DOMESTIC RESOURCE MOBILIZATION

Case Study of Rwanda, 1990-2016[1]

Summary

Rwanda has achieved considerable progress in building its tax system over the past two decades. The country's tax revenues rose from just under ten percent of GDP in 2000 to 16 percent in 2016 due to improvements in tax administration and tax policy. Key milestones include creation of the Rwanda Revenue Authority (RRA) in 1998, replacement of an inefficient sales tax with a more modern value-added tax (VAT) in 2001, and preparing for and entering into the East African Community (EAC) Customs Union in 2009 (effective 2010). Measures of productivity or efficiency of Rwanda's VAT and income tax collections improved steadily from 2001 through 2016 and are now among the strongest in East Africa.

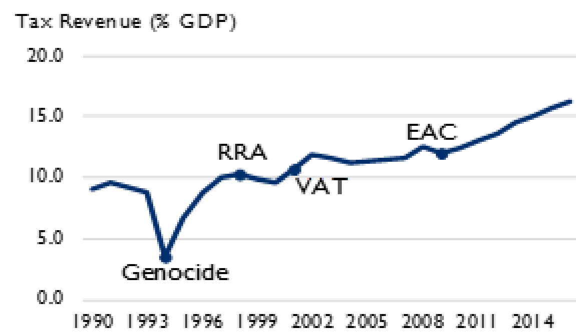
Rwanda has also been steadily been improving its tax administration by increasing taxpayer outreach and raising the number of registered taxpayers, providing better services, enhanced use of information technology (IT), and improving the use of risk management in conducting taxpayer audits.

Streamlining and modernization at the RRA have contributed to an improved business-enabling environment – as indicated by the increased ease for businesses of paying taxes and trading across borders.

Rwanda has benefited from considerable donor support to modernize its tax system, notably from the United Kingdom's Department for International Development (DFID) who provided a high level of technical and material assistance for two decades.

Rwanda's experience illustrates several basic lessons about domestic resource mobilization (DRM). First, a series of modest improvements in tax administration coupled with sensible tax policy measures can meaningfully improve revenue collections over the years. Second, Rwanda's success was built on a strong political, economic, and institutional foundation. Third, many of the DRM projects that supported these improvements would have benefitted from stronger monitoring and evaluation to enable a better understanding of the impacts of the reforms on a broad range of stakeholders.

Figure 1. Rwanda's Rising Tax Ratio, 1990-2016

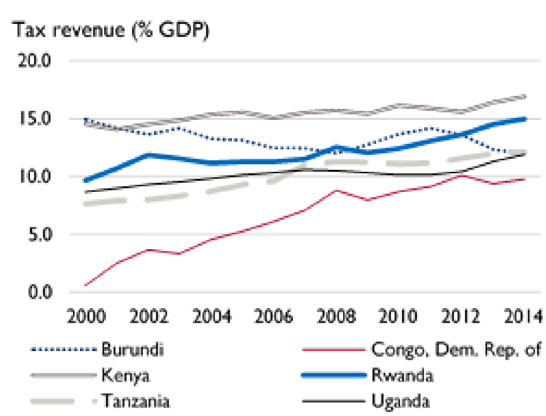


Source: Tax revenue total, 90-2005 OECD, 2006-2017 RRA.

Success in Mobilizing Revenue

Rwanda has been able to increase tax revenue by about six percentage points of GDP over the past 17 years while reducing administrative burdens on business. Other countries in the region have also made progress in raising their tax-to-GDP ratio, as shown in Figure 2, but Rwanda's tax ratio has risen more dramatically than most others over this period and by 2014 was second only to that of Kenya.

Figure 2. Tax ratios in Rwanda and Neighboring Countries



[1] This briefing note was prepared by Janine Mans based on a full-length case study written by Mark Gallagher available at: https://pdf.usaid.gov/pdf_docs/PA00T4XX.pdf

The main contributors to Rwanda's resource growth were the VAT, personal income tax (PIT), social security contributions (SSC), and a variety of non-tax revenues, all shown in Table 1.

Table 1: Contributors to Increased Domestic Resource Mobilization, 2001 - 2015

	2001	2015	Change
	Percent of GDP		
Total resources	**12.1**	**18.9**	**6.8**
VAT	3.3	5.2	2.0
PIT	1.1	3.8	2.7
SSC	0.5	1.0	0.5
Non-Tax	0.9	2.1	1.2

Note: "Total resources" includes taxes and SSC.

Table 2: Comparative Revenue Productivity Indicators

	Rwanda			SSA	World
Productivity measures	**2001**	**2008**	**2016**	**2012/13**	
VAT	0.22	0.25	0.29	0.33	0.42
Corporate income	0.06	0.07	0.10	0.12	0.15
Personal income	na	0.07	na	0.20	0.22
Taxpayers to tax staff ratio	na	na	161	316	677
Cost to collect $100 (US$)	na	3.01 (2009)	2.96	2.38	1.24

Note: Government of Rwanda and USAID Collecting Taxes database

Rwanda has been able to achieve much improvement in DRM by increasing the efficiency of collections and strengthening voluntary compliance. For instance, VAT, PIT, and corporate income tax (CIT) all showed nearly steady increases in revenue productivity (i.e., revenue collection as it relates to the tax rate and the tax base) for the entire post-2001 period. Table 2 presents revenue productivity information for Rwanda over the recent time period and compares this with revenue productivity in Sub-Saharan Africa (SSA) and the world as a whole.

How Rwanda Achieved These Results

Tax administration

Tax administration reforms began with the establishment of the RRA in 1998, and continued with further modernization focusing on reorganization, computerization, and streamlining of taxpayer services. In more recent stages, the RRA has been devoting greater attention to risk management and tax enforcement.

In RRA's early days, tax compliance requirements were costly and time consuming for taxpayers. Filing for any of the domestic taxes, or even obtaining a tax clearance certificate, required that a taxpayer physically walk into an RRA office to process paperwork, then go to a bank for payment, and finally return to the RRA. This resulted in long queues at RRA offices and banks, especially around peak filing deadline times. The finalizing of a return, filing, and payment for VAT, income tax, or Pay as You Earn (PAYE) on average took over 23 days. In 2011 and 2012, the RRA launched e-filing and e-payment – greatly reducing these taxpayer compliance burdens. RRA reports that it now takes three days to get a taxpayer compliance certificate versus the 10 days that was previously customary. Taxpayers can also directly pay their tax at the bank without having to make double trips to the RRA.

The RRA supported these process improvements with improved taxpayer education and assistance during 2010-2012, including the creation of a call center to which taxpayers can send queries and get almost immediate responses, usually by email on the same day. This was complemented by the establishment of a taxpayer training center, where taxpayers can go to learn about tax law obligations and rights, and form completion or data entry methods.

Improved taxpayer education and assistance have been effective, in particular, in helping RRA staff to bring more of the informal sector into the tax net. According to the country's National Institute of Statistics, the informal sector in 2011 produced about 46 percent of GDP, yet had been mainly untaxed. Following significant outreach and education programs, SME registration doubled from 42,538 to 90,485 from 2010/11 to 2011/12, while the respective revenue collected almost doubled from Rwf 385.2 billion to Rwf 651.9 billion.

Several system improvements also promoted higher revenue collection. By 2004 the RRA had implemented the Standardized Integrated Government Tax Administration System (SIGTAS), which supported data management for taxpayers and facilitated tax returns processing, enforcement, and audit. SIGTAS implementation eventually paved the way for automation of RRA frontline taxpayer services, such as e-filing and e-payment. RRA also required most businesses to start using electronic billing machines (EBM), which include a certified invoicing system and a sales data controller. EBMs reduce underreporting of sales, facilitate VAT payment and reduce the tax collection cost to the RRA. A study in 2014 showed that firms that had purchased and were using the

EBMs by the first quarter of 2014 were paying 6.5 percent more VAT than they otherwise would have.

Similarly, RRA invested in improved systems and processes in customs, including the introduction of the UNCTAD Automated System for Customs Data (ASYCUDA++) – a customs operations and data system widely used among developing countries – which led to the automation and streamlining of functions and greater control over core processes, while enhancing data collection, management, and reporting. The RRA has also implemented systems and processes for mobile declarations and mobile payments and established customs single-window operations at many of the country's border posts.

Over the whole period, RRA has followed a continual path of improvement in its systems, methods, organization, and staff – promoting improved capacity and better service to taxpayers. Semi-autonomous revenue authorities often face important external attacks on their autonomy and integrity, leading to declining revenue productivity after a few years of high performance. Rwanda has been able to buck this tendency, presumably because of the overall improvement in the country's governance system

Tax policy

Over the period Rwanda has taken steps to modernize its tax policy regime, including those components needed to bring Rwanda in line with the requirements of the East African Community (EAC).

Rwanda undertook its first major tax policy reform of the post-genocide era with the introduction of the value added tax (VAT) in 2001. The VAT replaced the sales tax, which had many exemptions and produced little revenue. Before 2001, the sales tax had been producing generally about 2 percent of GDP in revenues, whereas the VAT produced 3.3 percent of GDP in revenues in its first year, rising to 4.0 percent in 2005 and 5.2 percent in 2016.

Other significant changes in tax policy included: increasing the VAT rate from 15 to 18 percent in 2002, increasing the income tax on professional remuneration in 2004, reducing the CIT rate from 35 to 30 percent in 2005/06, and harmonizing some of its tax incentives in 2005 and 2008/09.

In 2003, the RRA was assigned responsibility for collecting some non-tax revenues, such as fines and fees; revenue from public property and assets; and proceeds from the sale of government vehicles. This duty was expanded with the addition of various administrative fees in 2007 that would now be collected by the RRA instead of other government agencies. Then in 2010, the RRA also assumed responsibility for the audit, collection, and enforcement of social security contributions from employers.

Rwanda became a signatory to the EAC Customs Union protocol effective in 2010. The protocol establishes common external tariffs, eliminates internal tariffs, and includes other reforms that would both result in lower tax revenues for the government and in lower protectionism from regional competition. For instance, the EAC required the removal of the sugar surcharge. It also required the Rwandan government to repeal the VAT charge on transport, specifically a tax on foreign trucks moving goods in and out of Rwanda.

One area where harmonization with EAC practices helped to stabilize revenue was the replacement of the ad valorem levy on fuels with a specific or unit-value fuel tax, set at a Rwandan franc (Rwf) value per liter. A key benefit of the new policy is that the government revenue per liter sold became independent of fluctuating international fuel prices. A unit tax also has the advantage over an ad valorem tax in that it actually helps to stabilize the domestic price of the excisable product. [2]

More recent reforms, such as assigning local taxes to the RRA to collect local taxes, imposition of a special levy on petroleum specifically to fund infrastructure investment, imposition of VAT on telephony, and mining royalties, have also contributed to raising the tax ratio. Together, these measures have added between 1 and 1 ½ percent of GDP to the tax ratio.

A timeline of major tax policy and tax administration reforms is provided in Figure 3 at the end of this note.

Donor Support

International donors provided key support to tax modernization efforts in Rwanda. Principal among them was the United Kingdom's DFID. In early years of its support, DFID placed expatriate experts in various line management positions, combining advisory and training functions with selected implementation responsibilities. Advisers worked alongside senior management to assist in developing stronger management systems and corporate planning and monitoring processes. During subsequent phases, DFID mobilized a package of support that addressed revision of major tax laws, roll-out of IT systems for domestic taxation and customs, further process

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[2] A specific unit tax can help stabilize domestic prices as well as tax revenues. However, the treasury runs the risk of declining real revenues if the tax rate is not updated on a regular basis to account for general price inflation.

improvements and institutional capacity building, and assistance on taxpayer education.

This assistance was complemented by a grant from Investment Climate Facility for Africa (ICF) from 2009-2012 to improve online filing and payments, streamline the taxpayer clearance process, and set up a taxpayer-training center. Other recent sources of technical assistance have been from the IMF's East Africa Regional Technical Assistance Center (in Dar es Salaam, Tanzania) and the U.S. Treasury's Office of Technical Assistance.

DRM assistance in Rwanda has yielded considerable value for money. The total value of this assistance, despite being one of the largest donor tax assistance programs in Africa over the past two decades, has not exceeded $40 million—an amount that is less than the amount the RRA collects in any three weeks, according to several DFID documents. Donor assistance did not create the Rwandan tax system, but it certainly played a role in its design and implementation.

Unfinished Business

Despite its overall success in increasing compliance, system efficiency, and revenue – as reflected in steady improvements in productivity indicators related to VAT, CIT, and PIT – Rwanda's CIT and VAT revenue productivity remain low compared to worldwide averages. For the CIT and VAT, generous tax incentives are a major contributing factor. For instance, in recent years, in an effort to substitute domestic products (especially textiles and leather products, cement, computers, and others) for imported goods, the Rwandan government has offered business tax incentives by eliminating VAT on imported inputs. These tax incentives cost the treasury revenue. According to RRA , in FY 2016/17 revenues forgone on domestic taxation came to 38 percent of domestic tax collections, and revenue foregone due to exemptions granted on imports amounted to 34 percent of customs collections. Almost all domestic tax expenditures were from VAT exemptions.

Continue strengthening the RRA. Two areas in which the RRA might make focused efforts include improving the taxpayer registry and the methods employed for mitigating compliance risks.

Control costs and raise more revenue. RRA has a high cost of collection compared to worldwide averages and regional good performers. In the most recent fiscal year, FY 2016/17, the cost of collection was Rwf 2.96 to collect Rwf 100. The worldwide average cost of a national tax system is at less than 1 percent of revenues. Tax collection in Africa is expensive for various reasons, but several African countries have been able to contain cost of collection, such as Botswana with a ratio at 0.88, Lesotho at 1.99, and Mauritius at 1.81. The RRA and the Ministry of Finance and Economic Planning must assess the most effective means of reducing the cost of tax administration, without reducing tax revenue productivity or taxpayer services.

Improve tax policy and policy analysis. For the VAT and CIT, tax incentives have created a large policy gap while it is not clear what has been their impact on business, investment, and job creation. The RRA and the Ministry of Finance and Economy have limited staff capacity to perform tax policy analysis or estimate the economic impacts of revenue measures. The need for improvement in that staff capacity was raised in a 2008 program evaluation by DFID, but has yet to be addressed by the Rwandan government.

Lessons Learned

R*evenue mobilization is a cumulative process.* While the implementation of VAT was a big driver of success, the case of Rwanda shows that a series of relatively small improvements in tax administration coupled with sensible but smaller tax policy measures can have meaningful impact on overall revenue collections over the years. For instance, the rollout of EBMs along with enhanced support to voluntary compliance and taxpayer outreach have each had incremental impact on revenue performance.

DRM success requires strong political, economic, and institutional foundations. The durability of the RRA owes much to an enabling external environment of good governance and the rule of law to curb corruption and ward off political interference. Indeed, RRA modernization has benefited from a stable political and economic environment as well as from sustained, strong political support.

Better monitoring and evaluation of DRM projects is sorely needed. Although the DFID project and the ICF produced reports on program objectives and outputs, it is difficult to attribute key successes in boosting revenue or cutting taxpayer burdens to specific changes in policy, administration, or other factors.

Figure 3: Timeline of Major Tax Reforms, 2001 - 2016