TAXES FOR GROWTH AND DEVELOPMENT

TAXES FOR GROWTH AND DEVELOPMENT

**Topic: Role of Taxation in State building and Good governance - The Rwandan experience**

Prepared by Ms. Mary BAINE
Commissioner General,

Rwanda Revenue Authority (RRA)

For

Norad's Annual Conference on Poverty and Development,

Oslo, Norway.

## A. Introduction

Ladies and gentlemen, it is my pleasure to take part in this conference and share Rwanda's experience specifically on tax administration and its role in state building and good governance as a tool to gradual poverty reduction. I wish to register my appreciation to Norad for the invitation.

Like all experiences, Rwanda's, also shows the major achievements and challenges encountered during its journey. Before I proceed, I am certain that most of you have heard about Rwanda for different reasons, both good and bad. Whether it is the 1994 genocide where a million people perished or our recovery story to becoming the top World reformers according to The World Bank 2010 Doing Business Report.

As a quick summary, Rwanda is a land locked country in the central part of Africa with a land mass of approximately 26,3338 sq km and a population of 10 million people. Its economy is largely driven by agriculture with over 80 percent of the citizens engaged in some form of agro based activity. The GDP per capita is estimated at US$480. The country is not endowed with natural resources and as such, has hinged its developmental agenda on the human resource (as stipulated in Rwanda's vision 2020 document[1]).
Rwanda is a member of the East African Community (EAC), Common Market for Easter and Southern Africa (COMESA) and the Commonwealth.

## B. Historical Background

The 1994 genocide alluded to, left Rwanda with her worst scar and near to total destruction of its social fabric. The period before this shows that right from the political setup, no power sharing mechanisms existed. It was characterised by exclusion and authoritarianism down to the economic setup where the meagre national resources were in the hands of a few. At the peak of the genocide and its immediate aftermath, the destruction was at such epic proportions that debate was rife in the UN corridors on whether to place Rwanda under UN trusteeship as a failed state. Therefore, the situation required unconventional solutions, stamina and clear focus to reverse this. Clearly it was a fight for life, never mind prosperity.

Ladies and gentlemen, the picture I just painted will leave most of you wondering what silver bullet Rwanda used to survive and move on to recovery. For all, survival was top on the agenda, therefore a common vision was agreed and everybody had to identify their role in this wider set up. Thus, was formed a sustainable partnership and by doing so, it was crucial that accountability be demanded of each other (state and citizens) for this vision to be realised. This scenario was even more profound for Rwanda during the reconstruction process since the need for resources was much greater than ever before. Funds were needed to rebuild and improve the infrastructure, provide basic services, develop capacity of the citizens, return to the global scene, et cetera, all of which constitute state building. At the same time, the source and composition of these funds had

[1] Vision 2020 is a document that highlights Rwanda's long-term strategy of becoming a middle income country by 2020.

to be predetermined for the long term development agenda. While dependence on aid was inevitable in the immediate term, it was agreed that due to its un-sustainability and inconsistency, it had to be a bridge to a more robust and constant flow of domestic resource mobilisation. It was immediately decided that more weight needed to be thrown behind domestically generated resources through taxation. As President Paul Kagame is often wont to point out, dependence on international aid is a temporary bridge that must be replaced by domestic productive capacity as well as a thriving investment environment that permits home grown capability from which to mobilise consistent financial resources.

### C. Need for fundamental reforms

The next step was for Rwanda to determine the nature of reforms to undertake. Rwanda learnt that for her development agenda to be based on domestic resource mobilisation (that is, achieve economic growth, lessen extreme inequalities, provide an exit from aid and fund the delivery of the MDGs, significantly improve the lives of all citizens, etc), the establishment of a strong tax system, an Auditor General's Office, Ombudsman's Office and a National Tender Board as key areas of reform, would drive this agenda to instil good governance and promote accountability. Hence to Rwanda, taxation was not merely a tool for raising funds for public expenditure, but also an instrument for building an effective state.

Borrowing from other experiences, taxation is viewed as a core manifestation of the social contract between citizens and the state. History has shown that the formation of accountable and effective states has been closely bound up with the emergence of taxation systems. For instance in the developed world, bargaining between rulers and taxpayers helped to give governments an incentive to promote broad economic prosperity and improve public policies in ways that meet citizens' demands. Unfortunately, this has not been the case for the developing world where citizens were expected to contribute without making any demands on the state. This philosophy held true to Rwanda prior to 1994. Thus taxation reform was singled out as a key ingredient for good governance and state-building. External expertise was acquired with the support of partners with a similar vision for a tax administration such as DFID, and these showed that taxes raised (and spent) transparently would shape the government's legitimacy as this would promote accountability to its citizens. This would further enhance good governance because to increase political efficiency, taxpayer consent was required. A competent bureaucracy was also necessary for effective resource mobilisation and to drive the development agenda forward.

To concretise the above, a semi autonomous agency, The Rwandan Revenue Authority (RRA), was formed in 1998 to spearhead all reforms in taxation in the country with a mandate to administer, collect and account for all tax and some non tax revenues and to provide services aimed at promoting business growth. Therefore, Rwanda's 'state-building' approach through taxation, among other major reforms, was anchored around the establishment of this system (tax policy and its administration), which would strengthen the legitimacy of the state through five core principles—political inclusion; accountability and transparency; perceived fairness; effectiveness; and political commitment to shared prosperity. Nevertheless, RRA had to overcome a host of challenges mostly associated with bad governance in practice that had been inherited but needed to be uprooted, namely;

Primarily, there existed a general resistance to taxation due to a limited tax payment culture. As people had been denied the right of accountability prior to this, there was a feeling of discomfort with taxation which led to a general opposition to paying taxes.

Secondly, the country suffered from high illiteracy levels and people could not comprehend the linkage between taxation and provision of public services by the state. To them, it was mandatory for a government to provide these services irrespective of where the funds came from.

Third, RRA was viewed as another bureaucratic agency adding no value but rather a new way of siphoning resources from the public to the state at best, or a new way of rewarding a chosen few to line their pockets at the expense of the general citizenry at worst.

Fourth, the compliant few, tax payment was not only cumbersome, but a burden too. The rates were exorbitantly high, compliance costs extremely unbearable and service delivery at the tax offices so poor that many potential taxpayers opted for informality. For instance, a single taxpayer had to visit separate offices to pay customs duties and domestic revenues under the same Finance Ministry; with separate procedures and no linkage of taxpayer account whatsoever. Additionally, one would count their luck if their particular consignment got cleared in two weeks.

## D. Reforms Undertaken

As a way of building consensus, RRA undertook a number of reforms and initiatives to not only change the status quo, but also re-write our peoples' history by enabling a development agenda that would change our livelihood through efficient and effective systems that ensured a steady collection of the much needed revenue. An example of this, is that our customs operations are now 98% computerised so goods can be cleared within an hour.

One of the very first fundamental reforms in taxation was the introduction of VAT in 2001 to replace the 'not so popular' sales tax (ICHA). Other than aiming at making the tax system more visible and transparent thus enabling constructive bargaining between taxpayers and the state, VAT was to act as a compensatory mechanism for the relative decline of trade taxes (as a result of tariff liberalisation). While some may not view VAT as an ideal instrument, it works to a great extent like a direct tax applicable to most consumers and has in most cases provide a practical way forward in widening the tax base in an economy like Rwanda's with a large informal sector.

Another important aspect was the avoidance of reliance on taxes widely perceived as unfair or as liable to be collected in coercive ways. Such taxes like "Contribution Personelle Minimum" (CPM) a form of graduated tax, contributed to poor collection rates and blocked the emergence of any kind of "social pact" around taxation in Rwanda.

The people's attitude towards taxation probably caused the biggest challenge to overcome and still remains so. However, government at both the central and local levels has supported RRA to undertake mass sensitisation campaigns where discussions underscore the importance of paying taxes while clearly spelling out the punitive provisions of the law for non compliance. To this day, we still maintain a substantial budget at RRA to cater for taxpayer education and sensitisation campaigns countrywide. Important to mention, is that the theme was and remains that both sides have obligations to meet and rights to enjoy embedded in a social contract to safeguard both the citizens and the state.

An additional key aspect of consensus building is the intolerance of any form of corruption in Rwanda. The tax administration took cue from here. Rwanda quickly realised that the success of its taxation campaign would largely depended on its credibility. At RRA, a very stringent approach was taken by clearly spelling it out in the staff code of conduct and establishing two departments to oversee work-ethics and deal closely with external agencies like the national police to fight this. Avenues that were viewed as fostering corruption were not only minimised but are an object of constant scrutiny to eradicate this vice.

To further strengthen the accountability aspect, Rwanda enhanced the tax administration-taxpayer relationship through a number of ways including;

a) The establishment of Tax Advisory Councils (TACs) in Rwanda's 30 districts. These are official forums that bring together relevant local and central government officials and opinion leaders from the private sector, RRA representatives and Finance Ministry representatives, to discuss tax policy issues. They are a very important source of information exchange and help in shaping our tax policy initiatives. These also endeavour to instil a taxpaying culture in the population.
b) The establishment of Tax Issues Forum (TIF). TIFs are an RRA/Private sector driven initiative that brings together officials from both institutions on a quarterly basis, to iron out any issues that may be hindering progress of either party.
c) Last but not least is, the establishment of a Taxpayers' Appreciation Day. This is one of Rwanda's innovations since 2002 which has gained prominence within the region and is held annually. The day is a culmination of a month of events nationwide including taxpayer sensitisation, education and engaging in pro-poor communal activities. The importance attached to these events is demonstrated by their being officiated by cabinet ministers while the final day is graced by the Head of State as chief guest rewarding the best taxpayers publically.

## E. Achievements so far

Ladies and gentlemen, most importantly, what did these reforms yield?

First, our core business being revenue mobilisation, it is important to note that since 1998, our revenues have registered a 6.5 fold increment. In real terms, this covers about 78% out of government's recurrent budget or 52% of the total budget say in 2009 up from a meagre 38% of the recurrent budget in 1998. Let me stress here too, that composition of these resources has also reversed within the same period with the larger portion coming from domestic taxes as opposed to the situation in early 2000 where the bulk was from trade taxes. Important to mention is that the improved revenue collections has enabled government to undertake pro-poor programmes including improvements in national health and reduction of child and marternal mortality, universal free primary education, free fertiliser distribution and progressive strides towards the attainment of MDGs.

The tax to GDP ratio has also increased tremendously over the years from approximately 9% in 1998 to over 13% currently. The initial government target was to grow this ratio by at least 0.2% per annum.

Secondly ladies and gentlemen, due to the consistency and predictability of tax revenues and along with the strong consultative forums between the different stakeholders, Rwanda has been able to link tax revenues to fund the Economic Development and Poverty Reduction Strategy (EDPRS) Agenda. The EDPRS is Rwanda's long term development strategy setting out three flagship programmes aimed at enhancing public investment, securing growth and protection for Rwanda's poorest and most vulnerable, and improving governance.

Thirdly, the tax administration has witnessed considerable improvements in compliance levels especially among the large taxpayers (who contribute approximately 75% of the total taxes) which now stands at 97%. Although the compliance levels are slightly lower for the small and medium taxpayers' segment, the rates have increased significantly overall since 1998.

Fourthly, through training and other forms of assistance to local government tax officers, we were able to decentralise some taxes like property and rental taxes with relative ease. We still maintain an active relationship with local governments regarding taxation. Now that the central government finances only 6% of all district budgets, it is evidence that decentralisation has become a key driver behind sustainable development as districts have their own income generation schemes that directly feed into development programmes, hence reducing poverty in a meaningful way that supplements the central government effort.

Lastly ladies and gentlemen, by joining hands with the private sector, civil society, development partners and all other stakeholders, we have been able to reform our tax governing laws to suite modern day doing business requirements. This directly feeds into our strategic plan to promote and attract investments.

## F. Current Areas of our Focus

Dear friends and colleagues, as we celebrate the forward leap in good governance and state building of Rwanda through taxation, there are still numerous challenges to overcome.

Key among these, is striking the right balance between trade facilitation and protecting government revenues. If we cannot reach that equilibrium, then one aspect stands to benefit at the expense of the other.

- A persistent informal sector also prevails and studies have indicated that a large number of business operations are done informally thus causing an imbalance of trade and eroding the already narrow resource base.

- Rwanda's being landlocked directly impacts on our trade specifically on the transport costs for imports and exports which are raised putting us at a less favourable position when compared to those countries close to sea. Although efforts have made by government to mitigate its impact on the cost of doing business by spearheading calls for removal of non tariff barriers and joining wider economic groupings like EAC and COMESA, it still remains a stumbling block.

- A complex tax system which still needs to be modernised to facilitate especially the SMEs in becoming compliant thus widening the tax base.

- There is a need to continuously develop the capacity of, and retain our staff due to frequent recruitments by the private sector. Any existence of skills gaps and shortage of numbers poses a risk to the tax administration.

- Special capacity requirements befall RRA to advice government on fiscal policy development and implementation.

- To keep up with the taxpayers' expectations, modern time-saving IT solutions are required. This pauses a challenge to the RRA which has to compete for central government funding with other national priorities as these are often costly both in acquisition and sustenance.

## G. Way forward/ Future tasks

Our vision being to become a self-sustaining nation that provides for it citizens as we gradually overcome poverty, Rwanda in general and the tax administration in particular intends to;

Consolidate the achievements registered in the last decade of existence while improving in areas that would directly feed into an investor friendly environment that attracts and retains Foreign Direct Investment (FDI), while nurturing local investments.

Promote our trade facilitation approach of revenue mobilisation from merely being a tax collection agency, and

Become part of and actively participate in a wider network of tax professionals such as ATAF one living example through which Rwanda is able to share experiences and learn from, in the quest to initiate and constitute policies that enable this trade to thrive and impact positively on our economy in general and citizens in particular, as key participants.

## H. Conclusion

Let me conclude by underscoring that it should and must be humanity's passion and ultimate vision to eradicate poverty. Not only is it the single lifeline for majority of the world's inhabitants, but it could pause more threats than one to the more privileged. However, like the story of Rwanda, one clear strategy could be adopted as a cornerstone to sustain this fight against poverty. While it may be slow and gradual, consistent strengthening of tax administrations is clearly the strongest and most sustainable tool to achieve this. Along the way, support by partners targeting pro-poor programmes is still relevant but should not and cannot be treated as a means to an end. More importantly, as a state building tool, it has proven performance.
I thank you.
.