Fiscal policies to reduce inequality

Analysis of German reform partner countries

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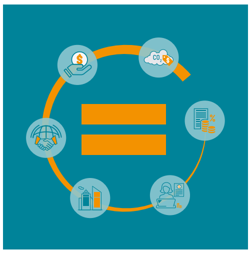

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List of abbreviations

ATAF	African Tax Administration Forum
AUC	African Union Commission
CIT	Corporate income tax
D	Dinars
ETB	Ethiopian Birr
ETS	Emissions Trading Scheme
EUR	Euro
GDC	German development cooperation
GDP	Gross Domestic Product
GFG	Good Financial Governance
GHS	Ghanaian New Cedi
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
ILO	International Labour Organization
IMF	International Monetary Fund
LEAP	Livelihoods Empowerment against Poverty
NDP	National Development Plan
NHIS	National Health Insurance Scheme
OECD	Organisation for Economic Co-operation and Development
PFM	Public Finance Management
PIT	Personal Income Tax
PMT	Proxy Mean Test
PNAFN	Programme National d'Assistance aux Familles Necessiteuses
PSGouv	Programme Social du Gouvernement
PSNP	Productive Safety Net Programme
RAMED	Régime d'Assistance Médicale
TIN	Taxpayer Identification Number
TND	Tunisian Dinar
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund
VAT	Value-added Tax
XOF	CFA-Franc BCEAO
WAEMU	West African Economic and Monetary Union

Glossary

Base erosion and profit shifting (BEPS) – refers to legal tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules in an artificial way to avoid paying tax.

Capital gains tax – a tax levied on the profit from the sale of an asset, for example, financial securities or property.

Carbon pricing – a cost applied to carbon emissions to encourage polluter to reduce the amount of carbon emitted. The most common forms of carbon pricing are a carbon tax or an emissions trading scheme.

Cash transfer – form of social assistance provided by the government to subgroups of the population deemed eligible by society on the basis of their vulnerability or poverty.

Contributory programme – transfers provided to people that depend on a history of contributions by the beneficiary or his/her employer, e.g. a pension.

Consumption tax – a tax levied on consumption spending on goods or services. Consumption taxes can include excise levies, sales taxes or a value-added tax.

Direct tax – a tax paid directly to the government/imposing entity by the person on whom it is imposed.

Distortion – when the imposition of a tax results in changes to economic variables that could result in lower economic growth over time. For example, personal income taxes can lead to less saving by the wealthy, which leads to less investment. The long-term impact could be less economic growth.

Elasticity – the extent to which the demand for a good or service changes with the change of its price. Goods that are necessities, such as staple foods and fuels, will see little change in how much of a good is sold, even if the price goes up. This good is said to be price inelastic. If consumers have alternatives, or if goods are a luxury, the amount of the good sold will change by much more than that of a necessity when prices increase. In terms of tax incidence, if a good's demand is inelastic relative to the supply, producers will be able to shift more of the tax onto consumers and thus consumers bear the incidence.

Equality – the right of individuals or groups to have the same treatment and the same social position.

Excise levy – a tax levied on the consumption of a specific good, often with the goal of raising revenue and decreasing consumption of a socially undesirable good like tobacco or alcohol.

Exemption – an exemption is a deduction to reduce the amount of income (entirely or partially) that would otherwise be taxed.

Externality – when costs or benefits are imposed on other parties without their consent. Often the solution to the problem of an externality is to internalise the cost, i.e. make the originators pay for the damage, through the use of a tax, such as a carbon tax.

Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) – the Global Forum is a group of over 160 jurisdictions that includes all G20 countries, financial centres, and the majority of its members are developing countries. Together they work on an equal footing to put an end to offshore tax evasion by fostering the effective implementation of transparency and exchange of information standards worldwide and more specifically, the exchange of information on request (EOIR) and automatic exchange of information (AEOI).

Income – money received on a regular basis, usually from a salary, in exchange for the provision of work, for the production/provision of a good or a service or the proceeds from investments.

Income tax – a tax levied on the income that a business or individual earns.

Indirect tax – a tax collected by an intermediary from the person who bears the ultimate economic burden of the tax. Usually refers to taxes such as consumption taxes.

Inequality – a fundamental disparity that permits one individual certain (material) choices, while denying another individual those very same choices. In terms of taxes this handbook focusses on two forms of inequality that are important:

- Horizontal inequality – do taxpayers with similar levels of income pay similar levels of tax?
- Vertical inequality – is the tax paid proportionate to the ability to pay? In other words, is the tax burden distributed fairly so that those who are able to pay more, pay more?

Nexus – a connection between the taxing authority and an entity that must collect or pay the tax. Without a sufficient nexus the taxing authority is not allowed to impose taxes on the income of the entity.

Non-contributory programme – transfers provided to people that are independent of a history of contributions by the beneficiary or his/her employer, e.g. cash transfer for disabled persons.

OECD Inclusive Framework on BEPS – an initiative where over 135 countries and jurisdictions are collaborating on the implementation of measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. This work includes the challenges of taxation in a digitalised economy.

Personal income tax (PIT) – a tax levied on an individual's income. This can include wages and salaries, which are usually paid to tax authorities by the employer, on behalf of the employee. The personal income tax often includes income from capital gains and income from interest. The treatment of dividends varies by country, ranging from fully exempt from personal income tax to fully subject to the tax. The self-employed have to file their own return and make their own payment.

Proxy means test (PMT) – gives a score to each household based on a set of observable household characteristics that are suggestive of whether a household is poor. Such characteristics may include the size of the household; the gender of the head of the household; the demographic composition of the household, household's assets, etc.

Recycled revenue – refers to the spending of revenue that is generated from the imposition of carbon pricing. On what objectives or how this revenue is spent determines how progressive the carbon pricing scheme/carbon taxes will be.

Share equity – the shareholder's claim on assets after a company's debts have been paid.

Tax base – the total amount of assets or income that can be taxed by a taxing authority, usually by the government. It is used to calculate tax liabilities. This can be in different forms, including income or the value of property. The base can be narrowed by increasing exemptions, i.e. excluding certain parts of the base from taxation.

Tax incidence – who ultimately bears the burden of a tax, as opposed to on whom it is initially imposed (only pays it to the taxing authority). For example, a tax on petrol is paid by refineries, but the tax is part of the final price of the product (however, (often) separately stated). Thus, the economic burden of the tax is on the consumer and not the refineries.

- A tax is regressive if the incidence falls on people in poverty.
- A tax is proportional if the tax rate is the same for all who pay, regardless of income.
- A tax is progressive if the rich pay more, i.e. the incidence falls on the wealthy.

Tax rate – the ratio, usually a percentage, at which a person or company pays tax.

- The **statutory** tax rate is the rate specified in the law.
- The **effective** tax rate is the rate that is actually paid, after all deductions.
- The **average** tax rate is the rate paid over all income.
- The marginal tax rate is the rate paid on the last Euro.

Value-added tax (VAT) – is a consumption tax placed on a product (or service) whenever value is added at each stage of the supply chain, from production to the point of sale. The amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed.

Wealth – the assets a person, family or corporate owns, including property and financial assets.

Wealth tax – a tax on the assets that an individual or entity owns, rather than on their income. Wealth taxes come in many forms:

- Property taxes levy taxes on the value of property that is owned.
- Inheritance taxes tax the value of the transferred wealth at the time of death.
- Net wealth taxes levy a tax, usually a small percentage, on the size of the assets owned.

1

INTRODUCTION

The objective of this analysis is to provide an overview of the state of inequality and existing fiscal policies to reduce inequality in the reform partner countries of German development cooperation (GDC) – namely Côte d'Ivoire, Ethiopia, Ghana, Morocco, Senegal, Tunisia and Togo. This analysis also assesses if and how new fiscal policies can be introduced, and reforms to existing policies can be implemented to improve their impact on the reduction of inequality. For GDC, reform partner countries are particularly reform-minded countries that receive increased support, both from technical and financial cooperation, tied to the delivery of agreed results (BMZ, n.d.).

The country briefs below contain information on each country emphasising the data available on inequality, the existing fiscal policies in each country and what further options are available. This study is part of a broader assessment on how fiscal policies are best implemented to reduce income inequality. As such, this study focuses on the fiscal policies that are frequently used by governments and/or could have a substantial impact on the reduction of inequality:

- On the revenue side: personal income tax (PIT), corporate income tax (CIT), digital services taxes, wealth taxes including property taxes, policies to effectively tax the wealthy, consumption taxes, and carbon taxes. Carbon taxes and digital services taxes are addressed because they are politically increasingly relevant, and their revenues can be reused for pro-poor spending.

- On the expenditure side: spending on social protection, in particular cash transfer programmes. Each country brief also presents data on government spending on health and education, although this study does not review education and health policies in detail.

2

COUNTRY BRIEFS

2.1 Côte d'Ivoire

Table 1: Côte d'Ivoire indicators[1]

Indicator	Latest available data	Source, latest date
Population (million)	26.9	World Bank, 2020
GDP per capita (EUR)	2,008.51	World Bank, 2020
Average monthly earnings of employees (EUR)	169	ILO, 2017
GDP (million EUR)	54,091	World Bank, 2020
Gini coefficient	41.5	World Bank, 2015
Income share of top 10% (percent)	31.2	World Bank, 2015
Income share of bottom 10% (percent)	2.1	World Bank, 2015
Poverty headcount at $5.50 a day (percent)	83.2	World Bank, 2015
Average GDP growth (percent)	1.81	World Bank, 2020
Government revenue/GDP	15.0	IMF, 2020
Government expenditure/GDP	20.6	IMF, 2020
Debt/GDP	47.7	IMF, 2020
Government expenditure on education as % of GDP	3.3	World Bank, 2018
Domestic general government health expenditure (% of GDP)	1.21	World Bank, 2018
Public spending on cash transfers	--	--
Labour force participation rate (percent)	56.06	World Bank, 2017
Labour force participation rate – female (percent)	48.17	World Bank, 2017
Informal employment (percent)	84.8	ILO, 2017
Gender pay gap[2]	--	--
Main industries	• Agro-processing • Cocoa and cashew nuts farming • Construction • Oil sector	--
Member of Addis Tax Initiative	No	--

1 GDP is measured in millions of constant US dollars. GDP per capita is measured on a purchasing power parity basis. Poverty headcount is ratio at $5.50 a day (2011 PPP). GDP average is over the last ten years. Data sourced from World Bank (n.d.) Development Indicators. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021a) Article IV. Average monthly earnings of employees and informal employment from International Labour Organization (ILO, 2020) decent work statistics. Public spending on cash transfers from ASPIRE database (World Bank 2020b). Latest years available 2015-2020. Current exchange rates are applied: Exchange rate 1 USD = 0.8817 EUR. Exchange rate 1 XOF = 0.0015 EUR.

2 There is no data available for gender pay gaps in developing economies.

Current tax policies

In Côte d'Ivoire, tax revenues were equivalent to 12.2% of gross domestic product (GDP) in 2019, improving slightly from 12.1% in 2018. The improvement was primarily driven by the digitalisation of revenue administration operations, which boosted value-added tax (VAT) collection. Preliminary estimates from the first quarter of 2020 indicate the need of additional funding equivalent to 0.2% of GDP due to the impact of COVID-19 pandemic and mitigation measures. Collecting tax revenues equivalent to only 12% of GDP will limit the scope of inequality-reducing policies on both the expenditure and revenue side.

The standard VAT rate is 18% and there is a 10% rate for fees and commissions charged by financial institutions (Deloitte, 2019). Some items are exempt from VAT, such as fertilisers, feed for livestock and farmyard animals, and medicine. A reduced rate of 9% applies to products made from durum wheat, milk, petroleum products and on equipment for the production of solar energy (Lloyds Bank, n.d.). In 2018, VAT revenues represented 21% of total tax revenues, which was lower than the tax revenues from other taxes on goods and services (38%). Despite recent improvements in collection, VAT revenue remains low mostly due to various VAT exemptions, such as in the agribusiness and transportation sectors. Recent data on the impact of VAT on inequality is not available. However, estimates from 2015 indicate that VAT was slightly progressive (Jellema and Tassot, 2020).

Among the taxes on goods and services other than VAT, in 2019 the government introduced a package of mobile money sector specific taxes, amounting to 7.2% of the mobile money providers' total revenue. This fiscal measure replaced a 0.5% transaction tax introduced in 2018, which caused public outcry. Mobile money operators may try to pass on the taxes to consumers, by increasing the price of their services. This would disproportionally affect poorer households and reduce poor households' access to these services.

CIT accounted for 13% of tax revenues in 2018. The CIT standard rate is 25% and a 30% rate applies to telecom companies. Some advantages are granted to the agricultural sector and specific firms through state conventions. CIT is not levied on the profits of small enterprises[3], which pay a presumptive tax in lieu of VAT and CIT depending on how large turnover is. Its threshold has not been updated since 2001, which means that the tax is becoming more regressive over time because inflation is reducing the value of the threshold.

PIT is imposed at progressive rates ranging from 2% to 36% on different types of income. Salaries are taxed at rates from 0% to 60% and a self-employed individual may elect to be taxed at a flat rate of 20% instead of being subject to the general income tax. In general, PIT revenues represent less than 1% of total tax revenues due to the high degree of informality of the Ivorian economy.

Property taxes are charged on the actual or potential rental income of landlords and apply to built and unbuilt land. Revenues from property taxes are collected centrally and are lower than those observed in comparable countries, which might reflect the complexity of the tax schemes including numerous tax exemptions (Franzsen and McCluskey, 2017; Tayoh, 2017).

In Côte d'Ivoire, wealth taxes on net wealth or on the transfer of wealth are not applied. There are transfer taxes, in case of a transfer of property through a direct sale. Tax rates vary depending on the type of transfer (lease or sale) and type of property (real estate or business) (PWC, n.d.).

Carbon taxes are also not implemented, although the government launched a project on carbon taxation in 2018 to plan, design and implement a carbon tax at national level, as well as to propose various options for the use of revenues generated (World Bank, 2019a).

The International Monetary Fund's (IMF) analysis of the performance of the tax system (IMF, 2019c) outlines that while there have been administrative improvements in tax collection, key drivers of economic growth remain relatively untaxed (for example, the construction, mining and oil sectors, and some exports such as cacao waste). This is mainly due to tax exemptions, which account for at least 1.5% of GDP in 2017-2018 based on national estimates (Government

3 This tax regime is only for entities with a projected turnover below 50 million XOF (approximately 75.000 EUR) if they are selling goods and below 25 million XOF (approximately 32.000 EUR) if they are selling services (Focus Venture, 2020).

of Côte d'Ivoire, 2018). Tax revenue performance is assessed to lag behind other countries in the region and emerging markets (IMF, 2019c).

The heavy reliance on consumption taxes limits the progressivity of the tax system, however the proceeds can nonetheless be used to decrease inequality. The highest share of tax revenues in Côte d'Ivoire in 2018 was contributed by consumption taxes, encompassing VAT, sales taxes and excise taxes (about 60% of total tax revenues). The impact of consumption taxes (with the exception of the excise tax on alcohol) is progressive in Côte d'Ivoire, potentially due to the various exemptions and reduced rates applied to certain goods. Nonetheless, the contribution of consumption taxes to inequality reduction is small (slightly above 0.25 Gini points[4]). Côte d'Ivoire achieves inequality reduction primarily through preschool and primary education spending rather than taxation (Jellema and Tassot, 2020).

4 The Gini coefficient is a statistical measure to represent the income inequality or wealth inequality within a country, region or any other group of people. The amounts can run from 0 to 100: Higher values representing more unequal distributions. A calculated amount of 0 represents 0 percent concentration income distribution (everyone receives exactly the same income). A Gini coefficient of 100 represents 100 percent concentration in a country's, region's or group's income distribution (one person receives all of the country's income).

Current social protection

In Côte d'Ivoire, the social protection system mainly includes contributory programmes, such as pensions and some form of social insurance schemes for formal private-sector workers and civil servants, only 7% of the overall population.

Cash transfer programmes, for example to orphans, disabled persons and poor households are negligible in terms of both coverage and spending. However, enhancement of the social protection system for vulnerable households is one of the objectives of the government's National Development Plan (NDP 2021–2025). In 2019, the government launched a national social programme (*Programme Social du Gouvernement* – PSGouv programme), to improve access to education, health care, electricity, potable water, social cash transfers, and employment opportunities for young people, as well as to improve connectivity, particularly in rural areas. While the programme was as large as 1.8% of GDP in 2020, most funds are allocated to investment spending to improve access to basic services. Development partners (World Bank and the African Development Bank) financially support the expansion of cash transfer programmes.

As part of the PSGouv programme, in October 2019, the government gradually introduced a universal health care system based on new social contributions, with some healthcare services provided free of cost to all citizens (for example prenatal and postnatal care). The scheme's sustainability needs to be assessed before national scale-up.

The PSGouv programme launched in 2019 might increase the equalising impact of fiscal policies in Côte d'Ivoire. As mentioned above, Côte d'Ivoire reduces inequality mainly through fiscal policies on the expenditure side. In this respect, the government's commitment to improve access to education, and health care, as well as to expand coverage of cash transfer programmes is promising. Nevertheless, the equalising impact might be reduced by the small size of the cash transfers (amounting to 0.01% of GDP)[5] and the use of public spending to finance subsidies, especially on electricity. These subsidies are regressive and increase inequality (Jellema and Tassot, 2020), although they are a key element of the government's strategy to improve access to electricity for poor households.

5 Preliminary estimate based on total spending on monetary transfers to rural households under the PSGouv programme in 2019 (XOF 3.7 billion – about 5.6 million EUR).

Scope for introduction of other policies

Using data from 2015, the Organisation for Economic Co-operation and Development (OECD) assessed that the combined effect of tax instruments and public spending is only modestly equalising in Côte d'Ivoire (Jellema and Tasson, 2020). Indirect taxes, except the alcohol excise tax, and expenditure policies, with the exception of vocational or tertiary education and electricity subsidies, are slightly progressive. Overall, fiscal policy reduces inequality by 1 Gini point. This is lower than the average of other low- and middle-income countries in Africa.

After several years of civil unrest ended in 2011, Côte d'Ivoire is experiencing a period of relative stability. The economy has been growing by an average yearly growth of 8% since 2012, driven by agribusiness exports (cocoa and cashew nuts value chains), petroleum product exports as well as good performance in the construction sector, telecommunications sector and other services. However, the COVID-19 pandemic affects the country's economic development and thus revenue collection negatively. Additionally, spending needs have risen significantly.

Despite previous stable growth, inequality has fallen slowly. In 2015, the Gini coefficient was only 1.7 points lower than the value registered in 2008. Inclusive growth is now a priority of the government, as identified by the NDP 2021-2025 and the Plan Stratégique Décennal Côte d'Ivoire 2030.

The government undertook an ambitious reform agenda to improve revenue mobilisation and public spending efficiency. The tax administration rolled out a new online tax filing module for firms, which facilitated VAT collections. A Single Tax Identification Number for all new businesses has been introduced to improve tax administration. Similarly, the ongoing development of an online cadastre should help boost property tax revenue.

The government has also recognised the importance of complementing efforts aimed to improve tax administration with fiscal policy measures to broaden the tax base, reduce distortions and contribute to a more effective resource redistribution. This is likely to have a positive impact on the reduction of inequality. Some areas of improvements were identified in the 2019 budget documents, for example reforms to the VAT, CIT (related to the reduction of exemptions) and property taxes (to facilitate administration). This could represent a good starting point to implement changes that are more ambitious.

On the expenditure side, abolishment of regressive subsidies (for example electricity subsidies) is likely to face social and political opposition due to concerns related to access and affordability. In fact, a 2016 electricity tariff increase was cancelled because of a strong negative reaction from the public.

The scope for introducing new spending policies and reforms is likely to be constrained by limited domestic resources. The implementation of the PSGouv programme, which is mostly accommodated within the current budget should progress. However, the fiscal deficit is expected to reach 5.3% of GDP by the end of 2020, due to tax relief in some economic sectors and increased spending in response to the COVID-19 pandemic. While this crisis might represent an occasion to foster investments in social protection, fiscal pressures might reduce spending in the medium term, reducing the scope for action.

More broadly, enhancement and sustainability of the inclusive growth agenda is subject to political risks, as well as external shocks, such as a decline in cocoa and cashew nuts prices. The October 2020 election confirmed President Alassane Ouattara for a third term in office. However, there has been ongoing tensions in the country with risks of more violence. In addition, it remains to be seen how the elected government will deliver its promise to not raise the cost of living domestically, while committing to raise taxes on profits.

Recommendations for application of reform strategies

While the expansion of cash transfers and the abolishment of regressive subsidies are advisable, there seems to be little scope for change in the short term due to political and fiscal considerations. Nonetheless, the country faces only a modest risk of debt distress, which might allow some room for increase in borrowing.

With this in mind, reform strategies can focus on improving tax revenue mobilisation to create fiscal space to expand public spending in the longer run. This is in line with the IMF's recommendations. The country could consider:

- **Rationalising and removing VAT exemptions,** especially for sectors and goods consumed by the relatively wealthy (for example, some imported goods).
- **Removing firm-specific tax exemptions** granted through state conventions. This would broaden the tax base and make the tax system more transparent.
- **Using the online property cadastre** to enhance property taxes collection capacity. Exemptions can also be removed, and rates simplified to move toward a single tax on both built and unbuilt land.
- **Supporting the government project on carbon taxation** and steering use of revenues generated toward social spending for cash transfers.
- **Supporting the government to counter tax avoidance and tax evasion** which would help to make the better-off paying their fair share of taxes. This would be in line with the country´s membership and corresponding obligations in the OECD Inclusive Framework on base erosion and profit shifting (BEPS) and the Global Forum.

2.2 Ethiopia

Table 2: Ethiopia indicators[6]

Indicator	Latest available data	Source, latest date
Population (million)	114	World Bank, 2020
GDP per capita (EUR)	825.57	World Bank, 2020
Average monthly earnings of employees (EUR)	60	ILO, 2013
GDP (EUR)	54,091	World Bank, 2020
Gini coefficient	35	World Bank, 2015
Income share of top 10% (percent)	28.5	World Bank, 2015
Income share of bottom 10% (percent)	2.9	World Bank, 2015
Poverty headcount at $5.50 a day (percent)	90.2	World Bank, 2015
Average GDP growth (percent)	6.01	World Bank, 2020
Government revenue/GDP	13.0	IMF, 2021
Government expenditure/GDP	16.0	IMF, 2021
Debt/GDP	52.7	IMF, 2021
Government expenditure on education as % of GDP	4.73	World Bank, 2015
Domestic general government health expenditure (% of GDP)	0.77	World Bank, 2018
Public spending on cash transfers	--	--
Labour force participation rate (percent)	79.6	World Bank, 2013
Labour force participation rate – female (percent)	73.4g	World Bank, 2013
Informal employment (percent)	--	--
Gender pay gap	--	--
Main industries	• Agro-processing • Textiles • Beverages	--
Member of Addis Tax Initiative	Yes	--

6 See footnote 2. Latest years available 2015-2020, except for Average monthly earnings of employees, data is for 2013. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2020a).

Current tax policies

Ethiopia has a fairly low level of tax to GDP, at only 11.7% of GDP in 2019 (IMF, 2020). Surprisingly, this level has declined over time, from 20% of GDP in 2004. The decline in revenue performance will have implications for expenditure, because there will be less revenue. With less tax being raised, tax instruments to reduce inequality will also be less effective. In order to have an impact on inequality, the government needs to improve revenue performance. The IMF (2020) Article IV Report from January envisaged revenue climbing to 14.7% of GDP by 2023/24, but this was before the COVID-19 crisis, so this number is unlikely to be achieved. The African Development Bank confirmed that tax revenues increased by 16%, but that the tax-to-GDP ratio decreased to 9.2% in 2020 as a result of the COVID-19 pandemic in 2020.

Ethiopia has a progressive PIT, with seven bands and a top rate of 35% on income over ETB 10,900 (EUR 236) per month. This is a low level to have as a top tax bracket and implies that many taxpayers will be paying the top rate. The basic exemption applies only on monthly salaries below ETB (EUR 13), which is quite low. Hill et al. (2017) found that Ethiopia's PIT was progressive but poverty-increasing because the basic exemption was so low.

Capital gains are taxed at 15%, CIT is levied at 30% and Ethiopia imposes a VAT of 15%. Financial services, medical services and supplying the central bank with gold are exempt from VAT. Excise taxes are levied on tobacco, alcohol, soft drinks, sugar and cars, amongst others. Import tariffs account for 30% of tax revenue, as does the VAT. Tariffs can be regressive as the poor consume more of their income on goods, while the wealthy consume both goods and services. Services are not subject to tariffs. Ethiopia does not have a carbon tax or a digital services tax. Ethiopia discussed to introduce a property tax in fiscal year 2020/21.

The central government provides 38% of total central government expenditure to state governments. Ethiopia shares revenue between the central government and regional governments. If a company is registered in a region, the central government will share any CIT with the district government where the company is registered on a 50-50 basis. For VAT, the split is 70% for national government and 30% for regional governments. This arrangement might have increased regional inequalities. Many companies have their headquarters in Addis Ababa, even though most of their revenue or production occurs in other regions. In this case, the revenue from the CIT will flow to Addis Ababa, the richest region. In the case of VAT, traders who buy their goods in Addis Ababa and then sell them in poorer regions are entitled to an input rebate from the region they sell in. There is thus a fiscal transfer from the poorer region to Addis Ababa. The fact, that regions also align with ethnic boundaries, can make these tensions even more significant.

Exemptions are a perennial problem for tax authorities in Ethiopia. In the Letter of Intent to the IMF, Ethiopia undertook to reduce exemptions on VAT and excise taxes for imported goods (IMF 2020a). Ethiopia also placed a moratorium on the granting of new tax incentives. In 2007, taxes foregone as a result of incentives were 4.5% of GDP and it is not clear that the situation has improved since then. A fiscal incidence study of Ethiopia found that fiscal policy reduced income inequality, with the Gini coefficient declining by 2 points due to fiscal redistribution. Fiscal policy reduced the depth of poverty but increased the number of people in poverty (Hill et al., 2017).

Current social protection

Ethiopia's Productive Safety Net Programme (PSNP) is one of the largest social protection mechanisms in Africa. It was created to assist chronically food-insecure households. It consists of two parts. The public works component allocates work to able-bodied beneficiaries to construct community-owned assets. Wages can be either in cash or food. The direct-financial support-component is for households with elderly or disabled breadwinners. Payments are set to be similar to the local minimum wage. PSNP has been in operation since 2005 and has been extended to cover most of the country. PSNP has 8.3 million beneficiaries, which is substantial but still less than half of the poor population.

Hill et al. (2017) found that the PSNP was strongly inequality-reducing. It reduced the Gini coefficient by 0.993 points. PSNP has shown to be effective in relieving poverty as it is well-targeted at the poorest communities. The scheme also has a positive effect on beneficiaries' acquisition of assets and improvement in nutrition outcomes. The World Bank estimates that it has lifted more than 1.5 million people out of poverty. PSNP has also been shown to increase agricultural productivity and to increase access of beneficiaries to healthcare and education.

Despite the successes of the PSNP, financing it has been difficult. In the past, PSNP was mostly funded by foreign aid, with some input from the government of Ethiopia. However, aid flows to Ethiopia have declined as the country's economy has grown. The result is that the value of the payments has declined over time. For example, the value of the benefit was tied to the cost of 15kg of wheat per person and 4kg of pulses. From 2015, the value of the 4kg of pulses was dropped from the benefit calculation. The decline in the size of benefits has reduced the anti-poverty impact of the programme.

Social protection will be even more important as Ethiopia faces a decline in economic activity caused by the COVID-19 pandemic. The United Nations International Children's Emergency Fund (UNICEF) estimated that COVID-19 would reduce economic growth by 2.9 percentage points in the current fiscal year (UNICEF, 2020).

Scope for introduction of other policies

Ethiopia is struggling to avoid a fiscal crisis. Debt has risen to 52.7% of GDP. This is not a substantial amount of debt, but it is concerning when revenue performance is so weak. As a result, Ethiopia has entered an IMF programme and has committed to reduce expenditure, which will limit the scope to increase expenditure on cash transfers. Indeed, fiscal consolidation often increases inequality.

Ethiopia subsidises electricity and fuel. Although it is difficult to establish exactly how large the subsidy is, the IMF estimates that it could be as large as 2.25% of GDP. This is a substantial sum in an economy that only raises 11.7% of GDP as tax revenue. A fiscal reform could move funding for these subsidies to cash transfers. This would have a substantial impact on inequality, as these subsidies are usually regressive.

In the Letter of Intent to the IMF, Ethiopia undertook to reform PIT by increasing the basic exemption. This would make the tax more progressive and reduce the administrative burden of the tax. The PIT brackets appear to be taken effect at quite low levels. An increased basic exemption should be allied with a steeper schedule that places the incidence on the middle-class and wealthy.

Recommendations for application of reform strategies

Ethiopia needs to urgently increase tax collection. It is very unusual for countries that grow rapidly to find that tax collection is lagging, but that is the exact situation that Ethiopia finds itself in.

- **The overuse of tax incentives needs to be stopped and reduced.** Currently tax incentives are granted by the Ethiopian Investment Commission, without any input from the Ministry of Finance. This needs to be corrected, with the Ministry of Finance having at least a say, if not an outright veto on any decisions on tax incentives.

- **PIT is important to reduce inequality, but Ethiopia appears to have misconfigured the tax.** The basic exemption should be increased, and the rate schedule made steeper, with a top tax bracket at a much higher level of income.

- **Ethiopia's decision to implement property taxes mentioned in the 2020 IMF Article IV Report is a good starting point.** Ethiopia should aim at implementing this decision thereby using a system which is practicable and relatively easy to implement. If implemented on a decentral level, this could improve the financial situation of the regions and lead to improved pro-poor spending and service delivery for the broader population. If linked to better service delivery, such a tax, if reasonable designed, might not face that much opposition.

- **Social spending on the PSNP needs to be maintained, as the programme has a significant impact on inequality and poverty.** This will be difficult to achieve under an IMF programme, when the government has committed to reduce expenditure.

2.3 Ghana

Table 3: Ghana indicators[7]

Indicator	Latest available data	Source, latest date
Population (million)	31.07	World Bank, 2020
GDP per capita (EUR)	2,053.07	World Bank, 2020
Average monthly earnings of employees (EUR)	69.41	ILO, 2017
GDP (EUR)	63,794	World Bank, 2020
Gini coefficient	43.5	World Bank, 2016
Income share of top 10% (percent)	32.2	World Bank, 2016
Income share of bottom 10% (percent)	1.6	World Bank, 2016
Poverty headcount at $5.50 a day (percent)	55.1	World Bank, 2016
Average GDP growth (percent)	0.41	World Bank, 2020
Government revenue/GDP	12.9	IMF, 2020
Government expenditure/GDP	28.2	IMF, 2020
Debt/GDP	78.9	IMF, 2020
Government expenditure on education as % of GDP	3.99	World Bank, 2018
Domestic general government health expenditure (% of GDP)	1.38	World Bank, 2018
Public spending on cash transfers	0.05	World Bank, 2016
Labour force participation rate (percent)	56.96	World Bank, 2017
Labour force participation rate – female (percent)	55.3	World Bank, 2017
Informal employment (percent)	78.1	ILO, 2015
Gender pay gap	--	--
Main industries	• Retail trade • Cocoa • Oil and gas	--
Member of Addis Tax Initiative	Yes	--

7 See footnote 2. Latest years available 2015-2020, except for Average monthly earnings of employees, data is for 2013. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021b).

Current tax policies

Ghana collects only 11.5% of GDP in revenue, less than the average for sub-Saharan Africa. Tax to GDP declined from 12.6% in 2018 and 12.2% in 2019 to 11.6% in the pandemic year of 2020. However, nominal tax revenue accrued by government increased from GHS 32.2 billion in 2017 to GHS 44.5 billion in 2020. The low level of revenue limits the ability of the state to use taxes for redistribution and for funding progressive expenditure. The government of Ghana has recognised the problem and adopted the slogan of "Ghana Beyond Aid", which seeks to reduce Ghana's dependency on international aid and increase tax collection through broadening the tax base, improving tax compliance and tax administrative efficiency as well as providing online tax filing. However, Ghana's economy grew at an average rate of just 0.2% for the first three quarters of 2020. This outturn reflects the huge impact of the COVID-19 pandemic on Ghana's economy. As such, tax revenue targets were revised downward to reflect the COVID-19 pandemic shock on the economy. Several tax policy measures were instituted to mitigate the impact of the pandemic. These reliefs included waivers of income tax on health workers, waivers on VAT and other levies on personal protective equipment and remission of penalties.

Ghana collects its revenue primarily from three main sources: (i) taxes on income and property[8] raise 6.1% of GDP, (ii) taxes on domestic goods and services (comprising excise tax, VAT, National Health Insurance Levy, etc.) raise 5.8% of GDP, and (iii) taxes on international trade just above 2.0% of GDP.

Ghana has a progressive PIT, with six bands. The top rate is 30%. The tax is only paid by a small minority of the population. As of 31 October 2020, there were 5.7 million taxpayers who had a taxpayer identification number, out of a population of 30.4 million – from which 3.8 million people live in extreme poverty as of 2016. Although this is a low number of taxpayers, it is a significant improvement as 3.7 million new taxpayers were registered in 2019 and 2020 alone.[9]It is hoped that these newly registered taxpayers do also pay taxes in the end, though COVID-19 might affect this negatively.

Regarding wealth taxation, there is no inheritance tax or net wealth tax, however, Ghana collects property taxes. These are levied by local authorities. In Accra the property tax is levied on properties containing a building, except if it is used for religious, educational, or charitable purposes. Government and hospitals are also exempt. Given the low percentage of revenue raised through property taxes in comparison to other taxes, it might be worth exploring if there is a way to increase the revenue collected through it.

Standard VAT is levied at 12.5%, but two non-deductible levies of 2.5% for education and health drive it up to at least 17.5%. Wholesalers and retailers can opt for a 3% sales tax instead of VAT.

Using its national identification card number as tax identification number for individuals is a first step to capture the vast majority of citizens in the informal sector who in the past used to remain outside the tax net. This is a positive step to broaden the tax base; however, it needs to be ensured that taxes are actually collected from those newly registered taxpayers and the newly gained taxpayer information does not end up as an unused file box.

Implementation of new revenue sources: Ghana has proposed to implement a COVID-19 health levy in 2021. This proposed levy will increase the VAT and the National Health Insurance Levy by one percentage point to support the government in raising resources to sustain measures to address the pandemic. A 5% levy on commercial banks on profit before tax has also been proposed to raise revenue to support the government's financial sector reforms started in 2018. A sanitation and pollution levy as well as an energy sector recovery levy, which in effect will increase transport fares, will be implemented in 2021. These levies tend to be more regressive and may increase the general prices of goods and services

8 Please note that no separate numbers for income tax and property tax revenue are available because official statistics report them together. However, overall property taxation revenue is negligible in comparison to other tax income in Ghana.

9 From 1 April 2021, Ghana has begun to use the national identification card number for tax identification purposes. This new system has replaced the individually issued Taxpayer Identification Number (TIN).

(although some of them, e.g., the pollution levy) might set socially desirable incentives.

Two important inequality-reducing policies have been withdrawn. A top tax bracket for the PIT, 35% on salaries above EUR 1,400 a month, was rescinded so the top PIT rate reverts back to 30%. An excise duty on vehicles with an engine capacity above 3 litres, effectively luxury vehicles, was also withdrawn. Both of these measures were withdrawn by government following a political outcry. Drivers and car owners' associations were stridently opposed to the vehicle tax (Restar, 2019). Hence, suggesting that elites will try to push back against inequality-reducing measures. Government might have been more successful if it appealed to fairness to reduce tax avoidance and evasion to increase the amount of tax that the wealthy pay.

CIT is mainly collected from the manufacturing sector but could raise substantially more revenue. World Bank (2020a) analysis shows that 3.7% of GDP could be collected from the manufactured sector, compared to actual collections of only 1.5%. Half of this revenue from the CIT could come from large firms. This shows that there is still considerable room to improve CIT collection. In order to better able to target non-filing/ non-compliant businesses, the World Bank recommends the construction of a database to determine which were tax compliant. However, this does not mean that there needs to be a separate database, it would be sufficient to include such information in the current database or systems e.g. used by tax auditors or other public officials responsible for risk assessment and case selection.

Current social protection

Ghana spends only 0.5% of GDP on social protection. This is much lower than the 1.5% of GDP that lower middle-income countries spend on average, and also lower than the 2.1% of GDP that lower-middle income countries in sub-Saharan Africa spend.

Ghana has several social protection schemes. The most important is Livelihoods Empowerment against Poverty (LEAP), which is a conditional cash transfer programme. Beneficiary households must be extremely poor and contain a pensioner, an orphan or a person with a disability to be eligible. Grants range from GHS 64 (EUR 9) to GHS 106 (EUR 15), depending on the number of members of a household. LEAP reaches 1.5 million individuals in 332,000 households. The conditionalities relate to school attendance and regular health checks. LEAP has been shown to reduce food poverty by 25% and enhanced education outcomes through reduced absenteeism and grade repetition. LEAP also allowed a 7% increase in participation in Ghana's National Health Insurance Scheme (NHIS).

Ghana runs a NHIS, which covers treatment of 95% of the diseases common in the country. LEAP beneficiaries are automatically members of the NHIS. Membership is subsidised for children under 18, pregnant women, seniors, and those living in poverty. In total, 6.9 million people of the total membership of 10.5 million are subsidised by the State. The subsidy is paid through earmarking of VAT revenue.

Ghana has a mandatory social insurance scheme for pensions. All employees are required to enrol in the scheme and a portion of their wages is paid over to a retirement account. A contribution from the employer and the state are added. The scheme has three tiers, with increasing contributions. Tiers 2 and 3 are run by private sector companies. There is an informal sector pension scheme but take up of the scheme has been low.

Schooling is free, with government providing a per-student payment directly to schools. In 2004, when the scheme was piloted in the 40 poorest districts, it resulted in a 36% increase in pre-primary enrolment and a 14.5% increase in primary school enrolment. It was extended to the entire country in 2005. The scheme reaches 2.6 million learners.

Scope for introduction of other policies

The government of Ghana's priority is to raise more revenue, as outlined in the Ghana Beyond Aid policy. Any policies that are implemented will depend on having more revenue to spend and collecting taxes which cover a larger proportion of the population, to have a greater inequality-reducing impact.

Like most developing economies, Ghana has a substantial informal sector and is a cash economy. This makes taxation difficult. In this regard, fostering of mobile money payments could be a solution and support collecting revenue.[10]

Ghana subsidises electricity but a World Bank analysis found that only 8% of the subsidy was going to the poor, as less than one quarter of people living in poverty actually use electricity (World Bank, 2016b). The current electricity subsidy is large and regressive, so it should be reformed. Unfortunately, there are many beneficiaries of the subsidy, so reform will be difficult politically. This reform could be tied explicitly to shifting the expenditure to cash transfers. If this reform were successful, it would potentially lead to a substantial reduction in inequality.

Recommendations for the application of reform strategies

Ghana's primary concern is economic growth and reducing dependence on aid. Any support to Ghana should be tailored with this in mind. On the positive side, political stability means that Ghana is a candidate for substantial reforms.

- The priority must be to increase the amount of tax that is collected. Ghana collects a large amount of tax through consumption taxes, which can be regressive. If possible, the effort to collect more tax should fall on income taxes. The drive to register new taxpayers was quite successful and should be continued. However, it needs to be ensured that the registered taxpayers will also effectively pay taxes. Therefore, a further improvement of tax authority performance is crucial. As tax collection increases, citizens will demand increased quality public goods and services in return.

- At the same time, though, possible adverse effects of specific tax policies must be taken into account. The current one-sided focus on increasing revenue runs the risk of overlooking side-effects of taxation on other desirable goals such as poverty reduction and allocative efficiency – especially if changes to the system are not being applied in a systematic and coherent way.

- Additionally, the government could increase its activities against tax evasion which could help to make the better-off paying their fair share of taxes. This would be in line with Ghana´s membership in the Global Forum.

- Ghana has recently discovered new oil reserves, which should enter production by 2023. Since oil production tends to be very profitable and Ghana has engaged the IMF on how best to tax the use of the oil reserves, this could result in an increase in tax collection. With transparent and accountable management of the proceeds, revenue could then be used for inequality-reducing expenditures such as health, education, or social transfers.

- Reform of electricity subsidies is needed. This may be more difficult to achieve in an environment of rising tax revenues due to increased oil production as the case for reducing expenditure will be harder to make when tax revenues are rising.

- Increased revenue means more resources for inequality-reducing expenditure. This may create some momentum for further expansion of social protection expenditure, which is at very low levels compared to its peers.

10 Please refer to the study on taxing mobile money commissioned by the GIZ Sector Programme Good Financial Governance for more detail.

2.4 Morocco

Table 4: Morocco indicators[11]

Indicator	Latest available data	Source, latest date
Population (million)	36.91	World Bank, 2020
GDP per capita (EUR)	2,653.26	World Bank, 2020
Average monthly earnings of employees (EUR)	--	--
GDP million (EUR)	99,518	World Bank, 2020
Gini coefficient	39.5	World Bank, 2013
Income share of top 10% (percent)	31.9	World Bank, 2013
Income share of bottom 10% (percent)	2.7	World Bank, 2013
Poverty headcount at $5.50 a day (percent)	30.2	World Bank, 2013
Average GDP growth (percent)	-7.12	World Bank, 2020
Government revenue/GDP	25.6	IMF, 2019
Government expenditure/GDP	29.7	IMF, 2019
Debt/GDP	65.2	IMF, 2019
Government expenditure on education as % of GDP	5.3	World Bank, 2009
Domestic general government health expenditure (% of GDP)	2.14	World Bank, 2018
Public spending on cash transfers	0.11	World Bank, 2016
Labour force participation rate (percent)	45.5	World Bank, 2017
Labour force participation rate – female (percent)	23.72	World Bank, 2016
Informal employment (percent)	--	--
Gender pay gap	--	--
Main industries	• Tourism • Services	--
Member of Addis Tax Initiative	No	--

11 See footnote 2. Latest years available 2015-2020, except for Government expenditure on education as % of GDP (2009). Exchange rate 1 MAD = 0.092 EUR. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021c).

Current tax policies

Total public revenue represented 25.6% of GDP in Morocco in 2019, of which 21.4% are tax revenues. This is in line with other countries in the region. This is higher than the average for lower-middle income countries (15.5%), but lower than neighbouring Tunisia (31.4% in 2012). Morocco's economic growth sharply decreased by 7.12% due to the COVID-19 pandemic.

While PIT and CIT rates are comparable to those of many European countries, their impact on income distribution is limited due to the high level of informality of the economy. The top marginal income tax rate in Morocco is 38% (for incomes over D 180.000 equivalent to EUR 16,600/year). CIT is nominally progressive, rising to 31% for companies with a taxable income over D 1 million per year (EUR 91,985) (Deloitte, 2019). In practice, the vast majority of CIT actually comes from just a handful of large and international firms, as the overwhelming majority of firms are small or very small and informal. This reduces the tax base and increases the reliance on financing from donors, the diaspora and the Gulf States. Taxes on incomes, profits and capital gains account for one third of total tax revenue, whereas taxes on goods and services (VAT) account for 44.9%[12]. The VAT rate is a flat 20% tax on consumer goods.

The heavy reliance on VAT and the difficulties of collecting income and corporate taxes mean that the tax system is unlikely to serve as an effective tool to correct income inequalities in Morocco. However, given the size of the overall tax envelope, there is scope for using the public purse to correct income inequalities through public expenditures.

Interviewees mentioned the complexity of the current tax system as one explanation for its relative lack of effectiveness. Currently, there are 32 different taxes in place. A large tax reform is planned, which aims to simplify the tax structure and broaden the tax base, focusing on two main taxes. However, to date, progress has been limited due to political sensitivities. State capacity for implementation is however considered to be adequate by regional standards (see World Bank, 2019b).

12 World Bank, World Development Indicators. Reference year 2018.

Current social protection

The current social protection system in Morocco is rudimentary. There are different elements of a contributory social protection system that have developed over time to cover different needs, such as an old age pension, maternity leave and unemployment. These cover only civil servants and some formal sector employees (up to 32% of the population).

In addition, there are different ad hoc (non-contributory) programmes that have been set up in response to specific needs (e.g. widows, ex-combatants, etc.). The most comprehensive non-contributory social protection scheme appears to be the means-tested health insurance cover for poor families (Régime d'Assistance Médicale, RAMED), which was set up in 2011. It aimed to cover roughly the poorest quarter of the population (UNICEF, 2018). The King of Morocco, Mohammed VI., has mentioned expanding health insurance and old age pensions further in the future.

In response to the COVID-19 pandemic, the Moroccan government has set up ambitious compensatory schemes aimed at mitigating the impact of lockdown measures on the population. These schemes amounted to D 12.3 billion (about EUR 1.1 billion), which is more than 4% of total government spending (Ruddle and Williams, 2020). Morocco could afford this fairly ambitious level of spending due to the modest size of its public debt compared to other countries in the region.

Scope for introduction of other policies

Inequality in Morocco must be understood in light of its particular socio-economic and political context. Moroccan inequality is higher than in neighbouring North African countries (Gini coefficient: 39.5, compared to 32.8 in Tunisia). This reflects, in large part, the legacy of authoritarian rule, where the Royal palace has historically exerted almost total control over many sectors of the economy. The key informants interviewed for this brief described the Moroccan economy as oligarchic and a rent economy, where access to markets and investments were severely restricted and subject to approval by the palace. The law is in some cases used arbitrarily to restrict commercial operations of economic actors not linked to the palace.

Furthermore, there are important inter- and intra-regional inequalities. Large coastal cities in the North of the country, as well as some tourist hotspots, have dynamic economies, whereas the rural hinterland experiences high unemployment and underemployment and living conditions that are close to those of sub-Saharan Africa. Very little effort has been made to date to correct regional inequalities.

In recent years, this reality has come under increasing pressure due to social discontent emanating from the Arab Spring movement in 2011, as well as security concerns related to terrorism. The elites have responded to these pressures through a combination of security measures, social spending and managed democratisation. A new constitution was introduced after the Arab Spring and the first parliamentary elections were held in 2016.

The interviewees for this brief emphasised that the strategy remains very focused on a security response with less priority being placed on addressing the social issues underlying popular discontent. Currently, there is a moderate party in government, which has campaigned on the promise of increased social spending. However, its power remains limited, as is that of the parliament, and major policy decisions continue to require the approval of the King. The King directly nominates the four key ministers in government (Foreign Affairs, Finance, Religion and Interior).

This being said, the COVID-19 crisis has opened up an opportunity to introduce more ambitious reforms. In response to the economic crisis and long-term structural under-performance of the Moroccan economy, the King has tasked a commission with elaborating a new development strategy fit for the post-pandemic world.

Unlike many other countries in the region, Morocco is not dependent on fossil fuels or other natural resources, which tend to create inequalities and other economic and political distortions. Furthermore, Morocco is also advantageously placed near the Southern tip of Europe, which has committed to investing heavily in renewable energy. With the right incentives and investments, this could potentially become a novel source of green public financing for the Moroccan state, which could be used to finance social programmes.

Recommendations for the application of reform strategies

- **Work on political reform alongside technical reforms, as a precondition for ensuring genuine and sustainable change.** The key informants emphasised that the major obstacles to reform in Morocco are political rather than capacity based. For economic development to be sustainable, economic transformation will need to go hand-in-hand with continued democratic and social reforms. Otherwise, there is a risk that future economic growth could be co-opted and curtailed by the current oligarchy, in much the same way as past growth has been. In the long run, this would also increase the risk of social backlash.

- **Continue creating additional fiscal space for redistribution.** One possibility is promoting investments in solar and other renewable energy sources, to create new streams of revenue for the government. The scope for drastically expanding progressive income tax or CIT in the near future is limited by the structure of the economy, which is dominated by small and very small enterprises and characterised by a high degree of informality. However, there should be some room for activities against tax avoidance and tax evasion which could help to make the better-off paying their fair share of taxes. This would be in line with Morocco's membership and corresponding obligations in the OECD Inclusive Framework on BEPS and the Global Forum.

2.5 Senegal

Table 5: Senegal indicators[13]

Indicator	Latest available data	Source, latest date
Population (million)	16.74	World Bank, 2020
GDP per capita (EUR)	1,331	World Bank, 2020
Average monthly earnings of employees (EUR)	--	--
GDP (EUR)	21,963	World Bank, 2020
Gini coefficient	40.3	World Bank, 2011
Income share of top 10% (percent)	31.0	World Bank, 2011
Income share of bottom 10% (percent)	2.3	World Bank, 2011
Poverty headcount at $5.50 a day (percent)	88.4	World Bank, 2011
Average GDP growth (percent)	0.9	World Bank, 2020
Government revenue/GDP	20.4	IMF, 2019
Government expenditure/GDP	24.3	IMF, 2019
Debt/GDP	63.8	IMF, 2021
Government expenditure on education as % of GDP	4.83	World Bank, 2018
Domestic general government health expenditure (% of GDP)	0.95	World Bank, 2018
Public spending on cash transfers	0.03	World Bank, 2015
Labour force participation rate (percent)	48.83	World Bank, 2017
Labour force participation rate – female (percent)	38.38	World Bank, 2017
Informal employment (percent)	90.4	ILO, 2017
Gender pay gap	--	--
Main industries	• Mining • Construction • Tourism	--
Member of Addis Tax Initiative	Yes	--

13 See footnote 2. Latest years available 2015-2020. Current exchange rates are applied: Exchange rate 1 XOF = 0.0015 EUR. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021d).

Current tax policies

Total public revenues, excluding grants represent 20.4% of GDP in Senegal. Tax revenue accounts for 16.3% of GDP. This is slightly lower than the average for Sub-Saharan Africa, but higher than other lower-middle income countries. The COVID-19 pandemic will most likely contribute to a downwards trend.

On paper, Senegal has a progressive tax system. Progressive income tax ranges from 0% for individuals earning less than XOF 630,000 a year (EUR 960), to 40% for those earning over XOF 13.5 million a year (EUR 20,500). In practice, however, this affects less than 1% of the population who work in the public and formal sector. The income tax rate was reduced in 2012 to stimulate economic growth and increase tax compliance. The corporate tax rate is flat but relatively high at 30% (Deloitte, 2019). Again, this concerns only the tiny sliver of companies that operate in the formal sector. Overall, the application of corporate and PIT is limited because over 90% of the economy is informal.

Taxes on income, profits and capital gains account for a quarter of total public revenues, while taxes on goods and services represent 34% of total revenue (the VAT rate is 18%). Donor grants accounted for 21.2% of revenue in 2018 but have been steadily decreasing over recent years.

The effectiveness of the current tax regime is undermined by numerous exemptions and loopholes, which amount to an estimated XOF 400 billion (EUR 610 million), about 3% of GDP (Thioubou, 2016). The IMF has been pressuring the government to improve transparency and reporting around these exemptions, but information remains inadequate. The government has used tax breaks to attract foreign investments. If those tax savings for foreign investors are not invested back in the company in the country, Senegal would not profit from these exemptions and would have forgone tax revenue. Effective revenue collection is further undermined by a number of subsidies for fuel, electricity, and rice, which tend to be regressive.

Significant efforts have been undertaken in recent years to improve the effectiveness of tax administration by simplifying procedures, making services available online for firms, and improving the management of the tax authority itself. The property register has been digitised, which will help secure property rights as well as facilitating collection of property taxes.

Excise taxes exist for alcohol, tobacco and some luxury goods. Sales volumes and compliance are low, meaning that these represent a small share of the overall tax revenue.

Current social protection

The current development strategy (Plan Sénégal Emergent) is resolutely pro-growth and has focused on removing inefficiencies and obstacles to economic growth. At the same time, there is a recognition that economic growth needs to become more inclusive to be sustainable and to serve as an effective tool for poverty reduction. Consequently, tax cuts and subsidy removals have been counter-balanced with increased investments in social assistance for vulnerable groups (women, disabled, elderly) and other social sectors. However, these programmes remain very limited in scope, estimated to be XOF 20 billion (EUR 30 million) in 2015 or 0.2% of GDP (World Bank, 2017a).

The main non-contributory social protection programme in Senegal is the cash transfer programme called the *Bourse de sécurité familiale*. It targets 600,000 poor families using a proxy mean test (PMT), which is implemented through a unique registry. Each eligible family receives XOF 100,000 per year (EUR 152). While important for beneficiary families, this programme pales in comparison to remittances from overseas workers, which represented XOF 1,177 billion in 2017 (EUR 1.8 billion) – that is, approximately 20 times larger than the total size of the cash transfer programme.

The COVID-19 pandemic has led to increased investments in social protection to mitigate the impact of the economic crisis. The unique registry, which was set up to target poor households with cash transfers, has been used to disperse emergency assistance (rice) to one million households at a cost of XOF 1,000 billion (EUR 1.52 billion). The opposition has criticised this initiative both because of the lack of transparency around how beneficiary households were selected, and because the single registry is thought to be out of date and not reflecting the current situation of the population.

In addition, some efforts have been put in place to support firms that have been affected by the crisis. However, because these grants require the firms to show that they have lost at least 30% of their turnover since 2019, its use is limited to formal sector firms that have official accounting records.

Scope for introduction of other policies

Government's top priority is to accelerate economic growth. Poverty reduction comes as a distant second and inequality reduction is mostly absent from the public discourse. The interviewees for this study highlighted that even the opposition is not concerned with redistribution but focuses mostly on political issues. However, there is the chance to consider inequality aspects at least to a certain extent when conducting fiscal policy reforms.

The COVID-19 crisis has led to a sharp increase in social spending. It is hoped that this may open up an opportunity to change priorities moving forward, not least by raising the expectations of the population and showing what is possible once political exists. Social pressures on the government have been rising in recent years due to increasing inequalities generated by the chosen development model. These pressures are likely to increase further during the crisis and will need to be addressed. The health crisis has also exposed structural deficiencies in the health system and increased pressure on the government to increase investments and accelerate reforms in this sector.

At the same time, the scope for action is limited as the economic crisis will further aggravate the public debt situation, which already rose to 63.8% of GDP before the pandemic, due to several expensive projects undertaken by the Wade government and continued high levels of public spending by the current government. The budget deficit is projected to reach 7% of GDP in 2020. The limited fiscal space should not prevent the government from improving income distribution by continuing to remove costly and regressive subsidies on fuel and electricity, that are both regressive from an income distribution point of view and damaging for the environment.

Several key informants also highlighted the limited capacity of the Senegalese state, which hamper progress on education and health outcomes, for instance, despite comparatively high and increasing levels of public spending on these sectors. Public expenditure on education represents 40% of total government expenditures, yet learning outcomes remain modest by international standards, due to quality issues (unqualified teachers, over-full classrooms, etc.). Improving state capacity and removing institutional inefficiencies will therefore be a necessary precondition, both for reducing the public deficit, and for improving the impact of social spending in view of reducing inequalities.

Recommendations for application of reform strategies

- **Given the structural constraints of the Senegalese economy, a high level of informality, and the capacity constraints of the Senegalese state, it is likely that PIT and CIT will remain limited for the foreseeable future.** Besides strengthening the overall capacity of the tax administration, work must continue to gradually extend the formal taxpayer base – ideally starting with those who have an income considerably above existing allowances - and improve collection and administration of these taxes, so that they can be ready to respond once the economy has developed sufficiently to make these viable sources of public finance. Further, there should be some room for support with activities against tax avoidance and tax evasion which could help to make the better-off paying their fair share of taxes. This would be in line with Senegal's membership and corresponding obligations in the OECD Inclusive Framework on BEPS and the Global Forum.

In the meantime, there are some avenues that could be explored, based on current constraints:

- **The implementation of a property registry could strengthen the enforcement of the property tax.** The increased cost to property owners is likely to be more than offset by the increased security of property ownership that comes from officially registering the property.

- **Taxes on repatriated profits by international companies are comparatively easy to enforce, as these companies belong to the formal sector.** This would also create an incentive for companies to **reinvest profits in Senegal as an alternative to paying the tax. Such measures must, of course, be carefully calibrated in order not to discourage foreign investment.**

- **There is scope for reducing inequality without incurring additional costs, by removing inefficiencies, and abolishing regressive subsidies that weigh on Senegal's public finances.** It needs to be assessed whether building back subsidies is politically more feasible than introducing new taxes, such as carbon taxes.

- **There is scope for improving the quality and efficiency of public spending in education and health care.** This would improve the impact of current social spending levels, which are already high be regional standards, without incurring additional costs.

2.6 Togo

Table 6: Togo indicators[14]

Indicator	Latest available data	Source, latest date
Population (million)	8.28	World Bank, 2020
GDP per capita (EUR)	806.71	World Bank, 2020
Average monthly earnings of employees	134	ILO,2017
GDP (million (EUR)	6,678	World Bank, 2020
Gini coefficient	43.1	World Bank, 2015
Income share of top 10% (percent)	31.6	World Bank, 2015
Income share of bottom 10% (percent)	1.9	World Bank, 2015
Poverty headcount at $5.50 a day (percent)	90.8	World Bank, 2015
Average GDP growth (percent)	1.75	World Bank, 2020
Government revenue/GDP	23.9	IMF, 2018
Government expenditure/GDP	24.7	IMF, 2018
Debt/GDP	73.6	IMF, 2018
Government expenditure on education as % of GDP	5.37	World Bank, 2018
Domestic general government health expenditure (% of GDP)	1.05	World Bank, 2018
Public spending on cash transfers	0.04	World Bank, 2015
Labour force participation rate (percent)	58.07	World Bank, 2017
Labour force participation rate – female (percent)	55.92	World Bank, 2017
Informal employment (percent)	90.1	ILO, 2017
Gender pay gap	--	--
Main industries	• Extractive industries • Production of clinker/cement • Trading activities • Service sector (transport and communication sector)	--
Member of Addis Tax Initiative	No	--

14 See footnote 2. Latest years available 2015-2020. Current exchange rates are applied: Exchange rate 1 XOF = 0.0015 EUR. Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2019c).

Current tax policies

In 2018, the tax to GDP ratio in Togo was 19.4%. The ratio is just below the West African Economic and Monetary Union (WAEMU) goal for its member countries to achieve tax to GDP ratios of at least 20% (Diallo, 2018) and above the average of WAEMU (15.2%) in 2018[15]. The tax to GDP ratio has been increasing since 2010, thanks to the government's significant efforts to improve tax collection and administration. However, the current pandemic will most likely have negative impacts on tax collection and tax to GDP ratios.

Taxes on goods and services are the principal source of tax revenues for Togo (Jellema and Tassot, 2018). In 2018, VAT generated 43% of tax revenues and other taxes on goods and services accounted for 35% of tax revenues. Togo applies a single VAT rate of 18%, except those items that are exempt, such as food, agricultural goods, as well as health and education services (Deloitte, 2019).

A recent analysis conducted by the OECD shows that VAT is progressive in Togo. The richest households contribute to around 30% of VAT revenue, while the contribution of the poorest households amounts to 2% of VAT revenue. VAT is therefore progressive, and it equalises the distribution of income in Togo. Similarly, excise taxes on petroleum reduce inequality because the poor generally consume less fuel than the wealthy. The richest decile pays about 46% of excise taxes on petroleum products, while the poorest decile pays around 0.1%.

CIT represented 10% of tax revenues in 2018. CIT is applied as a standard corporate rate of 27% and there are no tax incentives for small enterprises. This represents a barrier to formalisation and reduces the taxpayer base.

PIT accounted for 7% of tax revenues in 2018. PIT is progressive, rising from 0.5% on the lowest income band (XOF 0 – 900,000 (EUR 1,350) to 35% for individuals with an annual taxable income over XOF 15 million (EUR 22,500). Nonetheless, revenues from PIT are a smaller proportion of total tax revenues, compared to the average from other countries in Africa (15%), due to the large degree of informality of the economy (OECD, n.d.).

Togo applies a property tax on developed land, levied at 15% on the assessed rental values of buildings. Transfers of real estate and movable assets are tax free, but subject to a registration duty.

Togo does not apply any digital service taxes or carbon taxes (Deloitte, 2019).

The impact of tax policies, excluding the CIT and property taxes is progressive in Togo. VAT and other taxes on goods and services (for example, excise taxes on petroleum products) reduce inequality by about 0.8 Gini points, while the PIT reduces inequality by slightly above 0.5 Gini points (Jellema and Tassot, 2018). However, the impact of taxes on inequality reduction is much lower than the impact of policies on the expenditure side.

Current social protection

In Togo, government expenditure on social protection is around about 0.1% of GDP (ILO, n.d.). The current social protection system is elementary, and coverage is mostly limited to the formal sector. Workers in the formal sector have access to some forms of social insurance, such as old age contributory pensions (3% of population) (World Bank, n.d.).

Non-contributory programmes are primarily funded by development partners and encompass a school feeding programme and cash transfers programmes, mainly targeted at pregnant women and women with children under two years old. Targeting is not well developed. Activities to set up a national-level programme and expand coverage to all poor households, only started in 2017, with the support of the World Bank, UNICEF, United Nations Development Programme (UNDP) and ILO (World Bank, n.d.).

Qualitative data collected through interviews indicates that identifying beneficiaries is one of the key challenges in the expansion of cash transfer programmes, because people are not registered on government databases. In this respect, development partners are supporting the government of Togo to build national

15 Six country average from OECD/AUC/ATAF (2020). Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021e).

systems for targeting poor households and storing household information in a national social registry.

The current equalising impact of social protection policies is negligible, due to the limited size and coverage of current programmes. In fact, education and health expenditure drive reduction in inequality in Togo, with an impact of about 3 Gini points. Direct monetary transfers to households from the social protection system, as well as subsidies on agricultural products and electricity have no impact on inequality.

One issue emerging from the literature is that the combination of taxes and monetary transfers to households increases poverty in Togo. This is because the transfers received by the poorest households (mainly in the form of subsidies for electricity and in agriculture) are less than the total amount paid by these households in indirect taxes. This means that poor households are therefore net payers to the Togolese government, contributing more to public revenue than they benefit from public expenditure on social protection. Togo currently does not have a sufficiently broad social protection programme to protect the most vulnerable households (Jellema and Tassot, 2018).

In response to COVID-19, the government introduced an emergency cash transfer scheme, the so-called Novissi platform, for workers in the informal sector. The platform for social protection uses mobile phone metadata, machine learning and geospatial data, to pay beneficiaries through the mobile phone system. The poorest areas within Togo are targeted through high-resolution satellite imagery and information on household consumption. Within those areas the poorest individuals are then addressed through machine learning algorithms. Informal workers with a valid voting card could register and receive a transfer worth at least 30% of the minimum wage. The scheme reached more than 12% of the population (Regional Innovation Centre UNDP Asia-Pacific, 2020; World Bank, 2021). Digital solutions can be further leveraged to expand coverage of social protection and enhance impact on inequality reduction.

Scope for introduction of other policies

In Togo, the governance system is highly centralised, and the country lacks institutions that can promote a more equitable distribution of resources. This reflects decades of slow political reforms, only partially effective in promoting the establishment of democratic institutions. Presidential elections were held for the first time in 40 years in 2005. The incumbent President's son, Faure Gnassingbe, won the election and has dominated the political scene since then.

The governance framework favours those close to power, leading to an unequal allocation of resources across regions. Resources are primarily channelled to the capital city and southern regions and there is no decisive engagement from the government to improve living conditions in the north of the country. Poverty in the far north of the region of Savanes is up to three times higher than in the south. Access to services is also lower (as measured by transport time to markets, schools, water sources and health centres), compared to the coastal Maritime region in the south (World Bank, 2016a).

Inequality has been increasing since 2006, especially in urban areas. Low levels of state capacity limited fiscal space and weak incentives to reform power structures remain key barriers to formulating and implementing policies that are more inclusive. The high population growth rate outpaced the development progress, economic growth is mainly concentrated in the modern sectors, and access to quality services is limited and unequally distributed across the population, with women and girls having significant less access to education, and employment (Bertelsmann Stiftung, 2020).

Nonetheless, some improvements are occurring. For the first time in 32 years, Togo held local elections in June 2019 to elect municipal councillors, as part of the government's decentralisation agenda to improve accountability and service delivery at the regional and local level. This can potentially reduce inequalities in terms of access to services, and ultimately reduce income inequality.

Progress has been made in improving budget transparency and public administration. The Office Togolais des Recettes was established in 2014 to unify customs and tax services into a single administration. More recently, the government introduced tax identification numbers, reduced tax exemptions, and increased efforts to combat corruption and tax evasion. The IMF acknowledged these initiatives to improve revenue collection, broadening the fiscal space for further public spending (World Bank, 2017b). In addition, initiatives to mobilise additional revenues by improving mineral tax administration would enhance effectiveness of the tax system.

Within the 2017-2020 Extended Credit Facility programme with the IMF, government committed to improve spending efficiency and allocate more funding to social spending. Some results have already been achieved. Public debt fell from 76.2% of GDP in 2018 to 70.9% of GDP in 2019. The fiscal deficit stabilised at 1.2% of the GDP in 2019. Progress has been made in the social protection sector, with the government co-financing the school feeding and cash transfer components and launching its own labour-intensive public works programme in urban areas. However, this progress is likely to have deteriorated due to the COVID-19 pandemic.

Interviewees in Togo emphasised that while the president's agenda is reform oriented, with a strong emphasis on development to partially build his legitimacy in the eyes of citizens and international donors, strong resistance comes from other parts of the government representing the interests of the established elite.

Recommendations for application of reform strategies

In Togo, a lack of capacity and political obstacles hinders the progress towards more ambitious reforms. Continuous support to improve state capacity, tax administration and effective fiscal governance is necessary to build capacity to implement reforms, at central level but especially within the local and regional governance systems. Support for local and regional governance systems to improve access to services, reduce regional inequalities and foster democratisation processes would also be important.

There is scope to build on the current path of reforms and propose further strategies in view of reducing inequalities:

- **Togo should continue to strengthen its tax administration capacities.** Increased performance can lead to higher revenues which are necessary to finance inequality reducing measures and other basic services provided by the government.
- **Efforts to increase the taxpayer base, especially among the wealthier, and suitable measures against tax avoidance should be continued.** Otherwise the contribution of PIT and CIT is likely to remain limited, given the high level of informality of the Togolese economy.
- **Linked to the above: support the government's efforts in combating tax evasion which could help to make the better-off paying their fair share of taxes.** This would also be in line with Togo's membership in the Global Forum.
- **Abolishing subsidies for electricity and in the agricultural sector would enhance efficiency while also increasing the progressivity of public spending.** Reallocating resources away from subsidies to expand coverage of cash transfers would potentially improve the redistributive impact of public spending. In this respect, policies could build on the systems set up in response to the COVID-19 pandemic, to facilitate registration and disbursement of payments.

2.7 Tunisia

Table 7: Tunisia indicators[16]

Indicator	Latest available data	Source, latest date
Population (million)	11.81	World Bank, 2020
GDP per capita (EUR)	2,927.08	World Bank, 2020
GDP million (EUR)	34,594	World Bank, 2020
Average monthly earnings of employees (EUR)	--	--
Gini coefficient	32.8	World Bank, 2015
Income share of top 10% (percent)	25.6	World Bank, 2015
Income share of bottom 10% (percent)	3.2	World Bank, 2015
Poverty headcount at $5.50 a day (percent)	17.5	World Bank, 2015
Average GDP growth (percent)	-8.6	World Bank, 2020
Government revenue/GDP	26.9	IMF, 2020
Government expenditure/GDP	37.5	IMF, 2020
Debt/GDP	87.6	IMF, 2020
Government expenditure on education as % of GDP	6.59	World Bank, 2015
Domestic general government health expenditure (% of GDP)	4.18	World Bank, 2018
Public spending on cash transfers	0.55	World Bank, 2015
Labour force participation rate (percent)	46.98	World Bank, 2017
Labour force participation rate – female (percent)	26.49	World Bank, 2017
Informal employment (percent)	--	--
Gender pay gap	--	--
Main industries	• Agriculture • Oil and gas	--
Member of Addis Tax Initiative	No	--

16 See footnote 2. Latest years available 2015-2020. Current exchange rates are applied: 1 TND = 0.30671 EUR. Informal employment (Tustex, 2020). Debt/GDP, Government Revenue/GDP and Government Expenditure/GDP sourced from IMF (2021e).

Current tax policies

Tunisia collects more revenue than countries in the region and other lower middle-income countries. In 2017, total public revenue, excluding grants, represented around 31% of GDP. If we exclude social security contributions, total tax revenue was 21.7% of GDP (OECD, n.d.). For lower middle-income countries, average overall government revenue in 2017 was 15.5% of GDP and average tax revenue was 12.7% of GDP. However, the COVID-19 pandemic induced an overall GDP decrease of 8.6%.

Taxes on income, profits and capital accounted for 28% of total revenue collection, whereas the typically more regressive taxes on goods and services (VAT), accounted for 36% of the total. The share of regressive VAT was lower than in neighbouring Morocco (46.5% in 2012), but in line with the average for lower middle-income countries (36.9% in 2017). Inequality is also lower than in Morocco, with a Gini coefficient of 32.8, compared to 39.5 in Morocco.

In interviews for this study, it was mentioned that the problem of tax evasion undermines revenue collection efforts and lowers acceptance of taxation among those who have to pay. For civil servants and formal sector employees, income taxes are deducted by the employer. While the economy is more formalised than in neighbouring countries, tax compliance among usually high-earning self-employed workers, such as doctors and lawyers is very low, and monitoring efforts have been weak. This group is also politically influential, which means that political will to enforce compliance has been weak.

A very ambitious tax reform package was developed in 2014 to address these issues and to simplify the tax system. However, progress has been slow due to political instability with frequent changes of government and fragile governing coalitions.

Another issue mentioned was tax exemptions for foreign firms to attract foreign investments. This means that foreign firms pay proportionally less tax than local ones, even though they often have higher earnings. Further tax cuts are planned in 2021 to stimulate economic growth, following the COVID-19 pandemic. This includes cuts on excise taxes on luxury goods, which are likely to make the tax system even more regressive.

A final issue that affects income distribution is the issue of subsidies for fuel and other goods. Fuel subsidies represent 2.5% of GDP and are highly regressive. Furthermore, they have encouraged cross-border contraband for goods that are not-subsidised across the border. This implies a leakage of public subsidies to neighbouring countries. And since the contraband is illegal, it is not subjected to any of the required taxes or tariffs. Political will to address this issue has been weak, as this represents a major source of income for powerful groups in politically important regions that government coalitions have relied on for votes.

Current social protection

Tunisia has a well-developed contributory social insurance programme covering civil servants and formal sector workers, about 30% of the population. In recent years, a non-contributory social assistance programme, Programme National d'Assistance aux Familles Necessiteuses (PNAFN), has been developed to support poor families. This programme, however, covers only 8.7% of the population. This leaves a gap of about 60% of the population, who neither have access to the contributory social insurance system nor to the poverty-targeted social assistance programmes. The PNAFN provides D 180 (EUR 55) a month to 285,000 poor families. A D 20 (EUR 6) supplement is provided for each school-age child. However, 60% of beneficiaries are over 60 years old and often live in households without children; thus, putting the targeting in doubt. The PNAFN is means-tested based on self-declared income. A proposal was made to establish a single social registry and move to proxy-means testing to improve the targeting accuracy of the PNAFN.

There have been discussions to introduce a universal child grant. However, progress has been slow due to financial constraints and to political instability. Some additional social spending has been incurred during the COVID-19 pandemic to mitigate the effect of the lockdown on poor families. However, the spending has been much more modest than in Morocco (1.2% vs. 4% of GDP), due to the precarious economic situation.

Scope for introduction of other policies

Tunisia was one of the first Northern African countries that introduced democracy during the time of the Arab Spring uprising. To date, however, the social achievements of the revolution have been meagre. In the early years after the revolution, the civil service was expanded to combat unemployment and placate social unrest. There was also a rapid increase in civil servants' salaries. However, these increased public expenditures were not matched by increases in taxation.

This mismanagement of public finances led to a ballooning of public debt, which is now 77% of GDP (IlBoursa.com, 2020), and an increase in inflation, which has eroded the purchasing power of the middle classes. The interviewees said that the middle class has almost vanished since the revolution due to the economic crisis. These negative developments have largely outweighed the progress made in dismantling cronyism and oligarchic corruption that surrounded the Ben Ali dictatorship.

Given the continued political instability and economic constraints, the prospect for ambitious public investments in the near future is limited. However, there is scope for improving income distribution, by addressing inefficiencies, starting with the costly and highly regressive fuel subsidies. This could create fiscal space for financing social spending on the middle class, which has been battered by the post-revolution years. This should go hand in hand with efforts to combat tax evasion by the upper class, which undermines the financial capacity of the state and weakens social cohesion.

Recommendations for application of reform strategies

Based on the analysis of the Tunisian situation, the scope for addressing inequalities through public spending appears limited at the moment, due to the high level of debt and slow economic growth. Consequently, next to middle and long-term efforts to create more fiscal space through increased revenue and improved tax administration performance, efforts to reduce inequalities in the short term should focus on:

- **Removing costly inefficiencies, such as fuel subsidies:** Fuel subsidies currently account for 2.5% of GDP. Furthermore, they aggravate global warming and encourage cross-border smuggling. Removing fuel subsidies would therefore be a net gain for the Tunisian economy. Removing subsidies might be politically more palatable in the short term than the introduction of a new carbon-tax.

- **The savings from reduced subsidies could create the fiscal space needed to increase social spending on non-contributory social protection, which is currently weak in Tunisia.** A universal child support grant could contribute to reducing poverty and inequality in Tunisia.

- **Removal of inefficient tax exemptions and careful design of new ones could generate further revenue.** The government should carefully consider which tax exemption in the end benefits the local economy and thus is worth implementing and in what form. In this context, one important element of a well-designed tax exemption is usually to limit the application to a certain time. This holds also true for COVID-related recovery incentives. It should be avoided that once established and useful taxes, especially if they have an inequality reducing effect, are completely abolished forever to support the economic recovery.

- **Combating tax evasion by professionals, such as doctors and lawyers, and tax avoidance.** Combatting tax evasion and avoidance would have a direct positive impact on public revenue, but also, and more importantly, increase tax-acceptance by those who have to pay their taxes. This would be in line with Tunisia's membership and corresponding commitments in the OECD Inclusive Framework on BEPS and the Global Forum.

Improving the quality and quantity of public spending for inequality reduction through the above-mentioned steps is not only important for reducing inequality and stimulating economic growth in Tunisia. It is also vital to deliver democratic dividends that can help to cement the democratic transition that can serve as an example to other Arab nations.

3

CONCLUSIONS AND RECOMMENDATIONS

3.1 Conclusions and overall recommendations

Some common threads have emerged from the analysis of the German reform partner countries.

The first is that the ability to increase the fiscal space of the state to reduce inequality will be limited because most of the analysed partner countries do not raise much tax. Nonetheless, reform partner countries should increase their efforts to collect taxes via PIT and CIT as income taxes can be a powerful tool in reducing inequality. This is especially valid if those who can pay more are taxed, but the effects will not be felt if tax administrations are unable to effectively tax the middle class and the rich. All of the reform partner countries need to further strengthen their tax administration performance and capabilities and increase the amount of tax that is collected.

Secondly, and more obviously, more revenue for the state means a greater reach for targeted expenditure such as cash transfer schemes, which can have a substantial impact on inequality. Cash transfer schemes are only effective, if the amount transferred is high enough. The COVID-19 pandemic has shown the necessity of functioning safety nets for the population and has increased social spending. The fiscal space to maintain and expand inequality-reducing expenditure varies from country to country as some are burdened by higher debt-to-GDP ratios and have decreased their revenue generation capacity through overuse of tax exemptions and subsidies. The work to increase budget transparency should continue and intensify, where necessary.

Carbon taxes are currently non-existent, and most reform partner countries apply subsidies, either to petroleum products or to electricity, or to both. These subsidies are politically popular, but they are regressive, especially in developing countries where the poorest citizens often lack access to electricity and will use public transport. In many countries, these subsidies become large relative to government's ability to pay for them, and they can threaten fiscal solvency.[17]

Levels of informality and tax evasion are high in all the analysed countries, making it difficult to levy income taxes. Even though the informal sector harbours a significant share of persons that would not need to pay taxes due to their low levels of income, it can also cover the professional classes who could be significant taxpayers.

The property tax remains underutilised in the reform partner countries. The property tax is inequality-reducing and there are mechanisms to implement it, even in case of an environment of weak land administration. Encouragingly, Ethiopia plans to begin collecting property taxes in the fiscal year 2020/21. Senegal and Côte d'Ivoire are also planning to collect property taxes in the near future.[18]

17 As discussed in the Handbook, Mexico and Indonesia were able to build support for reform by explicitly tying the reduction of subsidies to the set-up of a more efficient and better targeted cash transfer programme. The government used the lack of evidence of the positive impact of food subsidies to argue for better use of resources, with the objective of not only alleviating poverty, but also promoting longer-term human capital development through conditions attached to cash provision.

18 There does not appear to be any progress towards collecting carbon taxes or digital services taxes.

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