POLICY DIALOGUES

Collect More, Spend Better? Enhancing fiscal redistribution in West Africa

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PITCH

The pursuit of Domestic Resources Mobilization (DRM) objectives needs to be in agreement with the other SDGs set by the 2030 Agenda for Sustainable Development, in particular the elimination of extreme poverty (SDG 1) and the reduction of inequality (SDG 10). This requires careful incidence analysis to determine whether fiscal systems contribute to inequality and poverty reduction. The objective of this study was to analyse and compare the incidence of fiscal systems of 3 western African countries: Côte d'Ivoire, Mali and Senegal. In all 3 countries we find that the impact of fiscal systems on inequality is slightly progressive but that more could be done to enhance the redistributive power of existing systems.

METHODS

The analysis relies on different data and tools: (1) individual and household level data from 3 recent household surveys (EMOP 2011, ESPS 2011, ENV 2014), (2) a detailed description of the 3 fiscal systems, (4) the CEQ conceptual framework, and (4) the Openfisca platform, an open source tax-benefit calculator parameterized to simulate the fiscal systems of each country.

Following the CEQ conceptual framework, we make use of 4 income concepts:

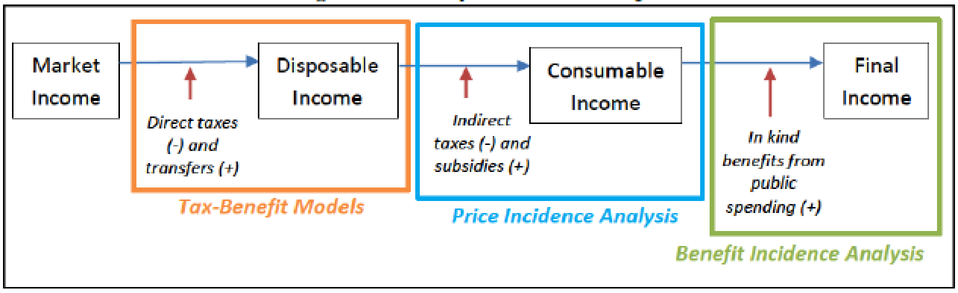
Market Income, i.e income before any direct taxes are paid and any direct transfers are received,

Disposable Income, i.e. income that is available to households after they have paid taxes and benefited from direct public transfers,

Consumable Income, i.e. income available after taking into account indirect taxes and indirect subsidies,

Final Income, i.e. income that includes the monetized value of the use of assignable public services such as education and health.

By comparing the distribution of these different income concepts, one can assess the distributive impact of the different components that constitute the fiscal system.



RESULTS

Fiscal systems in Mali, Senegal and Côte d'Ivoire have a slightly progressive impact on inequality: the comparison of final income with market income indicates that inequality goes down overall. This results from the combination of slightly progressive direct taxes, regressive indirect taxes, and progressive public spending on Education.

These results can be explained by various features: (1) Direct taxes are paid by a very small fraction of the population; (2) Indirect taxes such as VAT and import tariffs affect poorest households more since they consume a higher share of their income; (3) Primary schooling rates are high and poorer households tend to have more children.

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Key words Fiscal incidence, redistribution

Geography Côte d'Ivoire, Mali, Senegal

Themes Economics – Fiscal systems design

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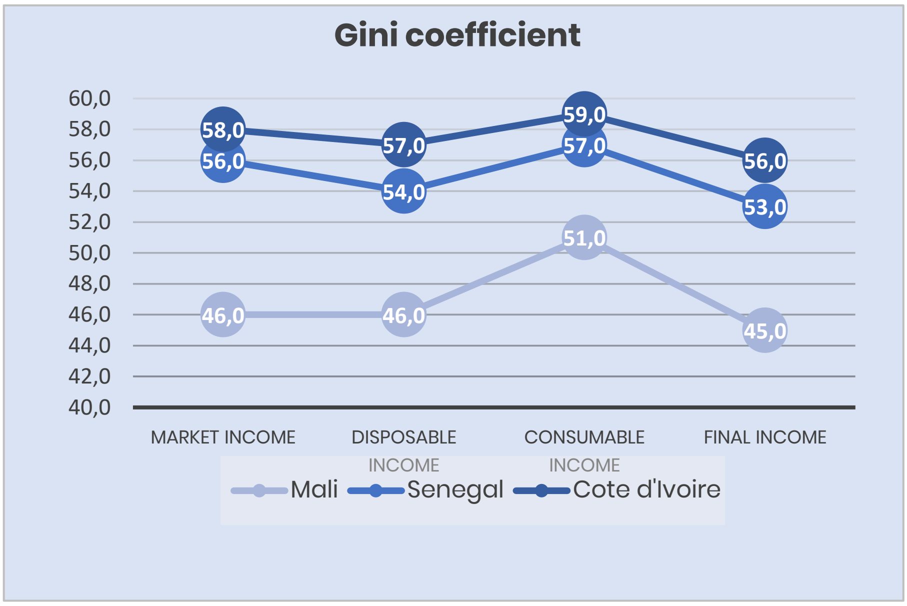
Who pays direct and indirect taxes and who benefits from transfers and public spending? Formal wage workers pay the bulk of personal income tax revenue. While they represent a small share of the work force, more than 40% of them belong to the top income decile of income distribution. Similarly, top income decile households contribute a high share of total direct tax revenues. However, it is also true that a very small share of households from the top income decile contribute to direct taxes. As expected, the contribution for indirect taxes is much higher and more spread across the population. Public spending on education is progressive despite not being equitable.

Which tax instruments will allow raising domestic resources while contributing to poverty and inequality reduction? Personal income taxes (PIT) are slightly progressive in all 3 countries because they are computed using a progressive schedule. Hoewever, a large fraction of top 10% household do not contribute to the PIT. While indirect taxes are expected to be regressive, some exemptions are intended to make them less so. For instance, food products are generally exempted from VAT. However, these exemptions do not seem to be working in the 3 countries under study, probably because they are not "targeted" enough on basics products. This result calls for further analysis. Public spending on education is clearly progressive first because primary schooling rates are high in all 3 countries, and poor households tend to have more children and thus "receive" more public primary education spending. This holds despite the fact that enrolment rates in higher education increase steeply as income rises and that spending per pupil is much higher in tertiary education than in the primary sector. In a dynamic perspective, increased schooling in secondary and higher education is expected to make aggregate public spending on education less progressive. This adverse effect could be mitigated if efforts are made to promote equal opportunity of access to secondary and tertiary levels. Targeted direct transfers could also contribute to poverty and inequality reduction. However, these transfers are costly to finance and to administer. The financial amounts needed to make a significant dent in poverty rates with direct transfers are likely to be beyond the financial capacities of the 3 countries under study.



RECOMMENDATIONS

- Fiscal Policy 1: Expand the reach of direct PIT - no need to change the fiscal law, but more efforts are needed to expand and enforce the payment of PIT beyond the pool of formal wage workers. This requires improving the information system to measure incomes at the individual level for a larger share of the active population.
- Fiscal Policy 2: Reexamine the incidence of exemptions to VAT and import taxes to ensure they are targeted appropriately. Better targeting should decrease the regressive character of indirect taxes.
- Transparency: increase transparency on public spending, civil servant recruitment, and public procurements. While willingness to pay (WTP) taxes is quite high in all 3 countries, these levels could be explained by two facts: first, only a small fraction of the population contributes to direct taxes; second, the withholding of wages taxes “at source” makes the payment of these taxes much less salient. Keeping WTP taxes at high levels while expanding the payment of PIT will require Governments to increase the transparency of their functioning.
- Data: much more and better data is needed to investigate more thoroughly the questions that this study tries to address. Two areas of improvement appear particularly relevant: first, the quality of data collected through household surveys should be improved significantly; second, fiscal data at the individual or micro level should be made available to researchers.

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