (except perhaps for certain skills, or for top management) as the constraints imposed by the civil service system on human resource management: hiring, firing, promotion and rewards. In many countries, the regulations governing the public service make it extremely difficult to fire someone, no matter how inefficient or corrupt. In Lesotho,

[4] Prior to the establishment of SARS, the South African tax departments did pay bonuses to staff if collections exceeded the target, but the basis for this bonus payment was problematic, particular in terms of the criteria used; these criteria are now being reviewed.

examples were quoted of staff who had been suspended on full pay for months - even years - while the laborious procedures of the Public Service Commission were carried out. The public service system can also makes recruitment very slow: again in Lesotho, they have been waiting for months to fill a number of essential positions. In South Africa, recruitment of essential staff was held up by a blanket ban on public service recruitment, until the Act establishing SARS gave the organisation the power to hire staff directly.

In theory, at least, the Revenue Authority model gives managers much greater freedom to manage their staff in a businesslike way. But of course that freedom is not without constraints: any organisation, public or private, functions within a legal and political environment, and there can still be legal and political consequences of dismissing staff. In South Africa, the law setting up SARS requires consultation on all staffing matters with the Trade Unions, which in South Africa wield considerable power. In Lesotho, there appeared to be an unrealistic view that adopting a Revenue Authority model would solve all their staffing problems, despite the fact that in a small country like that, no organisation is immune from political pressure.

#### 5.2.3 Ability to Take Legal Action

In South Africa, one specific advantage cited is the ability to pursue legal action to recover tax arrears without having to wait for the State Prosecutor, which has a vast backlog of work. This enables SARS to take action through the courts much more speedily. This advantage was not mentioned in other cases (except Lesotho where, when prompted, they acknowledged this as a potential advantage of a Revenue Authority). Strictly speaking this change does not require an autonomous revenue authority but it may be easier to achieve alongside other structural reform especially if there is opposition from existing prosecutorial authorities.

#### 5.2.4 Integration of Tax Operations

The other often cited advantage of a Revenue Authority is the opportunity to integrate tax functions within one organisation. This provides the opportunity to structure revenue collection along functional lines rather than according to the separate taxes, and to gain economies of scale and information. In most countries, tax administration is divided between two or even three organisations: Customs and Excise, and Internal Revenue (dealing with personal and corporate income tax), with Sales Tax/VAT being attached to one or other of these, or being a separate department. There are potential gains in integrating tax administration functions, notably in the areas of:

- tax payer identification and records
- cross-checking liabilities between taxes
- accounting and auditing
- IT/computerisation
- legal services.

Many developed countries, e.g. UK, have more than one revenue department. The logical argument for this is that the diseconomies of integrating such large organisations outweigh the potential benefits, and that sharing of information does not require integration. It has been suggested that this is a matter of historical accident however and there have been proposals in the UK to unify the separate functions (see Bloom, 1997). Some developed countries such as Canada and the Netherlands have already moved in this direction (see *Tax Administration Review* number 16, u.d.)In developing countries, with a relatively small tax base and scarce professional resources, the arguments for integration appear to be especially strong.

It is, of course, perfectly possible, to integrate the operations of tax departments without adopting the independent Revenue Authority model. Nevertheless, establishing a revenue Authority provides an opportunity to bring about integration which might otherwise be resisted by the departments concerned.

#### 5.2.5 Other Benefits of Management Autonomy

Other potential benefits of autonomy include:

- flexibility in managing the budget to achieve the objectives of the organisation, without constraints of public service budgeting regulations
- a degree of protection from across-the-board budget cuts (this was cited in Kenya where budgetary cuts in the past had jeopardised revenue collection, thereby making the budgetary situation worse)
- giving the organisation control over its buildings and equipment, without being dependent on the Public Works Department, and being able to have their own Tender Board (cited in South Africa)
- reduced scope for political interference: although this can never be eliminated, autonomy makes such interference more difficult.

Much of this can be seen as giving the strong managers discussed earlier the scope to exercise their ideas across a wider range of the organisation's activities. The model might also facilitate the recruitment of such top managers outside of conventional civil service regulations. This might even extend to the appointment, probably temporarily, of an expatriate.

More generally, the organisational shift involved in this change may make it easier to introduce other changes. Introduction of a radical new structure may legitimate efforts to address matters which are not directly connected with structure. In particular this type of reform may be attractive to donors and senior politicians whilst acting as a context for more widespread reform in tax administration.

### 5.3 Arguments against the Revenue Authority Model

#### 5.3.1 Higher Costs

The Revenue Authority model usually involves higher costs, since one of the justifications is to be able to pay higher salaries. These higher salaries may be partly offset by reducing the number of employees, particularly getting rid of inefficient and corrupt employees. But in most cases costs will increase significantly. This can be justified if revenues increase: what matters is the ratio of collection costs to tax yield. The only question then is whether the Revenue Administration model imposes costs greater than are necessary to achieve the increase in tax revenue. This might occur because an independent body pays more than is necessary to recruit staff, particularly to those at the top, and uses its budgetary flexibility to indulge in costly offices and other overhead costs. This is particularly a risk where a Revenue Authority receives a percentage share of tax revenues, and has freedom to use these.

Has this happened? Costs have certainly increased with the adoption of Revenue Authorities, and in most cases there have been significant restructuring costs. Information on costs is not available in most cases, but the impression is that, although revenues have also risen, costs have increased as a percentage of revenue. This may well be acceptable, given the urgent need for additional revenues, but raises the question of what is an appropriate ratio of costs to yield.

In Zambia, costs are reputed to have increased to over 4% of tax revenue compared to a limit specified in the ZRA Act of 3% and a target of 1.9%. In most cases, the budgets of Revenue Authorities have continued to be constrained by their annual allocations from the Ministries of Finance.[5] Indeed, in some cases, it is suggested that funding has been too constrained, such that the Revenue Authority has not been able to operate to its full effectiveness. Where total revenue collected rises it might be reasonable to expect some increase in costs as a percentage of revenue collected reflecting the rising marginal costs of collection as more difficult sectors and taxpayers are addressed.

### 5.3.2 Is a Revenue Authority Necessary?

Whilst the dire financial position in certain countries (e.g. Uganda in the early 1990s) provides an obvious case for a Revenue Authority, the case is less obvious in others. In Lesotho, pay differentials between the civil service and the private sector are not all that great, except for certain key skills, and the main argument for a Revenue Authority appears to be the need for powers to hire and fire. It is arguable that this might be better achieved through a general civil service reform.

In Kenya, the case for a Revenue Authority was not based on the need to increase tax revenues, but rather to make tax administration more efficient and effective. If, however, costs increase, for the reasons discussed above, in a situation where tax revenues are not intended to be increased, then collection costs as a proportion of yield will increase. This reduces rather than increases efficiency. This may have been the case in Kenya, although figures for collection costs were not available. In such a situation, the only justification for adopting the Revenue Authority would be if improved performance (in terms of reducing evasion) lowered the tax burden on those already paying tax and/or increased equity between taxpayers and tax defaulters.

In South Africa, costs may not have increased much, since (with the exception of senior managers) salaries were not increased significantly with the introduction of SARS, although there were certain “transitional” costs. If these transitional costs achieve other efficiency gains in the organisation (e.g. by removing corrupt or inefficient employees), then the overall efficiency may increase. Unfortunately, information was not made available on collection costs in SARS.

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[5] Failure to obtain a funding system based on a percentage of tax revenues was, apparently, one of the main reasons for the early departure of the first Chief Executive of SARS.

As the Revenue Authority model becomes the "standard", countries which have less obvious need for this approach are tempted to adopted it. This may be driven by those in senior positions within the existing tax administration system, who have a vested interest in securing the higher rewards which the Revenue Authority would offer them. This may well have been the case in Kenya, where the reform was driven from inside rather than by external advice.

### 5.3.3 Impact on the Wider Civil Service

One consequence of the Executive Agency model is the fragmentation of the public service. This can have consequences in terms of inter-agency co-ordination and co-operation. In the case of the Revenue Authorities, this can bring some specific problems. One is that the higher remuneration within the Revenue Authority may creates jealousies on the part of those within the civil service with whom the Revenue Authority has to work: Ministry of Finance, police, immigration, courts, etc. This may lead to a reluctance to co-operate. The weakness of those parts of the civil service can jeopardise the performance of the Revenue Authority, and the pay differentials may make that problem worse. Higher pay within the Revenue Authority may also contribute to pressure for increased pay in the rest of the civil service (e.g. in Uganda).

Fragmentation of the civil service may also impede the overall reform of the civil service. Many countries which are adopting Revenue Authorities are also undertaking civil service reform. Such reforms are also directed at improving performance, and often involve increased flexibility over pay and employment conditions. Picking off particular institutions like tax administration may reduce the incentive for wider civil service reform, and make the process more difficult.

### 5.3.4 Risks of Autonomy

Giving an institution greater autonomy from the civil service carries risks. This is illustrated by the case of Uganda. The autonomy which protected the organisation from political interference and allowed management to improve performance, also allowed corrupt practices to re-emerge, thereby undermining the performance of the organisation. As a result, the Minister of Finance had to step in and remove the Board and some senior staff, in order to get the organisation back on track. Thus, autonomy does not guarantee anything, and an appropriate regulatory environment is still required.

## 5.4 Governance Framework

### 5.4.1 Boards

The Executive Agency model, derived as it is from the private sector corporate model, seems to require a Board. The standard pattern for Revenue Authorities has been to establish a Board with representatives of the government and the private sector, to ensure that the interests of both the government and the tax-payer are represented.[6] Yet

[6] Interestingly, in South Africa, the Board was only appointed some time after SARS was established.

it seems that the Board has been one of the main sources of conflict in the Revenue Authorities. There are a number of ways in which problems have manifested themselves:

- Board members, and particularly Board Chairmen, having been appointed, feel the need to exercise their power; there are many examples (Uganda, Kenya, Zambia) of the Board interfering in day-to-day management of the organisation, particularly in employment matters, even in relation to junior level staff

- as a result, relationships between the Board and the Chief Executive/Commissioner General are often very strained

- Boards tend to be dominated by government appointees, and even the private sector “representatives” may be government nominees; as a result, the private sector does not perceive its interests as being represented; even so, Boards are often riven by conflicts between the government and private sector representatives (e.g. Kenya). Zambia appears to provide a better example of private sector representatives carrying out their stated role suggesting that the appropriateness of private sector representatives will depend on individual circumstances, on the particular people chosen and on the nature of any organisations they represent.

- the presence of the Permanent Secretary (or similar) of the Ministry of Finance on the Board (as in Kenya) compromises the ability of the Minister of Finance to regulate the Revenue Authority

- the remuneration of Board members on the basis of meetings attended, rather than as a lumpsum honorarium, was also cited as a problem in the case of Zambia.

#### 5.4.2 Relationship with the Government, particularly the Ministry of Finance

Another major source of tension is the relationship between the Revenue Authority and the Government, particularly the Ministry of Finance. This has a number of manifestations:

- overt political interference: in Kenya, the head of one of the departments within KRA was removed on instructions from “above”, as was the Board Secretary, despite objections from the Commissioner-General

- in Zambia, the head of ZRA has direct access to the President; whilst this has offered ZRA a high degree of protection, it cuts across the logical line of authority to the Minister of Finance and may have created conflicts

- in Kenya, heads of individual tax departments continue to deal directly with the Ministry of Finance, thereby undermining the position of the Commissioner General; the same applies in Lesotho (although not yet a Revenue Authority)

A particular issue relates to responsibility for tax policy. In principle, the Minister of Finance should be responsible for tax policy and the Revenue Authority for implementation. However, there appear to be cases where this has become confused, with the head of the Revenue Authority undermining the position of the Minister of Finance over tax policy. Of course, the Revenue Authority has a duty to provide the information on which the Minister of Finance can base policy. In addition they can often usefully highlight loopholes in existing tax legislation and suggest aspects of legislation that impose uneconomic collection costs. On occasions, Revenue Authorities appear to have either gone beyond their duty to provide information and trespassed into the policy area, or have failed to provide the necessary information.

## 5.5 Internal Organisation

5.5.1 Functional versus Tax-Based Structures

The common pattern for a Revenue Authority appears to be to have a Chief Executive or Commissioner General, with Commissioners for each of the main tax revenues (Income, Customs, VAT), together with a number of supporting units (IT, legal, administration, finance, etc.). Such a model does not fully reflect the functional approach, that is, restructuring revenue collection according to function rather than according to tax. However, it may be argued that there are sufficient differences in the way in which taxes have to be collected, and where they have to be collected (e.g. ports) that a completely functional approach is impractical.

SARS, on the other hand, appears to have adopted a functional approach, combined with regional structure. In the SARS structure, the management committee (EXCO) comprises the five Regional Managers and the heads of the seven functional departments (finance, human resources, law/administration, business systems, IT/communications, client services, special investigations). In this “matrix management” approach, the Regional Managers are responsible for the management of the service in their regions, while the heads of the tax departments in those regions (e.g. the Controllers of Customs) are responsible for technical aspects. This division of functions and responsibilities has not been clear or easy, and the change from an arrangement where the head of the tax department dominated, has required considerable adjustment in attitudes.

5.5.2 Integrating Departments

Where separate tax departments have existed in the past, integrating these into one organisation can be quite problematic. In Zambia, it has certainly taken time. Integrating the former departments of Inland Revenue and Customs & Excise has been one of the major problems for SARS, particularly because of perceived “cultural differences” between the departments.[7] The new structure of SARS is more like that of the former Inland Revenue than Customs & Excise, and in most cases it has involved Customs and Excise staff moving into the former Inland Revenue offices. Whilst there are good

[7] This “cultural difference” could be reinforced by the fact that the two former departments are receiving technical assistance from two different agencies; Customs & Excise from HMCE and Inland Revenue from the Swedish Tax Bureau.

reasons for this, it has left a feeling amongst some of the staff of Customs & Excise that they have been "taken over" or marginalised. This has been exacerbated by the functional and regional structure of SARS which means that the management committee (EXCO) includes no specific representation for Customs & Excise. On the positive side, however, integration has permitted a redistribution of staff within SARS which has been to the benefit of Customs & Excise.

### 5.5.3 The Role of Common Service Units

Whatever the structure adopted, certain common services are required: finance, legal, administration, IT. However, the role and position of these common service units are not unproblematic, particularly where the former departments already have their own separate systems. There is a risk that they may be unwilling to give these up, and even seek to establish their own separate service units, such as IT support, if they are not satisfied with the common services. This appears to have been an issue in Uganda, where a project review (Price Waterhouse, November 1995) emphasised the need for clearer delineation of responsibilities. These problems can be made worse where there is external technical assistance to one part of the organisation whose performance is being judged on the collection of that particular tax.

### 5.5.4 Decentralisation

Most countries have some system of decentralisation of tax administration, with local tax offices. However, there may be problems about the number, structure, role, function and staffing of these offices. An IMF report on Uganda (November 1996) noted that there were too many regional offices supervising local tax offices, and not enough skilled staff at the centre.

As noted earlier, SARS adopted a regional structure from the outset, but this was not without problems, in terms of the relationship between the Regional Managers and the heads of the tax departments in each region. Some in the organisation perceive the Regional Managers as an unnecessary tier of management.

### 5.5.5 Appointment of Staff

There are two basic approaches to the appointment of staff to newly established Revenue Authorities. One is to advertise all jobs, and require staff of existing tax departments to apply for their jobs. The other is to transfer all staff (perhaps with a few exceptions) to the new organisation. The former model, which was used in Uganda, provides the opportunity to get rid corrupt and inefficient staff, although, as the Uganda case shows, this does not prevent malpractices re-emerging. The latter approach seems to have been more common. In Kenya, there appears to have been a marked reluctance to remove staff, no matter how inefficient or corrupt. Clearly such an approach greatly diminishes the benefits of the Revenue Authority model. In South Africa, generous redundancy packages were offered prior to the establishment of SARS and many people were "encouraged" to leave. In the case of Customs & Excise, this resulted in the departure of most of the top management. Whilst this created a problem in the short term, the long term benefits will probably be considerable.

## 5.6 Funding Basis

Again, there are two main possibilities. One is to give the Revenue Authority a share of the revenues collected. The other is to give the Authority an annual budgetary allocation. In either case, it is difficult to know where the level should be set, but in the latter case it is easier to correct on an annual basis than the former[8]. The former, it is argued, gives the Authority greater incentive to perform. However, there is the problem that tax yield may vary due to circumstances unrelated to the performance of the Revenue Authority (changes in tax policy, tax rates, exemptions, changes in the economy, etc.). The former approach also gives greater autonomy to the organisation, since it does not have to submit its budget to the Ministry of Finance for approval. The first Chief Executive of SARS sought a percentage of tax collected, on the grounds that SARS should operate like a commercial organisation and be rewarded for its performance without having to have its budget scrutinised by the Ministry. However, this was not accepted.

A compromise is to have an annual budgetary allocation with an additional allocation based on a percentage of collections above a specified target. An alternative is to have a low percentage of tax collection as the basic budget, supplemented by a higher percentage of collections above a specified target. This latter approach has been adopted in Kenya, with a basic allocation of 1.5% of the budgeted tax yield for the year plus 3% of any surplus above the target. There still remains the problem of how to set the percentages so as to match what the organisation requires: in the case of Kenya, it is the view of some that the basic percentage was set too low, hampering the development of KRA. Whatever model is adopted, there has to be balance between the need for adequate and predictable resources to manage the task, and the need for motivate the organisation to function efficiently.

If the organisation receives a percentage of tax yield, whether as its whole budget or just as a supplement, it can use some or all of that to reward staff through individual bonuses.

This raises the question of the capacity within Ministries of Finance to oversee the policy and funding of Revenue Authorities. This was generally not an issue addressed by DFID aid. Long term sustainability suggests that some support in this area might be beneficial.

## 5.7 Making the Revenue Authority Work

Earlier chapters have discussed a range of issues related to revenue administration in general, and these would apply equally to Revenue Authorities. In terms of aspects specific to Revenue Authorities, and drawing on the cases studied, the following seem to be critical:

[8] In the case of Tanzania, the Board of TRA apparently proposed that TRA should receive 5% of tax revenues, but this figure was not based on any proper estimate of the resources actually required to run TRA (Coopers and Lybrand: Inception Report, April 1996).

5.7.1 It takes time, to set up and to consolidate the organisation: institutional structures, ways of working, attitudes, etc. do not change overnight. In Kenya, KRA was set up after only seven months preparation: some consider this was too short, and things were not adequately prepared. In South Africa, the changes involved in integrating two large and very different tax departments have required a substantial period of “adjustment”

The benefits of relaxing HR restrictions appear to flow more quickly than the benefits of integration. This could usefully be built into project timetables. Integration benefits need considerable timescales given the nature of organisational change that is required. In some cases it may be appropriate to separate these issues and proceed initially within exiting (non-unified) organisations given them separately the benefits of autonomy. This would multiply the number of projects (although not all tax agencies might be included initially) but might make improvement more achievable within appropriate time scales.

5.7.2 A similar point is that too many changes at once are difficult to digest. In practice, where the situation is dire, there may be little choice but to make many radical changes at once. But in South Africa, the view of one senior executive of SARS was that too many different reforms had been attempted at one time: autonomy from the public service, integration of the two departments, modernisation of systems, and decentralisation to the regions. It might have been better to have attempted the first three using a centralised model first, and only decentralising once those changes had been consolidated. Limiting change and allowing top managers the space to concentrate on setting appropriate governance relationships is crucial.

5.7.3 Autonomy from the public service has to be matched by an appropriate framework of regulation and accountability, which allows management the freedom to manage but ensures that serious failures are prevented, or tackled speedily. The obvious example here is Uganda.

5.7.4 Related to this is the need for a clearly defined relationship between the Government and the Revenue Authority. That relationship should be through the Ministry of Finance, which is charged with both fiscal policy and regulation of the organisation. There needs to be clarity about who is responsible for what. Representation of the Ministry on the Board should not be allowed to compromise the Minister’s ability to regulate the activities of the Revenue Authority. At the same time, there should be clear rules to prevent arbitrary political interference in the management of the Authority.

5.7.5 The Board should include representatives of tax-payers, not just as nominees of the Government, but as representatives of stakeholder organisations, e.g. Chamber of Commerce. The responsibilities of the Board should be clearly defined to prevent interference in day-to-day management of the Authority.

5.7.6 Success will depend, in large part, on such obvious things as:

- good working relationships between the Ministry of Finance, the Board and the Chief Executive/Commissioner-General
- dynamic and honest leadership from the Chief Executive/Commissioner-General, who should be a good manager (rather than a tax expert), who can build a corporate team
- proper human resource management policies, including rewarding good performers and getting rid of incompetent and corrupt employees. The latter is crucial if significant increases in remuneration are to be justified.
- where remuneration is a key part of the package systems to maintain appropriate differentials are needed. In Zambia a formula approach to comparison with appropriate private and public organisations had been effective in maintaining high remuneration levels with limited political controversy.
- clear relationships between, and clear responsibilities of, the various parts of the organisation: top management, functional or service units, traditional tax departments, and regional structures/local offices
- changing staff attitudes within the organisation from confrontation/policing to customer service, from traditional civil service to corporate, from reactive to proactive.

## 5.8 Conclusions

The Revenue Authority model has much to offer, particularly in those situations where civil service pay rates are a real obstacle to employing qualified staff, and where civil service regulations inhibit effective human resource management. Autonomy can provide managers with the necessary flexibility to perform. RAs do not, however, provide a panacea for everything, and do not guarantee insulation from political interference, nor a guarantee against incompetence or malpractice. Nor is the RA model always necessary, or even the best, approach to some of the problems of tax administration, and could inhibit wider civil service reforms. Nevertheless, the urgency of the need to mobilise revenues in some countries makes the RA model an attractive one.

Experience suggests that factors which are likely to influence success of an RA include:

- devising an appropriate framework for regulation and accountability of the RA, to counterbalance its autonomy; this needs to ensure that performance standards are achieved but prevent interference with operational decisions
- the Board should have clear terms of reference which prevent interference in day-to-day management; it should include both representatives of private sector and government; tax-payer confidence is likely to be enhanced where the former are perceived to be genuine representatives of the private sector (e.g. from Chambers of Commerce, etc.) rather than just government nominees
- the Ministry of Finance needs to maintain a degree of independence from the Board to enable it to regulate the RA, and there needs to be a clear division of responsibility between the RA and the Ministry of Finance over tax policy

- time is needed to establish and consolidate an RA; too many organisational changes (autonomy, integration, systems modernisation, decentralisation, etc.) at the same time can create management overload
- while the RA model offers potential benefits from integration of tax departments, these benefits are less quickly realised than those related to human resources (flexibility over pay, hiring and firing, etc.)
- the roles and functions of “common service units”, and of any decentralised offices, need to be clear, as does their relationship to the operational tax departments and to the centre, as well as the criteria for judging their performance
- proper HR management policies are essential, which reward good performance and deal with poor performance
- tough action is required at an early stage to weed out incompetent and corrupt staff; this is easier if all staff have to apply for their jobs at the outset, but this requires political support; vigilance is required to ensure that corruption does not re-emerge
- a funding package which involves an annually approved basic budget plus an additional amount based on a percentage of tax revenues above a specified target probably provides the best balance between autonomy, accountability, predictability and incentives; at least in the initial years there is likely to be a bargaining process over the level of funding, given the uncertainty
- dynamic and honest leadership from the Commissioner-General/Chief Executive is crucial, as are good working relationships between this person, the Board and the Ministry of Finance
- the RA needs to work at changing staff attitudes from hostile, reactive and bureaucratic, to customer-oriented, proactive and professional.

# 6. The Management Contract Model (i.e. Mozambique)

## 6.1 Introduction

Contracting-out of revenue collection represents an ancient method (as “tax farming”) which had fallen out of favour. Tax collection had universally become a service that is provided by civil servants employed in traditional civil service organisations. Indeed in popular imagination direct tax departments almost epitomise the stereotypical civil service arrangements.

However the notion that governmental activities must be delivered by public agencies as well as being funded by government has come under criticism. Increasingly (but until now mainly in the West) government services have been contracted out.

By the mid 1990s a number of studies had made the heretical suggestion that tax collection could be privatised (see Kiser and Baker, 1994 and Byrne, 1995).

To date the only significant example of contracting out of tax collection is the current project in respect of Customs Administration in Mozambique. This chapter examines that experience against a background of other programmes to reform tax administration and theoretical material on contracting for government services. (There was earlier experience of a temporary privatisation of some aspects of customs work to a pre-shipment inspection company in Indonesia which has now largely ended. Analysis of this in the literature has tended to combine it with the overall analysis of pre-shipment inspection services)

The analysis here in part is restricted because of the commercial nature of the contract and the relationship that DFID has with the contract. The contract is between a UK contractor and the Government of Mozambique. DFID is providing partial financial support to the Government of Mozambique but is not strictly a party to the main contract which was agreed prior to DFID’s involvement as a result of an international tender. DFID is further involved in financially supporting contract management by the Government of Mozambique. This particular contract arrangement and the genuine need for commercial confidentiality limit the detailed release of figures in this study. Further study of this ongoing project is highly desirable because of the challenge it throws to conventional approaches to tax administration reform.

## 6.2 Contract Specification and the Market for Contractors

The superficial attraction of contracting for tax collection is that a contract can specify the tax to be collected, the consideration to be paid and then the client (i.e. the relevant government) can simply sit back and receive the specified revenues. If they are not paid then the contractor will not be paid. To some extent some of those involved in the original DFID moves to support this project have followed this line arguing that a contract is thus superior to conventional project arrangements by providing a cast-iron means of enforcing non-payment ion the face of non-performance.

As the project has proceeded this apparent simplicity has quickly diminished. Three key aspects make this apparent.

Firstly to the extent that the project is about current tax collection, that collection is affected by exogenous factors, most notably in the economy. Whilst the objective of this part of the project is eminently measurable (i.e. cash collected) it is not at all clear in advance what the threshold for adequate performance is. Neither is it possible to construct a simple formula to specify post hoc what the target should have been. Targets set at contracting stage appear to have been based on inadequate analysis although at the time they were said to represent conservative estimates. This issue of exogenous influences on tax collections discussed more fully in chapter 8.

Secondly the amount collected can be affected by the actions of the government (a key party to the contract). The contract actually specifies some duties for the host government (e.g. in passing laws to support human resource changes). Beyond this any changes in, say tax policy such as increasing an exemption could be argued to affect tax collection. Once a government defaults on some aspect of its responsibilities it is hard to envisage a contract mechanism that could satisfactorily calculate the adjustment automatically.

Finally the project requires not just immediate performance tax collected but a hard-to-quantify improvement in capacity with eventual handover to Mozambican staff. Setting off this difficult-to-quantify objective against the more easily quantifiable collection targets is difficult in a conventional contract arrangement. (Again this is discussed more in chapter 8.)

This strongly suggests that the only basis for such a contract is a trust-based or relational contract (see Williamson, 1985, Walsh, 1995). Such contracts emphasise a degree of mutual trust between contractor and client based on the mutual benefits of a successful contract. To the client these are a good performance, now and in the long term; to the contractor they are continued business with the client and with other clients in the long term. Thus reputation forms a key support to trust - the contractors (and the client's) need to be seen as a high reputation organisation prevents them from exploiting the less than complete specification in a relational contract. To some extent such arrangements are common in technical assistance contracts and thus DSFID has considerable experience in this field. A key difference however is that this contract is for a prime government service, failure in which will be disastrous for the government whilst over-pricing will be, at the least embarrassing.

Kiser and Baker (1994) look at the issue of exploitation. They argue that promoting competition can reduce exploitation. This is only partially true since once a contract is won if it is awarded for the length of time needed to recover initial costs then opportunities for exploitation may arise. Ironically the very knowledge of future competition can actually encourage exploitation or opportunism since (if there is no trust that a contract will be re-awarded) a one-off opportunity will be created for the contractor. This could only credibly be limited by a reputation effect.

In the case of Mozambique an initial competitive tender was held. It is understood that one other bid was received. By most standards of competition this is a disappointing response. Without knowing the nature and amount of the bid it is difficult t know how competitive the market really was. Pure competitive theory would see competitive bidding as a way of eliminating surplus profits for a contract. Without a fuller market in the field it is difficult to be sure that the overall cost is superior to a reformed internal provision. However a sympathetic view would regard this as a dynamic position - successful operation of this contract could open up the market and, in principle, the market does appear contestable on an international basis with many countries possessing tax administration expertise which could be fed into a bid.

Dependence on a contractor could be reduced by breaking up contracts (Kiser and Baker, 1994). This strongly suggests that it may be undesirable to contract for all revenue functions in a single contract. In Mozambique the contract has been restricted to Customs and it is probably operationally difficult to envisage breaking this up further.

This pushes attention back to the reputation issue and a positive relationship between partners.

### 6.3 Conflicts of Interest

In the context of Mozambique this exposes a particular problem that may be experienced by countries undergoing structural adjustment. Where large-scale aid is conditional on effective tax administration reform the interests of client and contractor can become enmeshed. A client may be tempted to support a contractor's claim that all is well in order to support the client's claim that they have done their job. For a client this may be easier than confronting a contractor but risking the more important relationship with, say, the IMF.

This suggests that donors involved in supporting initiatives in this field need to be convinced of the commitment of beneficiary governments to the reforms involved (rather than just following a donor-led agenda). In this sense this is a special case of the over-riding need for political commitment noted in chapter 2.

### 6.4 Contract Management

The relational contract envisaged above suggest the need for skilled project management support within the client organisation. In Mozambique DFID have financially supported this and it appears to have some success. Ideally such project management support has expertise both of managing contracts and of tax collection itself.

If reputation forms a crucial part of the success of such a contract then future projects might seek to make the impact of the contract more transparent. This could strengthen the effectiveness of the reputation route by ensuring that contractors know that their performance will become widely known. Where the terms of contracts and the performance are not widely known a contractor may successfully be able to argue to future potential clients that performance was good despite there being large-scale problems. This suggest that frequent publication of detailed figures showing collection, costs and exogenous factors could have benefits.

### 6.5 Short and Long Term Aims

The Mozambique project has explicitly both short and long term aims. It might be argued that contracting out is an effective model for a pure short term (i.e. current collection) project. To some extent this would have the virtue of simplifying the contract management problem. Putting in long-term capacity building measures might be required for domestic political reasons. Alternatively it could be justified on cost grounds if domestic staff could operate successfully on lower salaries (after taking account of productivity effects).

However this raises the wider question noted in chapter 1 of why revenue collection projects need donor-funding. This becomes particularly clear where a whole service is contracted rather than a particular technical assistance input. It could be argued that a contractor sure of its ability to improve performance would be happy to operate on a commission basis (similar to earlier tax farming arrangements). In principle such an arrangement could cope with an additional burden of capacity building through a premium payment although there is an obvious conflict of interest for the contractor who is being asked to contribute to their own removal.

Payment on a non--performance or lump sum basis (either funded conventionally by a beneficiary government or through donor assistance) appears on the surface to thus contradict the principles of contracting out. It might be argued that potential instability or bankruptcy of the government concerned might mean that some guarantee of funds is necessary with a performance-related payment being (as in Mozambique) only a part of the contract .payment. In Mozambique the picture is complicated by the fact that the contractor had to take on existing officers of varying quality and meet their pay. Thus the contract sum might be seen as meeting those costs. Alternatively the use of lump sum reimbursement could be seen as reducing the risks for the contractor.

### 6.6 Conclusions

The Mozambique case provides insufficient data for a clear verdict on contracting out. It raises many questions about the adequacy of trust and reputation as a basis for delivering services and about why a pure performance-related contracts is not possible. It is providing valuable experience about the details of managing a contract and in particular revising targets in the light of changing exogenous factors.

Future projects in this field might need to:

- test whether the market for such contracted services is growing
- examine the possibility of pure performance-related contracts funded entirely from collections
- promote greater transparency to make reputation a stronger weapon
- give donors a role purely in contract management support
- drop capacity building as a separate aim
- extend competition to non Customs fields
- attempt such a reform in a country with more secure financing of its own

Such approaches have the potential to open up a new stream for reform. Careful monitoring is needed to ensure however that the risks of contracting are not too great.

If the contracting out option does expand then particular pressure could be put on UK resources since this is intensive in its use of expatriate staff. This issue is further discussed in chapter 7 below.

# 7. Project Design and Project Management

The study has raised a number of issues concerned with design of projects to assist tax administration:

## 7.1 Design issues

### 7.1.1 Blueprint versus process

The ideal is process not blueprint, harnessed to clear performance objectives. While this ideal is challenging to attain, and in particular raises monitoring and management issues for the donor, there are practical steps which can help. The experience of the revenue projects demonstrates some of these:

- In Zambia, there was insufficient attention to early diagnosis of problems and development needs in the departments. As a result, diagnostic studies were being carried out in 1997, well after the terms of reference had been decided and the contracts let.
- Insufficient flexibility in the project design, in the form of specific training activities for what was essentially a process project, was a further mistake.
- Delay in implementation owing to disputes over the managerial autonomy of ZRA disrupted the implementation schedule. The project had been tied to a fixed implementation schedule.
- Initial design tended to emphasise training rather than other activities and planned training activities tended to be delivered even where the fit with overall project objectives was poor.

The blueprint design of the original ZRACP resulted in considerable implementation difficulties. A process based approach has now been adopted and the project is moving ahead.

A true process approach however places pressure on project management, monitoring and evaluation. These issues are discussed in the next chapter.

The emphasis on training activities rather than other forms of capacity building has been noted elsewhere (see e.g. Brinkerhoff, 1994, on World Bank experience). This observation can be attributed (as does Brinkerhoff) to the traditional approaches adopted in institutional analysis. An alternative interpretation is that training interventions with their relatively easily demonstrated “deliverables” are attractive to contractors as representing a safer form of activity and one which they are used to delivering. If contractors have influence over the design of projects this may well be reflected in a preponderance of training initiatives. This possibility is difficult to prove. It appeared consistent with the evidence in a number if cases although contractors (and donor staff) tended to claim that such training activities were appropriate and that problems were more in the design and appropriateness of training.

### 7.1.2 Short term vs. Long term

There is a clear risk of overburdening senior management with detailed initiatives in the early stages of a reform process. As noted earlier management's most effective contribution may be in developing the basic competence and honesty of the organisation rather than introducing wholly new systems and procedures.

In Zambia the DFID assistance divides into long and short term. Long term assistance has provided senior expatriate line managers and advisors. They have formed the backbone of ZRA top management from the interim secretariat in 1994-5, through the direct appointments thereafter, to the present when the first two Zambian commissioners has been appointed.

Unrealistic time scales is a related problem. For example both South African projects were six months only, extended to one year in the case of the first project. Such short projects also seem to be out of proportion to the amount of effort and length of time required to prepare and approve a project - typically nine months to a year and out of relation to the scale of organisational change envisaged. The temptation is to resort to short term deliverables. The first South African stage concentrated on enforcement activities which were effective in themselves but with limited sustainability. In the current project there are better designed approaches but the possibility remains that the emphasis on training and other inputs will need longer-term support to enjoy real long-term effectiveness.

### 7.1.3 Using logframes well

If they are compiled well and used well, logframes are a powerful process tool in achieving, revising and maintaining focus for a project, and in providing a basis for evaluation. The criticism is often heard that logframes aid and abet a blueprint rather than process approach. But this is mistaken. Even if the activities in a project consist of processes only, the logframe helps to focus on what is a reasonable target level of benefit to be created by the processes (e.g. improved relationship between tax administration and tax payers) , and how we can know if it has been attained (e.g. increased level of compliance, reduced level of complaints).

Unfortunately logframes are often prepared and used poorly. Typical weaknesses are:

- purpose, outputs, success indicators, means of verification and even activities are poorly specified;
- targets are unrealistic;
- the initial logframe is not revised to reflect changes in the project so becomes unrepresentative;
- the project's logframe is not used as an ongoing, developing management tool, so few know about it or own it;
- construction of the logframe is regarded as a chore in the paperwork which does not require participation of all stakeholders in the project.

The revenue administration projects include both good and poor use of logframes. In the Zimbabwe Dept of Taxes project, the logframe specified outputs well, including improved reception areas for the tax administration and specified training for more than half the staff. A good means of verification was included, namely the complaints register. But unfortunately the complaints register had not been compiled and made available at HQ, as agreed in the logframe. The project might usefully have included the management of the complaints register as an activity. In the second South African project the logframe is incomplete lacking quantified output indicators and does not appear to reflect the project TOR, nor the 'consensus building' workshop on which it was supposed to be based. The Zimbabwe Customs & Excise project did not set measurable targets in its logframe.

**Use of the Log Frame in Malawi**

The Joint Project Review in June 1997 by IMF, DFID and the Government of Malawi identified a number of problems in the use of the log frame:-

- "the vertical logic of the PF is flawed: achieving the Purpose, even when the assumptions are met, would not necessarily lead to the achievement of the Goal, nor is it necessary in order to achieve it."
- "the indicators of project success do not measure the extent to which project objectives have been met. This is particularly true at Purpose level where the objectively verifiable indicators (OVIs) do not measure sustainable institutional capacity."

The quantity of revenue collected in principle provides an appropriate and measurable indicator of performance of revenue administration. But shifting exemptions, policies and economic fortunes make the size of revenue a good measure of performance only in relation to annual revenue targets. Where revenue raising is an output of a project, the logframe should be revised annually in line with revenue targets. This is discussed in more detail in the next chapter.

Finally, log frames should not be used to the exclusion of user-friendly narrative. Rather, they provide a summary focus for the narrative.

### 7.1.4 One contract or more ?

In some cases multiple contracts have been let, often for good reasons. It was not always clear that this was ultimately effective however. In Zambia, letting two contracts (Coopers & Lybrand and Crown Agents) created additional co-ordination tasks although the split into two contracts was made on value for money grounds. As a general rule it would appear best to keep a single contract. Alternatively a single main contractor with a sub-contractor may reduce co-ordination tasks. Failing this considerable effort will be needed in design to clarify the roles and considerable efforts made to monitor and nurture effective contractor co-ordination. Multiple contracts do not increase competition. Widening the contractor base does.

### 7.1.5 One donor or more ?

In some countries multiple donors were involved in the tax agenda. For a particular donor this presents both opportunities and threats. Additional donors bring additional resources, ideas, approaches and access routes. To the extent these complement then multiplicity is beneficial. To the extent approaches conflict there is a danger. Sophisticated recipients may seek to play off donors against each other to retain more control than donors feel is appropriate.

In South Africa the DFID-SIDA co-operation has generally been close but DFID’s input to the strategic management agenda within SARS appears to have been limited. From a DFID perspective its expertise in tax administration could benefit SARS whilst its involvement in one particular area (customs) may lead to sub-optimal interventions. For example separate IT developments may be sponsored by DFID and SIDA with insufficient overall co-ordination across SARS.

In Tanzania, multiple donors appeared to complicate matters considerably (UNDP on income tax, World Bank/EU on VAT, UNDP/World Bank on ASYCUDA for customs, DFID on establishing Tanzania Revenue Authority).

On the other hand there are different approaches from other donors which should be encouraged. SIDA’s approach is generally more ‘hands off’, leaving the contractor (the Swedish Tax Bureau in this case) and the client to work things out together, whereas DFID/BDDSA has sought to be closely involved. SIDA also provides much more in the way of training for the technical assistance staff coming in, both directly (a two week programme) and indirectly, through paying the Swedish Tax Bureau to run seminars itself. SIDA explicitly sponsors a partnership approach between the recipient organisation and a matching organisation drawn usually, but not always, from Sweden. This twinning arrangement has not been followed in quite the same way by DFID in this sector although it does offer interesting opportunities.

A final issue of donor co-operation is the perception other donors and their contractors have of DFID and DFID contractors. Evidence here is anecdotal but we were told by several sources without prompting that DFID and its contractors were difficult to work with. The specific suggestion made independently by several people was that DFID always wanted to have the tax administration field to itself. The accuracy of this comment is difficult to assess. We did hear some comments by DFID staff that suggested that other donors were seen as a threat although detailed discussion always elicited a proper desire for good co-ordination between all parties. Ill-designed interventions by other donors would be a threat to a good project and badly-carried-out projects by other contractors would properly be unwelcome. However, regardless of the veracity of the claim, there does appear to be a need for DFID to improve its image amongst other donors in this field.

## 7.2 Resource issues

### 7.2.1 What makes UK practitioners succeed or fail in the field ?

A number of issues arise concerning the deployment of UK-funded practitioners. One is whether TCOs or contracted staff should be in line or advisory positions. Zambian experience indicates the critical role which expatriates can play in senior line positions in the early stages of reform (e.g. VAT introduction). We have emphasised the importance of effective managers and where these are lacking there is a clear role for donor support provided there is a succession planning activity to cope with their eventual replacement.

In other projects expatriate staff were put into less senior positions e.g. in South Africa where the first project gave HMCE staff operational powers. This might be justified as part of a quick wins strategy to yield early results. However this type of activity clearly has question marks over its sustainability and generally support is more likely to be successful in advisory, training and other capacity-building roles. Indeed in South Africa this has happened in the second project and this is a good example of how such an advisory role can still be very much a "hands-on" role with staff accompanying local officers on raids for example.

In Lesotho the DFID-funded Sales Tax Adviser took the view that direct involvement on a selective basis in operational tasks such as seizures was important in terms of sending the right signals too staff regarding the importance of these activities as well as providing opportunities for on-the-job training.

It was suggested to us that UK staff in direct taxes were less appropriate than those in the indirect taxes sector. The rationale was that the size of the UK direct tax operation was so great that it would be difficult to translate experience to the much smaller economies typically involved in reform projects. It is difficult to judge this - there had been some positive experiences with staff drawn from smaller Commonwealth countries in Zambia and the Nordic countries were also suggested as a possible recruiting ground. On the whole however inter-personal skills and other non-technical issues generally seemed more critical than the precise technical experience a particular consultant brought to their job.

### 7.2.2 TCOs: Getting selection, preparation and support right

There were a number of cases where UK staff had not proved fully effective. This is of course another of the generic weaknesses of technical assistance projects which have been widely criticised for deploying staff with inappropriate technical and non-technical skills to overseas countries resulting in attempts to relocate developed country solutions and failing because of an inability to work within differing cultures.

We saw a large number of TCO and contractor staff who were performing very effectively with sensitivity to local cultures and needs. Those responsible for managing staff were conscious of this as an issue and were able to cite a number of measures that had been introduced:-

- selection criteria for staff now emphasised successful overseas experience

- some attempt in selection (in one case using formal psychometric tests) to determine the effective personality for such postings
- active monitoring of staff
- the replacement of staff who were under-performing.

These approaches could usefully be formalised and become the norm. The effectiveness of measures such as psychometric testing are at too early a stage to properly judge. Monitoring of this could aid other programmes that require similar personnel.

The SIDA practice of not putting anyone in the field on a long term assignment before they have successfully performed in short term assignments in the country and undergone orientation training, may be worth consideration.

Clearly technical skills alone are insufficient. An understanding of organisational development, human resource management, capacity building and change management are vital, as are training skills. In some cases we were not convinced that these were adequately emphasised. Some of the most effective staff in contrast were those that had worked in internal consultancy roles within their UK organisations e.g. one of the senior staff in Zambia.

The most common strengths consultants had were relevant technical experience, often successful management experience in the UK and sometimes training experience. Change management experience in particular was much rarer except in those that had already worked overseas reflecting the typical work experience pattern of operational staff drawn from HM Customs and Excise and the Inland Revenue. Interestingly an academic study of change within HMCE itself (Colville et al, 1993) identified problems in achieving change against a background of reforms such as the Financial Management Initiative and suggested that achieving change was considerably more difficult than had been envisioned.

Ideally staff selected will already possess this wide range of relevant skills. However one strategic issue raised by DFID's wide-scale involvement in this field is the growing pressure on a limited pool of skilled personnel. This makes it increasingly less likely that all of a team in a particular project could conceivably possess relevant overseas and change management skills. Similarly few are likely to be experienced in operating in an advisory or internal consultant mode. In a few cases we noted issues of cultural or racial sensitivity which might result in problems for personnel. Efforts to develop all these skills and sensitivities more widely in staff selected may be appropriate.

One classical fear raised by the generic literature is the temptation to attempt to duplicate one's home country systems overseas. On the whole this did not particularly appear to be an issue in the tax administration field where personnel were clearly able to distinguish the impact of differing policies, needs, resources and capabilities on the systems and strategies to be adopted. One small area of concern however was where UK aid was going to a particular part of the tax administration function that paralleled division within the UK. The best example perhaps was support to the Customs function within SARS. There did appear to be a possibility that this assistance, whilst very effective in terms of Customs' needs, might not sufficiently emphasise the unification of administration.

### 7.2.3 HMCE and Inland Revenue: direct or via other contractors ?

A considerable number of staff are sourced from HM Customs and Excise where they are serving officers. This was much less frequently the case with the Inland Revenue apparently reflecting the limited resources of the Inland Revenue at a time of considerable change domestically.

In some cases HMCE staff were able to work direct, usually through a call down contract with DFID. In the case of larger projects HMCE does not generally bid for projects; instead it supplies staff as a sub-contractor. The reasons apparently are limitations on its ability to as a public organisation with commercial bidders. This may be undesirable in some cases where HMC&E staff are the key input and contractors may have very limited value to add over and above their input. If it were possible to lift this limitation or reduce its effects this might provide DFID with greater value for money. Conceivably a different legal status for Customs' International assistance Division might free up its ability to compete. Having said this current Customs thinking appears not to favour greater involvement - it is happy operating on a cost-recovery basis and sees itself as a partner of DFID from within government.

There is a concern reported to us that the call-off contract DFID has with HMCE means that DFID Development Divisions have a limited role in appraising the performance of HMCE staff or evaluating their input. Apparently, in one case in South Africa where an HMCE officer proved to be unsatisfactory, DFID still had to pay. Whilst recognising that the institutional linkages may be more important than contractual ones, performance appraisal is still important. Having said that, GoSA, SARS, and the two "consumer groups" we met all seem to have been very satisfied with HMCE's inputs. This might suggest that the call off contract's scope be reduced and HMCE move to a more conventional contracting arrangement.

### 7.2.4 Dependence on Two Key Contractors

Outside of HMCE most of the contracts in this field have been won by two main contractors. Whilst other contractors have bid for work these two contractors bids are consistently evaluated to be the best. The more these contractors win projects of course the more entrenched this position may become as their experience makes other contractors increasingly less attractive.

This situation may well limit variety in approaches adopted however and may have implications for value for money in projects. The problem mentioned above of a limited pool of UK expertise also perhaps is worsened by the use of two contractors - other contractors might be innovative in sourcing (or growing in-house) expertise from fresh alternatives.

Thus, if DFID is to continue to develop its niche amongst donors in this field, a widening of the span of potential contractors is desirable. The difficult thing is to achieve this whilst remaining within a proper tendering procedure. Encouraging bids from a wider range, publicising DFID's commitment to this sector (and thus the market opportunities that exist for contractors) and favouring bids that demonstrate innovation would help. More controversially down-playing the role of prior experience would help if projects can be identified where this is less crucial or where other factors in a bid can offset lack of experience.

### 7.2.5 Does DFID need more tax administration expertise ?

Tax administration projects are normally the responsibility of Government and Institutions specialists. In recent years there has been a degree of de facto specialisation in that one London staff member has been involved in a number of projects. This provides a route for feeding experiences of existing projects into new projects. The obvious question is whether DFID needs technical tax expertise to guide these projects. One answer is that DFID can call on expertise from a range of partners but since these partners form the limited range of potential contractors this will not always be satisfactory. One particular danger is that leadership by experts in institutional and governance issues will lead to projects that focus on governance and institutional reforms. To some extent the circumstantial evidence confirms this - the dominant approach is the unified autonomous revenue authority. Some other donors in the field argue that this approach has been over-applied, though they tend to ascribe the reasons for this as being fashion.

On balance there may not be enough workload to justify an in-house tax reform specialist. Access to an outside source of advice independent of the main contractors might provide a useful source of advice however and this should be investigated.

This issue relates to the wider issue of institutional learning within DFID on tax administration. The large number of projects and their diverse management arrangements mean that overall institutional learning can be limited. Creating a single focus for this either by strengthening the role of a single GID specialist in London or by using an outside adviser with a comprehensive mandate would have benefits.

### 7.2.6 DFID versus local funding of projects

Comparing revenue administration projects, the issue arises of how much DFID resources relative to local resources should be going into them. The South African projects are a case in point. South Africa is not a poor country, and projects like this clearly generate substantial returns for the client. There is therefore a question about why DFID should be funding this at all. Indeed, there is evidence from the files that SARS would be willing to pay for HMCE's input, but it is also perceived that there would be political problems in doing this. This raises issues which go well beyond tax reform into the country strategy for particular countries. However the special nature of tax administration reform as an area which can be self-financing even in the relatively short term should be recognised.

This might lead to more targeting of resources in terms of which countries are helped and to a reshaping of projects away from traditional technical assistance approaches. The Mozambique approach represents in some ways an innovative approach. DFID support might then be in providing project design and monitoring expertise (possibly funded by aid) but with the contractor input funded wholly or partly out of increased collections.

## 7.3 Management issues

### 7.3.1 Who manages, and from where ?

Contractor staff and counterparts frequently spoke of the complexity and confusion they perceived in project management. The roles and relationships between Development Divisions, London and High Commission or Embassy were said to be unclear. In some cases there seemed to be several people within an individual office who were involved in a project and who had dealings with host country officials and/or contractors. The multiplicity of roles reflects a genuine multiplicity of needs within the UK government with different interests and competences involved. A clear statement of responsibilities for individual projects would clearly help although in practice there are obviously overlapping issues. A more radical approach would be to direct relationships with outside agencies (both host governments and contractors) through one main stream wherever possible

In some projects additional layers of management have been introduced, not always with success. In Zambia originally inputs were managed from the UK by a bought-in resource. This led to frustrations within the ZRA about their perceived lack of control over resources. Where DFID is supporting senior management as in the ZRA it clearly seems appropriate to cede control over the detail of inputs to them as has now happened.

### 7.3.2 Management of TCO Projects

In some cases smaller projects have involved the deployment of TCOs without a clear management arrangement being in place. In Malawi for example the Project Review undertaken in 1997 went as far as to say that the project “Has no management structure”. Day-to-day management of TCOs by DFID staff will normally be inappropriate. One option is the creation of a co-ordinator role from amongst a team of TCO’s but this may lack the appropriate authority for effective supervision. This suggests that such arrangements do need some form of management which can only easily be supplied by the use of a formal contractor system at least where TCOs are deployed for some time and where several TCOs are in related positions.

### 7.4 Conclusions

In summary:-

- a process approach is needed in project design
- the project activities should be managed as close to the project as possible
- all stakeholders should be involved in the management of the project, not just the design
- managers should not be overloaded with too many innovations early in a project
- log-frames need careful attention at the initial design stage and need to be properly revised during the life of the project
- the field from which contractors are drawn needs to be widened
- recruitment of individual consultants and TCO’s needs to emphasise effectiveness in overseas situations and in change management as well as in relevant technical tax fields

# 8. Measuring Performance

This chapter reviews the specific management question of how performance of projects can be measured and the implications this has for relationships between donor, contractor and host government.

### 8.1 Measuring the Outputs of Revenue Projects and Setting Targets

8.1.1 Maximising Revenue Collected
In principle the output of revenue collection itself is easy to measure since it is simply the tax collected and any Management Information System will be producing that as an absolute minimum. The output is measurable in a simple easily comparable way i.e. cash. This however is rather deceptive.

One problem is that, even if all other factors are constant, it may be difficult to estimate what a meaningful target might be. The existence of evasion is, by definition, unknown. There are some techniques which try to estimate this e.g. for import taxes by examining export figures from related countries (but these themselves may be inaccurate or even themselves inflated to generate false tax reimbursement claims). Similarly there are some attempts to measure the size of the domestic black economy e.g. by looking at the amount of currency in circulation. The danger is that if a target becomes a serious contractual requirement then any contractor will seek, sensibly, to get very modest targets set in the face of this uncertainty over the true potential for tax collected. A competitive market for tax administration projects might bid up such a target but only to the extent that the profits from the project warrant the perceived risk.

More fundamentally the ability to collect tax is affected by a number of external factors which can change during the project. These include:-

- tax policy (including tariff level changes and changes in exemptions)
- the overall growth of the economy
- shifts within particular parts of the economy
- inflation
- exchange rates
- weather.

**Targets and Exogenous factors in Zambia**
In Zambia there was criticism of the original targets that were set which were said to be based on guesstimates. Tax collected was then heavily affected by results in the highly-significant mining industry and by the government introducing new exemptions. Collecting tax from some parastatals proved difficult with insufficient support within government. All of these trends made the rigid application of any target impossible and no pre-set formula for varying targets could cope with such changes.

Thus where one is seeking a measure of the performance of the tax collection function there is no simple measure. One basic approach is to set a target and measure performance against a target. At the most basic level a target would attempt to anticipate changes in the exogenous factors and allow for them to set a fair but appropriately-demanding figure for what should be achieved.

A slightly more sophisticated approach would be to set a target that varies in some specified way compared with exogenous factors. This might mean for example a target that is expressed in terms of growth of revenue relative to inflation or to nominal GDP.

However these still lack credibility since none of them can capture all the effects and interactions that influence tax outcomes. This problem is not confined to taxes . Casley and Kumar (1987) identified similar problems in the context of agricultural projects and argued that, to establish causal relationships, a consistent high-quality time series for (in their case) at least nine years would be necessary. The difficulties of creating such a time series and the length of time means that, as an aid to contract management and evaluation, such an approach is hard to conceive of in the context of tax administration projects.

Agreeing tax targets up front may help but it is unlikely that a contractor would agree to be contractually bound by a genuinely demanding target where this could be influenced by external factors. Additionally there are likely to be donor or counterpart obligations in the contract and experience suggest that in most cases there is some failure there too. Where both parties are in partial default, a conventional contract loses its force as a simple arbiter of outcomes.

Trying to agree on performance targets as an ongoing exercise thus becomes the only real option changing a contract from a classical business contract into a relational contract where trust is needed on both sides. The main source of trust in a relational contract is both parties' need for credibility and reputation - if either of them are seen to play unfairly this will damage their chances of successful contracting (with the same or, perhaps, other partners) in the future. Such a relational contract would involve a continuing dialogue between contractor and customer about the appropriate performance given the changing exogenous conditions. This implies a considerable increase in contract management activities for a donor relative to a conventional contract.

Relational contracting relies on establishing stable ongoing partnerships however and it may be hard to achieve this in a public sector regime which enforces (for good reasons) re-tendering of new contracts. This creates one-off exploitation opportunities where a contractor may have more to gain from maximising income from a current contract than from playing "fair" to get future contracts.

Tax policy has some special features in this list of exogenous factors. It is exogenous to a pure revenue collection function but it is not exogenous to the host government. Giving additional tax exemptions was a problem in several countries we examined e.g. in Lesotho a major hydro-electric and water project was exempted from tax whilst in South Africa frequent increases in the classes of goods exempt from import taxes was cited. Of course tax policy could be frozen for the duration of a tax administration policy to facilitate contracting for administration performance. However this would unduly restrict appropriate policy reforms. A more radical strategy would be to internalise the problem by making a single contract for policy reform and for administration reform. This is also unacceptable however since it unduly commits a host government to implementing policy changes it may not welcome (perhaps on non-financial grounds).

The conclusions of this study suggest that meaningful tax targets can only be set in fairly narrowly constructed tax reforms. A specific intervention to assist in say tax enforcement could conceivably have a sensible target set at the outset. The only difficulty would then be ensuring that all donors and, most importantly, counterpart obligations were met. If they were then such a contract would probably be enforceable. In South Africa such a target was set early on and was achieved successfully.

In other cases targets are only a guide to performance and all participants in the programme need to recognise this and seek trust-building arrangements which can facilitate appropriate target setting and revision.

One particular approach that needs to be avoided is measuring the immediate net fiscal impact of a project (total additional revenue collected less total additional costs of collection) and then arguing that, as long as this is positive, then the project is a success. The impact of taking possibly a large amount of resources out of the private sector at great cost to spend a small amount on additional public services is likely to be severely detrimental to the economy. A measure which takes better account of the impact of costs to the economy of tax levies is needed.

### 8.2.2 Minimising Collection Costs

A project that seeks improvements in tax collected should, ideally, have a matching target in terms of the impact of costs of collection. Such a target could involve reducing costs or might involve allowing costs to increase but within a prescribed limit e.g. as part of a move to improve remuneration.

Again this measure is available in simple to capture and easily comparable cash form. It might be appropriate to express it in terms of real values after adjusting for inflation. More typically a target in terms of % of revenue collected is used which captures some of the relationship with the results of administration.

This measure does not have the same weaknesses as discussed earlier for tax collected. It is relatively much less affected by external factors. The national labour market might influence wage costs and general civil service policy might also affect wage costs but these could be adjusted for relatively simply. Targets on cost of collection were often adopted in the projects we saw and did not in themselves suffer from major problems. However collection costs represent only one dimension of a tax agency's objectives and this target does need to be set alongside expected changes in tax collected. One area that may cause difficulties is if there are reorganisation costs associated with re-staffing an agency with more skilled staff. This one-off cost is however relatively easy to cost and could be anticipated.

### 8.2.3 Minimising Taxpayer Compliance Costs

As noted above taxpayer compliance cots come in a number of forms. A single measure cannot capture these realistically. In practice these costs are likely to be measured by a number of ad hoc measures appropriate to the particular circumstances. Such measures might include for example:-

- average time taken for goods to clear customs
- number of complaints received
- proportion of tax returns audited

None of these measures is unambiguous and some of them capture elements of customer service rather than pure compliance costs. (Some of them also overlap with the process measures discussed elsewhere.) One potential difficulty with them is setting an appropriate target but the risks of getting this wrong are less severe than with the earlier targets discussed and co-operation with contractors and counterparts more likely to generate a sensible figure.

A more debatable issue is how far costs should be incurred in setting up systems to record such figures. In some cases contractors are not keen on doing so and argue that the costs of so doing are too high relative to the benefits. Our view is that the increasing emphasis on customer orientation means that a sustainable reform needs to make this investment. Some selectivity in picking a reasonable number of key measures is advisable but these should exist.

### 8.2.4 Enforcing Import/Export Limitations

The enforcement of rules limiting imports and exports suffers from a classic problem observed in law enforcement. By definition failure to enforce rules will not be recorded and so efforts in this field are hard to measure properly. One option is to ignore this theoretical difficulty and simply to use **direct indicators** such as successful seizures of goods or successful prosecutions either by number or volume or value. This is a fair indicator but its incompleteness would mean that it would be unreliable as an absolute contract requirement. Contractors in particular will resist requirements that depend on external factors. For example a separate prosecution agency may frustrate efforts to bring offenders to courts whilst inadequate legal powers may frustrate effective action against smugglers. Both of these problems are widely observed (and are another argument for linking administration projects to wider projects).

An alternative approach is a **process-oriented measure** that requires resources to be spent on these activities e.g. requiring a certain number of inspections or devoting teams to particular activities or delivering particular training activities. In general these appear to work less well because they can distort behaviour and even discourage focused action. In South Africa such targets tended to result in unthinking quota-achieving behaviour rather than a more targeted selective inspection function.

A final approach is to use a **proxy variable**. One indicator of the success of customs performance is the incidence of drugs offences within the country. This is a particularly weak measure however subject to many variables other than customs performance. In general these are only suitable as broad indicators and not as contractual requirements.

### 8.2.5 Enforcement of Tax Laws and Equity

The remaining objectives of tax administration agencies are especially hard to measure involving non-financial issues. These are only really subject to qualitative and subjective opinions in the absence, say, of measures which record the relative impact of tax administration on the poor. Monitoring of press reports, discussion with special interest groups and political debates may reveal areas of concern which would need to be followed up.

## 8.3 Short Term and Long Term Issues

As already noted projects typically will (and should) have both short and long term objectives. This poses a challenge for monitoring the performance of projects. The idealised log frame approach would suggest that this would involve post project reviews at appropriately times.

There are limitations to this. Firstly we did not note extensive use of post project reviews. Where project completion reports were done it was often by the contractor rather than a review by DFID or an outsider. More crucially once projects had ended there tended to be a loss of interest in them either because that activity in that country had ended or because a follow-on project started that took all the limelight and made subsequent reviews of earlier projects redundant.

This has obvious implications for institutional learning within DFID (which this report is itself is a partial solution). However in terms of the nature of the project monitoring and management it has important implications.

The most concrete performance measures which are actively measured are short term collection figures. This can distort contractor activity away from long-term capacity building towards generating revenue. This problem is frequently acknowledged in other areas of technical assistance. To counter this the only obvious solution is to rely on process or input- based measures of capacity building activities. Thus efforts say to do training or introduce new computer systems are monitored in terms of whether targets or milestones are reached.

This approach can work if there is sufficient “vertical logic” in the project design to ensure, if the processes are carried out, that eventual capacity building will occur and future performance improve. However where there is not this logic then process based measures are of only limited value.

In practical terms this again forces the relationship between DFID and contractor into a trust-based relational one. Flexibility in inputs is needed arguing against rigid adherence to an original project design. In some projects we noted that large amounts of donor time were devoted to agreeing the initial design of the project but that comparative freedom was given to contractors during a project provided they continued to deliver the broad inputs specified. In other cases contractors suggested that donor staff were too much involved in detail during projects. This relationship clearly needs careful nurturing and can only be successful with full trust on both sides.

## 8.4 Post Project Reviews

The projects examined often appeared to lack a formal post project review. In some cases a review had been done but authored solely by the implementing contractors. This suggests that a fundamental aspect of the log frame approach to managing projects is being lost and institutional learning is weakened as a result.

In some cases the lack of such a review appeared to reflect the ongoing nature of reform with attention being focused on discussing and designing project extensions or new projects. Where no project extension was under active consideration it was particularly difficult to access organisational learning. This was the case in Zimbabwe for example.

The reliance on contractors to write post project reports is clearly  a weakness. Such reports may of course be valuable in themselves but they do not substitute for a report by those managing the project. Some would argue (see e.g. the World Bank OED, 1996b) that such reviews should be undertaken by people independent of those responsible for monitoring the project. The Project Review of the Uganda Capacity Building Project undertaken by Price Waterhouse (reviewing a project undertaken by another consultancy firm) is noticeably critical.

In tax administration the use of long term objectives means that such post project reviews are of particular significance.

## 8.5 Conclusions

In summary

- efforts to establish firm revenue collection targets, especially in broad-based projects are unlikely to be successful. Instead emphasis should be placed a continuing dialogue with contractors to agree and revise targets
- targets for the reduction of collection costs are more realistic
- for other objectives such a range of measures are possible which are indicators of performance but these should not be the sole basis for project evaluation
- the vertical logic of log frames needs to be improved
- where long-term objectives are present long term evaluation needs to be undertaken and care exercised to avoid biasing project activities in favour of more immediately measurable short-term activities

# 9. Conclusions

Detailed conclusions and recommendations are highlighted in each chapter. However a number of broad themes are brought together here.

### 9.1 DFID has developed a unique niche in tax administration reform projects

No other donor has the breadth of experience in Africa that DFID has now acquired. This includes both bi-lateral and multi-lateral agencies. The IMF's involvement has emphasised policy rather than administration and they have had less hands-on involvement in tax administration projects (as opposed to supporting reform in tax administration). Outside Africa other bilateral donors have been involved, most notably USAID and the World Bank and regional banks have promoted projects, most notably in Latin America. However DFID's involvement ranks at least equal to these efforts.

This raises a clear question over future strategy for DFID. An opportunity exists for further expansion in this field. It lies at the heart of government and is entirely consistent with a poverty-oriented agenda providing (as a successful revenue administration project can) a sustainable means of financing future expenditure on poverty-oriented expenditure programmes. UK expertise in this field (especially HMCE but also the whole tax administration profession) is highly regarded and past UK achievements are acknowledged in the donor community.

The main limitations on this are:-

- limited expertise on the contractor side
- possibly limited expertise within DFID to take on an expanded role
- a limited range of countries where tax administration reform is viable.

Each of these is discussed below.

### 9.2 Integrating Tax Policy and Tax Administration

Programmes that integrate reform of policy and reform of administration are desirable. DFID experience in this has been limited. A number of projects, notably involving the introduction of VAT (in Ghana, Zambia for example) have involved aspects of policy. However more widespread involvement in tax policy have been less prominent.

This is perhaps surprising given the links with tax administration and the potential impact of tax policy on the poor. Of course many existing projects have involved co-operation with other agencies, notably the IMF, and so links with policy have been made. However there would appear to be greater potential to extend this. UK expertise in tax policy is widespread amongst the practitioner and academic communities and could be usefully accessed.

### 9.3 An emphasis on people and organisations

A clear theme in the findings is that high quality staff and organisational factors matter more than specific technical instruments. Such instruments have much to offer but their success or failure will most frequently be determined by personnel or organisational factors. Rarely are "state-of-the-art" technical measures needed.

This suggests that projects need to emphasise the recruitment of effective personnel and the development of organisations, especially at the outset. Personnel includes both contractor and TCO staff and employees of the revenue organisations. Projects need to support the effective recruitment (and if necessary and sustainable) the remuneration of local staff. In some cases expatriate staff will form an effective solution at least in the short term.

### 9.4 Scale and Length of Projects

A consistent theme is that projects in this field involve substantive change and cannot be achieved in short time periods. Equally interventions over a range of different fields are needed. Typically revenue organisations are large and diverse. This suggests that good results are likely in most cases from fairly large-scale projects that continue over a significant time period - say a minimum of three years. There may be isolated exceptions e.g. where a clearly defined need for particular support on a new initiative suggests a small TCO project may be useful and where the preconditions for such a project are met.

There are dangers in such projects - beneficiaries can come to rely on long-term advisers for example so careful design and monitoring is needed. Possibly projects may need to be conceived in phases with clear conditions for continuation to the next phase. However planning this in advance will, with effective management on the donor side, allow projects to continue without disruptive halts to contractor inputs.

### 9.5 Limited Contractor Resources

To date projects have drawn from a small number of generally effective contractors. These in turn are drawing on a limited pool of expertise originating often as serving or former officers of the UK revenue agencies.

Expansion of DFID's role in this field could be constrained by this factor. Limited bidders for projects can limit choice and may, on occasions have value-for-money implications. More concretely there may be a shortage of individual staff.

Efforts to address this could involve:-

- sourcing staff from other developed countries
- sourcing staff from other developing countries
- sourcing staff domestically, perhaps from the private sector
- developing other contractors
- developing deeper relationships with HMCE and UK Inland Revenue

### 9.6 DFID Project Management Resources

The nature of tax administration projects means that a hands-on approach to managing contracts is needed. Existing DFID staff in Development Divisions have workloads which make this difficult. Sometimes relatively junior staff were taking responsibility for management tasks. A further expansion of tax projects could place this under further strain.

### 9.5 A Partnership Model

The focus on political commitment as a key determinant of the success of projects has already been identified. This leads naturally to support for a partnership approach with beneficiary governments. This combines with the problems of corruption noted throughout the report to suggest that a future strategy for DFID would involve a choice of countries based on:-

- a small number of countries extending beyond Africa
- countries picked where political commitment can be sustained
- countries picked where corruption is at manageable levels or where reforms to address corruption are in progress and reasonably likely to have some success
- countries picked where expenditure management is reasonably good or where complementary projects in the field exist

Projects would emphasise:-

- links with tax policy reform
- effective management
- appropriate organisational restructuring where relevant
- sensible time scales

Relationships with contractors would:-

- emphasise long-term partnerships within projects
- but do this within an overall framework of encouraging diversity in contracting

The last element of partnership (with contractors) is potentially the most tricky to managing involving as it does a tension between nurturing long-term trust and the encouragement of bids from competing contractors.

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