

Concept Note on the Medium-Term Revenue Strategy (MTRS)

The purpose of this note is to further develop the concept of *Medium-Term Revenue Strategy* (MTRS) presented in the paper that the Platform for Collaboration on Tax (IMF, OECD, UN, WB) submitted in July 2016 to the G20 Finance Ministers meeting in Chengdu, China.¹

The core elements needed for an effective implementation of an MTRS are outlined in Box 10 of the paper, reproduced below. As explained in the Platform paper, the fully-fledged implementation of an MTRS in a given country would require a holistic, synergetic, and steady development of the core elements.

Box 10. Core Elements of an MTRS

- ✓ A social contract on the level of revenue mobilization effort for the medium-term (5-10 years) with due consideration to the poverty and distributional implications of the associated measures
- ✓ A comprehensive reform plan for the tax system, reflecting country circumstances and the state of institutional capacity:
 - A redesign of the policy setting to meet the revenue goal.
 - A reform of the revenue agencies to properly administer the policy setting and to achieve a high level of taxpayers' compliance to meet the revenue goal.
 - A strengthening of the legal framework to enable the policy redesign and administration reform, including by balancing revenue agencies' powers and taxpayers' rights.
- ✓ A country's commitment to a steady and sustained implementation, notably by securing political support and resourcing.
- ✓ Secured financing for the CD effort (technical assistance and training) to support the country in overcoming domestic constraints to formulate and implement an MTRS effectively.

As many countries are currently undertaking significant revenue mobilization efforts, notably based around tax system reforms, some of the above elements (or parts of them) are already in place, to some extent—but not necessarily with the reach, synergy, and sustainability that the Platform for Collaboration on Tax (PCT) envisages in its paper. As stressed there, the revenue mobilization effort is not only about the quantity, but also its quality. Elaboration on the Platform vision follows.²

Social consensus on medium-term revenue goals. Revenue goals should be determined in tandem with expenditure needs/goals. Regarding the latter, there are evident links to be made with the 2030 Agenda for Sustainable Development, centered around 17 Sustainable Development Goals (SDGs) to be achieved by 2030. These goals are more ambitious in reach and revenue requirements than previous development agendas. The medium-term timeframe the PCT paper suggests is 5-10 years to progressively reach the revenue objectives needed to achieve the 2030 timeframe for full implementation of the SDGs.

Governments must lead and inform the national dialogue that determines society's expectations for the level of public services and the related expenditure needs that determines revenue collection targets—health, education, social entitlements, employment, poverty reduction, etc.—and social and economic development countries will be pursuing. In tailoring the SDGs to countries' contexts, political leaders are central to building broad consensus across multiple stakeholders and representatives of the community.³

¹ *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries*, Platform for Collaboration on Tax (IMF, OECD, UN, WB), July 2016. At: <https://www.imf.org/external/np/pp/eng/2016/072016.pdf>.

² As the Platform paper stresses, the revenue focus of MTRS is the tax system (including in this both customs and the range of fiscal regimes that may be applied to the extractive industries). Other financing sources (lending or external aid) were not addressed, except the external support for capacity development (CD)—technical assistance (TA) and training.

³ Figure 4 in the Platform document describes the wide range of stakeholders involved in tax reform. Among these, external institutions (e.g. Platform partners), and agencies providing budget support should help in this dialogue, as part of the relationship they maintain with countries—e.g. the IMF through its surveillance and lending activities with countries.

The development agendas will require significant medium-term revenue generation that countries will have to have the capacity to accurately forecast and sustainably generate. These need to be matched with the medium-term expenditure needs—ideally forecast through medium-term budget framework (MTBF), in countries able to do so. Although, in DCs (in most LICs in particular) the capacity to undertake medium-term budgeting is limited (though capacity building support can help), some vision of expenditure needs will have to be periodically estimated to enable setting revenue goals.⁴

This *medium-term revenue mobilization objective* will have to be reflected in formal documents that governments are typically responsible for producing: government programs, annual public sector budgets, medium-term budgets, etc. Periodic reporting to the public on progress with these commitments is central to Government accountability to the electorate.

A central document is a MTRS, which will describe (at a high level) the road map of the reform of the tax system—see next section and attachment 1 for the contents of such a document. Implementation of this road map will require a whole-of-government commitment to the revenue mobilization effort—see subsequent section on what country's commitment entails.

Reform of the tax system.⁵ Under an MTRS a carefully sequenced overhaul of the tax system and its three core components—tax policy, administration and legal framework—will almost certainly be needed. Diagram 1 in the Platform paper provides a framework for this undertaking.

Redesigning tax policy settings. When medium term (5-10 years) tax revenue needs have been forecast, the next task is determining (a) how efficient, equitable and effective the current tax policy framework is in meeting the revenue needs, and (b) how it should be adjusted.

- Detailed diagnosis of the policy design features (e.g. neutrality vs bias), tax mix (e.g. consumption, labor, capital, natural resources), and economic and social impact (e.g. on growth, equality, etc.) will be needed.
- A multi-year high level road map of the tax policy options will have to be elaborated, which accompanies the projected expenditure needs/goals. This high level road map will have to be periodically revised (e.g. every year) and updated (e.g. every three years) to timely respond to material adjustments in the needs/goals, change in circumstances (political and other), and emerging issues.⁶

Though revenue needs (to match expenditure needs) will frame this exercise, raising the level of revenues may not necessarily be always the primary objective, not at least in some periods—as described in the Platform paper. The quality of the tax policy framework is important to avoid compromising growth, fairness and other or creating perverse incentives (e.g. harassment of taxpayers, excessive discretion of legal powers, corrupt practices, and aggressive tax planning).⁷ In adjusting the policy settings consideration needs to be given to the capacity of taxpayers, the profile of the business environment, and the capacity of the revenue agencies to implement the policy choices and manage the tax system.

⁴ As the Platform paper stresses: *At the outset (of launching an MTRS), a clear revenue mobilization objective for the medium-term has to be determined. This needs to be driven by the country's own objectives, be compatible with achieving the SDGs, reflect the macro fiscal context, and be complementary to the other sources of available (projected) financing.* And as also mentioned, MTRSs focus on the tax revenues, but other sources of financing for development have to be considered.

⁵ The term 'tax' comprises all type of taxation: domestic, on external trade, and other special one like on natural resources.

⁶ In DCs (in most LICs in particular), undertaking this exercise on a periodic basis will be challenging, perhaps not feasible, and CD support will be needed. Importantly, this CD support should not only help in diagnosing and redesigning the policy setting but also in closing the capability gap and helping create autonomy (for example, by helping to build strong tax policy units).

⁷ As the Platform paper states: *It is not just how much revenue is raised, but how it is raised that matters.*

Reforming the revenue agencies. Meeting revenue needs will depend on ensuring taxpayers' compliance; and efficient and effective revenue agencies are crucial to this. The policy settings define the best quality policy choices to raise the revenue needs. Achieving success rests on the efficient, equitable and effective implementation of policy by revenue agencies. In many DCs (and most LICs) revenue agencies need to be modernized to fulfill this role. However, addressing their weaknesses has often not been a sufficient priority. The political economy to undertake and sustain administrative reforms is complex, and sometimes more challenging than short-term revenue raising. Often, the choices made are ill-conceived. Hence the importance of the broad national consensus described above to provide the enabling political environment for broader and deeper reforms.^{8,9}

Strengthening the legal framework. Taxation establishes a legal relationship between taxpayers and the State. Thus, the tax policy and administration components of the tax system are set in laws. And the correct application and respect of the rule of law is crucial for the success of a tax system. In this regard, well-prepared laws are significant determinants of the efficiency and effectiveness of the tax system.

In implementing MTRs, careful examination of the laws governing the tax system will be required, including both the substantive laws setting the taxes (VAT, PIT, CIT, Excises, Customs Duties, NR taxes, environmental taxes, etc.) and the procedural ones establishing the revenue agencies' powers and taxpayers' rights (registration, filing, payments, audit, collection enforcement, disputes, appeals, etc.). Attention also needs to be paid to meeting international treaty and other obligations.

Enhancement and adaptation of the legal framework will also have to accompany the changes in the policy and administration settings while implementing the MTRs. A consistent and integrated approach will have to be exercised to ensure the legal framework fully supports the policy and administration settings.

Country commitment. Commitment emerges strongly when a sense of urgency arises. In the context of reforming the tax system, motivations can be diverse. For example, a more ambitious medium-term social program can be a high priority for a government and adapting the system to mobilize more revenues could be the primary response to move ahead. Correcting distortions in the design and application of the system that are hampering economic growth can be also a strong motivation.

In any event, governments must lead the effort in reforming the tax system, as a country-owned objective to secure financing, while enabling social and economic development. This reform should become a whole-of-government strategic priority, embraced by key authorities and entities within governments—certainly by those more directly related to the tax system—but also by the several stakeholders that help shape the tax system performance.¹⁰

Broad consensus (and wide consultation) will be also crucial in defining the agenda for the tax system reform; taxes affect citizens and economic units across a nation and the tax system's legitimacy determines in great part taxpayers' behavior and compliance, consequently the efficiency and effectiveness of the tax system.

To help forge the consensus, this effort should be managed and coordinated by the highest level of government, likely the Ministry of Finance empowered by presidents and/or prime ministers. And a formal

⁸ See 'Current Challenges in Revenue Mobilization—Improving Tax Compliance', IMF, 2015.

⁹ In designing and implementing policy and administration reforms, quick wins in modernization and revenue will have to be considered, in the context of the wider vision of achieving medium and longer terms goals.

¹⁰ As described in the Platform paper (and represented in figure 4 of the paper), the tax system is not only a matter for revenue agencies, taxpayers, tax professionals, and ministries of finances. It also involves a variety of stakeholders impacting how the tax system performs: government, parliament, judiciary, civil society, media, business community.

reform management approach should be adopted to ensure: (a) continuity and medium-term vision of the reform process, (b) resources for design and implementation (including partnership with external support), and (c) sustained political support during implementation.

Experience has shown that successful tax system reform deepens on a sound revenue reform strategy, good governance arrangements and teams to manage the strategy, and visible and sustained political support for a steady reform strategy implementation.

Under a reform management process some key governance arrangements have to be put in place: an accountable sponsor (at the highest government level), a steering committee(s) (to provide the whole-of-government support, sometimes with representatives beyond the government), reform management structure and team (identifying the key agencies involved and a core team to help implement the reform strategy), and operational arrangements to help design, implement, and monitor the reform strategy implementation.

External support. As mentioned, in DCs (particularly in most LICs) the capacity to formulate and implement MTRs is limited. Thus, external CD support (by TA providers and donors) will often be essential to its effectiveness. In many countries such support is already present. And the high priority that revenue mobilization has gained in recent years implies that this CD support will increase.

This external support can be used to help the Government establish the medium-term revenue reform strategy. There is some evidence that where multiple CD providers are supporting the country in RA reforms the efforts are not always coordinated or well aligned objectives. In some cases, reform initiatives have been in conflict or not well sequenced. In part, this could be because CD providers have to prioritize their own institutional mandates over collaboration with other CD providers. There are often difficulties in measuring reform outcomes and attributing them to individual providers. All this, in turn, puts additional pressure on recipient countries (particularly those with more limited capacity) to manage an intensified CD support.

A sea-change in helping organize the CD support can be achieved with the adoption of country-owned MTRs, if the revenue strategy is embraced by the community of CD providers:

- Country recipients should designate one TA provider to take the lead in supporting the authorities in formulating the reform of the tax system, in close collaboration and consultation with other CD providers. This lead TA provider should support the country's reform management governance to safeguard the integrity of the revenue strategy and coordinate CD support. It will also need to provide timely advice for its adjustment and update, and in selected core tax system areas—policy, administrations and legal settings—as needed.
- CD support must be provided and received under the umbrella of the tax system reform strategy, at the appropriate time and with the scope envisaged in the reform strategy. This implies that the CD support to formulate and implement the tax system reform strategy must be sequenced according to the priorities set by the authorities and outlined in the implementation plan of the reform strategy.
- A formal agreement (e.g. MOU) between authorities and CD providers, with some explicit recognition of the roles, contribution, sequencing, etc., on both sides: country and CD providers. New CD providers should be guided to be part of the agreement. to avoid poorly designed and dispersed efforts, not provided in a synergetic manner with other elements of the overall effort. Donors supporting the financing of the CD effort could be organized in multi-donor trust fund to facilitate the formal agreement and simplify the use of funding, implementation, and reporting.¹¹

¹¹ Experience shows some good examples of coordination, without a formal agreement. Mainly based on good will of staff from some CD providers, particularly in the field. However, experience also shows that this good coordination is many times short life and, instead, very fragile and not sustainable. And not strong enough to protect the good coordination when a new CD provider

Embracing the above coordinating approach is an important distinctive feature of the MTRS relative to current revenue mobilization effort, and what CD providers have been undertaking so far. It will require strong willingness and commitment from the CD providers to successful adoption and implementation of MTRSs.

brings 'compelling' new priorities (and sometime 'incentives') to a country. Thus, the good will of some work in the field is not enough, and the country's effort is suddenly jeopardized by a 'lone ranger' trying to gain its own space and in its own conditions.

Appendix 1. Medium-Term Revenue Strategy Document – Contents

The MTRS Document should describe the high-level road map that the government will formally adopt to guide the reform of the tax systems. It should broadly describe the governments' strategy for reforming the tax policy, administration, and legal settings over the next 5-10 years, aiming to finance countries' economic and social programs through 'quality' revenue, i.e. a tax system that will mobilize resources, reflect distributional considerations and create appropriate incentives for economic and social development.¹²

Reform of the tax system contents

Redesigning the tax policy setting. This part of the *MTRS Document* should contain:

- A 5-year projection of Government's revenue needs (maybe as a percentage of GDP)—expenditure plans—including the financing gap to be mobilized through the tax system.
- A two-fold diagnostic of the current policy framework (major taxes):
 - against principles of sound tax policy setting and international trends.
 - against its capacity to meet the projected revenue needs.
- Intentions to change the tax policy setting to meet the revenue needs specified, and at the same time improve its design principles:
 - e.g. replacing sales tax for VAT, changing progressivity of PIT, broadening CIT base.
- A 5-year horizon timetable with the sequencing of intended policy changes and accompanying legislative changes.
- A responsible structure (e.g. policy unit) to lead the: reform process and work, engagement with stakeholders, and discussion in Parliament.

Reforming the revenue agencies. This part of the *MTRS Document* should contain:

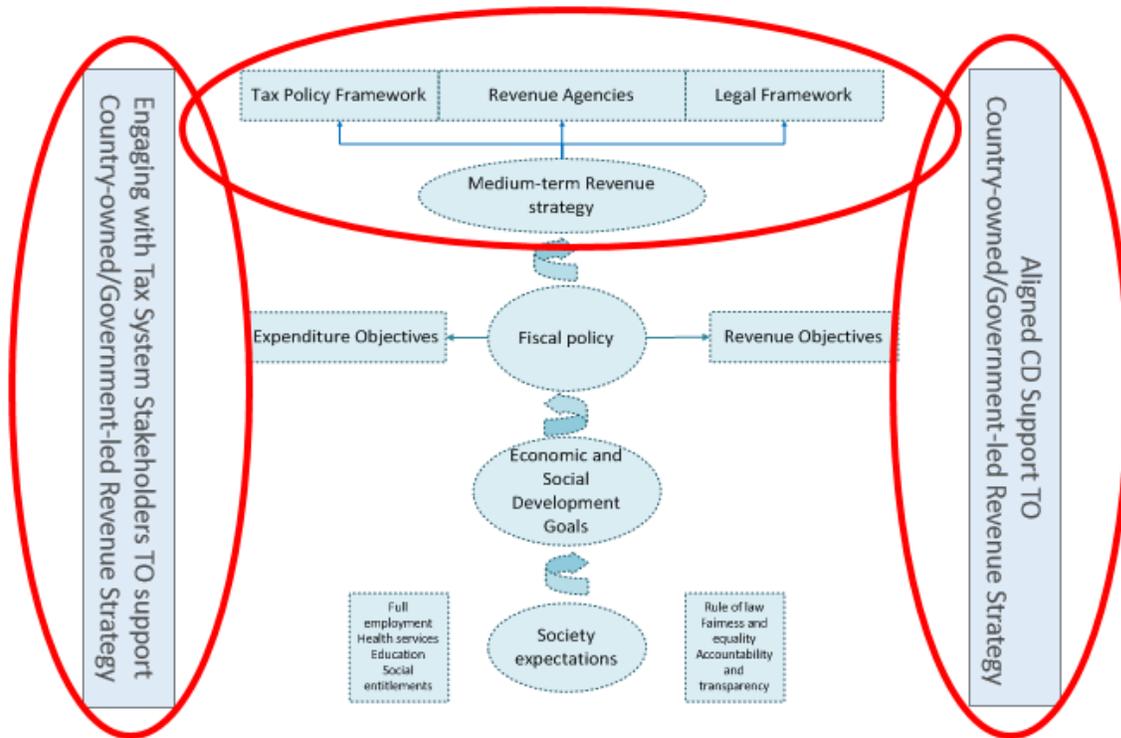
- A three-fold diagnostic of revenue agencies on their administration of the policy framework to achieve high taxpayer compliance:
 - levels/rates of taxpayers' compliance with main taxes.
 - institutional management and governance arrangements against good international practice and trends (e.g. measured through TADAT and other tools).
 - management and performance of core revenue administration functions against international benchmarks and trends.
- Intentions to reform tax agencies towards modernization and adoption of good international practice and trends.
 - e.g.: full adoption of self-assessment, greater autonomy and accountability of agencies, a shift to digital revenue administration, full automation of processes, securing professionalization and integrity.
- An investment plan to support reform implementation, notably resource needs and sources.
- A 5-year horizon timetable with the sequencing of intended revenue administration changes.
- A governance structure to lead the reform process, engage with stakeholders, and undertake the work, and support Parliamentary discussion.

Strengthening the legal framework. The policy and administration reforms will likely require significant shift in the tax legal framework. The *MTRS Document* should identify the major changes need to enable the intended policy and administration changes, especially those to remove barriers to reform modernization of revenue agencies.

¹² Preparation of this *MTRS Document* will be informed by diagnostics and reform options for tax policy, administration, and legal settings undertaken by countries themselves or with CD support. Thus, this *MTRS Document* should be brief and strategic.

Beyond the MTRS Document, the process leading to and supporting an MTRS will be crucial for its success. Its inclusive formulation, public adoption, and sustainable and full implementation will determine its success—going beyond just preparing a paper to store in a shelf or a partial and untidy implementation. The following diagram aims to illustrate the process that will entail an MTRS.

Medium-Term Revenue Strategy – MTRS



Though not elaborated on above, the MTRS document would also include a section on commitments by providers of CD, agreeing to supporting this government-led effort in a coordinated and 'subordinated' manner to government-led effort, providing some assurance against pressures to prioritize the providers own agenda over the country-led effort.