

Raising domestic resources for health

Can tax revenue help fund Universal Health Coverage?



POLICY BRIEF 2 | Financing research theme

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For countries that aspire to achieve the goal of Universal Health Coverage, the question of how to increase funding for health is of fundamental importance; external sources such as donor funding can be unstable and unsustainable, and insurance schemes often exclude the most poor and marginalised populations. Ensuring 'health for all' requires substantial increases in funding from domestic sources in a sustainable and equitable manner.

One way of increasing revenue is through improved tax collection and larger total government budgets. Recent evidence from South Africa, Kenya and Lagos State in Nigeria, shows that it is possible to increase tax revenue without raising tax rates. What has been more challenging however, is ensuring that this additional revenue is allocated to the health sector.

This brief outlines how the countries increased tax revenue and identifies common factors across contexts. It then uses the South African experience to explore whether the health sector benefited from additional tax revenue. The brief concludes with recommendations for health sector officials about how to negotiate more successfully for additional resources to be spent on health.

How did countries increase tax revenue?

South Africa

Since the end of apartheid in 1994, South Africa has more than doubled total government revenue in real terms (see figure 1). What makes this success particularly striking is that it was achieved as new tax policies decreased rates for individuals and companies.

Strong economic growth is a key factor explaining the rise in tax revenue and the increase in the proportion of tax

revenue collected from companies shown in figure 2.

Figure 2: Sources of tax revenue

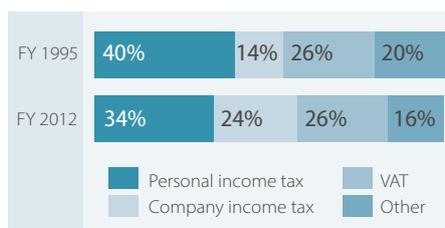
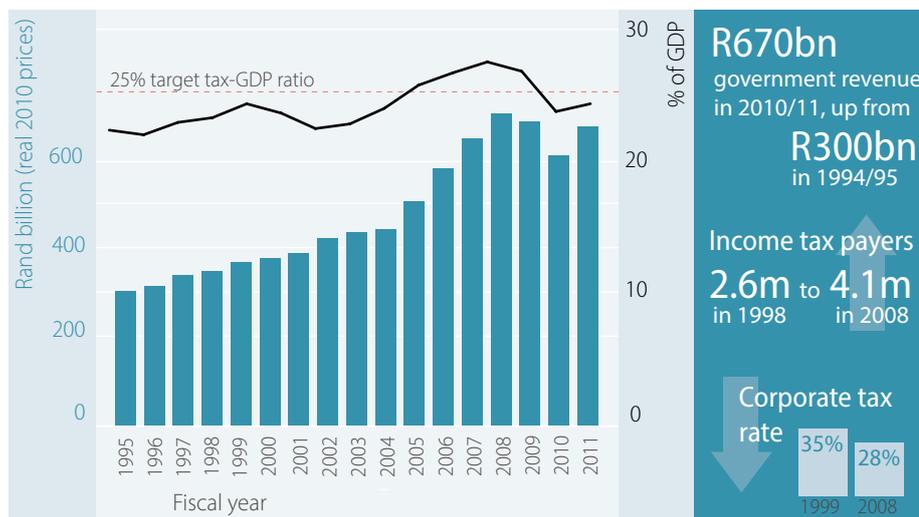


Figure 1: Total government revenue in South Africa, 1995-2011



Key points

- RESYST has generated new evidence showing that governments in South Africa, Kenya and Lagos State in Nigeria have increased domestic tax revenue by expanding the tax base and improving the efficiency of tax collection systems.
- In Kenya and Nigeria, specific efforts have been made to reach the informal sector by taxing small businesses in Kenya and reaching informal trade associations in Nigeria.
- In all three contexts, powerful politicians gave support to tax policy reforms and the tax collection agencies, and this led to additional funding for their operations and strengthened human resource capacity.
- In South Africa, despite achievements in raising tax revenue, the share of government spending allocated to the health sector did not increase, partly because, in a quasi-federal context, it was unable to convince the Cabinet and Treasury of its effectiveness.
- A critical challenge for Ministries of Health is to find ways to make a better case for health during budget negotiations so as to expand their share of government spending.
- International actors, including WHO and donor organisations, have a role in helping Ministries of Health to develop the technical and analytical capacity to effectively advocate for health and demonstrate the benefits of Universal Health Coverage.

Tax reforms also contributed to the rise in revenue including simplified tax structures; the elimination of inappropriate exemptions and incentives; and multi-pronged enforcement strategies including targeting of high net-worth individuals. At the same time, strategies aimed to build positive public perceptions of taxation and successfully built on citizens' commitment to achieving the goals of 'the new South Africa' to encourage voluntary compliance.

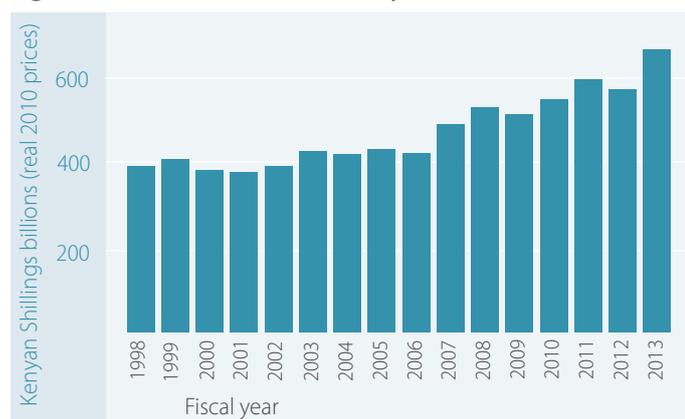
These reforms were implemented by a transformed tax collection agency - the South Africa Revenue Service (SARS), which was characterised by strong leadership, experienced staff and limited political interference.

It is possible that South Africa could have increased tax revenue even further and achieved a higher tax-GDP ratio; however, macroeconomic policy constrained the tax-GDP ratio to 25%, with the aim of stimulating economic growth.

Kenya

Kenya also undertook major tax reforms following a change of government in 2002. Since this time government revenue increased from Kshs. 424 billion in FY 2003, to Kshs. 670 billion in FY 2013 (figure 3).

Figure 3: Total tax revenue in Kenya, 1998-2010



Tax reforms included the introduction of a 'Turnover tax' for small businesses that aimed to bring informal sector businesses, such as agricultural enterprises, into the tax envelope. The Kenya Revenue Authority (KRA) - Kenya's tax collection agency, also implemented strategies to improve compliance including outreach campaigns to sensitise and educate tax payers, and providing assistance in filling in tax returns.

The success of KRA in implementing these changes was helped by management and staff who were committed to modernising and reforming the agency. The KRA was given the autonomy to recruit, retain, train and motivate high calibre staff, and to remove corrupt workers. There

was also political support for tax generation and the KRA from the government and external development agencies: reforming the tax revenue administration was a key priority in the government's macroeconomic framework along with strengthening accountability and transparency.

Nigeria

Between 2000 and 2010 Lagos State increased tax revenue from N600 million to N20 billion, and it is currently the only state in Nigeria to have achieved fiscal independence. The huge increase in revenue is predominantly made up of the state's internally generated revenue, which includes personal income tax, land sales tax, transfer fees and car licences.

Strong economic growth contributed to the rise in tax collected between 2000 and 2010, and a growing middle class of educated people in the state widened the tax base. The Lagos State Internal Revenue Service (LIRS) also took steps to reach the large informal sector by transforming the membership bases of informal trade associations into tax bases, and by employing women to promote dialogue with women's market trade associations so as to collect tax.

Further, LIRS has worked to reduce corruption by requiring payments to be made through banks (rather than in cash), and to increase compliance through education and penalties. It has also increased the number of tax field officers from 300 to 6000 staff to educate citizens, register new tax payers and assist them in making payments.

The experiences from these three countries demonstrate that with commitment and creativity, it is possible to raise additional domestic resources. This is helped by tax policy that expands the tax base, and tax administration that reduces the tax gap through promoting compliance and strong enforcement.

Figure 4 outlines the factors that contributed towards increased tax revenue in all three contexts. One key factor is the support that tax policy reforms and the tax collection agencies received from powerful politicians, resulting in additional funding for their operations and strengthened human resource capacity.

In addition, all three tax collection agencies were able to function autonomously and to implement tax collection strategies and reforms to suit their political, economic and social contexts. In South Africa this meant targeting high net-worth individuals and building on citizens' aspirations to contribute towards the development of their newly democratic country. In Kenya and Nigeria, specific efforts were made to reach the large informal sectors.

With commitment and creativity, it is possible to raise additional tax revenue without increasing rates. This is helped by tax policy that expands the tax base, and enforcement and compliance strategies to reduce the tax gap.

Figure 4: Factors explaining improved tax collection capacity in South Africa, Kenya and Lagos State, Nigeria

External environment	Political transition to democracy and government legitimacy Strong economic growth during key periods	The organisational capacity of the tax collection agency	A transformational strategy for tax collection that: <ul style="list-style-type: none"> • Was founded on a clear vision, shared values and good governance • Created a streamlined organisational structure and new culture • Invested in the recruitment and development of skilled staff • Invested in computerisation • Dealt swiftly with corruption Prioritisation of tax collection activities and simplified tax filing systems Multiple strategies to promote tax compliance, including positive public perceptions Strong tax enforcement strategies, including public shaming of defaulters
Features of the public sector	Political support from powerful politicians Continuity of strong leadership in both government and tax collection agency Tax policy reform that rationalised tax rates and expanded the tax base Administrative autonomy for the tax collection agency, which enabled operational efficiency and recruitment of highly skilled staff Adequate funding of the tax collection agency	Human resource capacity	Increased numbers of skilled staff Active retention of skilled staff Appropriate deployment of staff Strategic use of incentives to motivate staff, including training and performance-based remuneration
The task network for tax collection	Strategic use of external consultants Cooperation between tax collection agency, government departments and private entities (especially banks) to build a coherent tax information system		

Did the health sector benefit from increased revenue? Findings from South Africa

Increased tax revenue led to more money being spent on health per person in nominal terms. However, the percentage of the budget allocated to health fell by 1.6% between 1996 and 2004, and a decade later, it remains below the 15% target set by the Organisation for African Unity's 2001 Abuja declaration (figure 5). One explanation for this is that, despite

Figure 5: Percentage of government expenditure spent on health

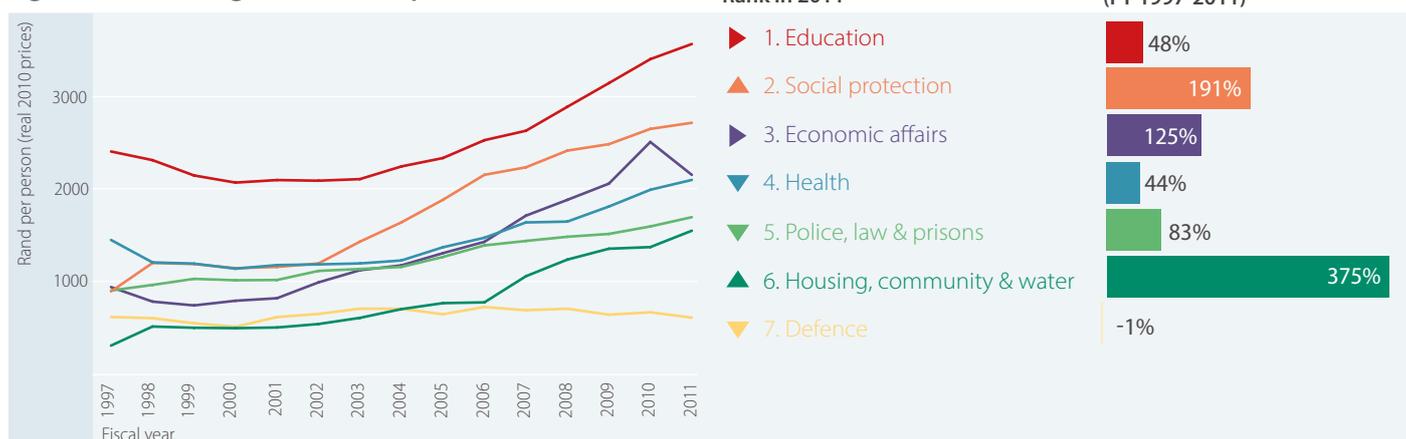


economic growth, South Africa's macroeconomic policy reined in public expenditure and required rapid servicing of debt, squeezing out social sector spending.

However, during this time, government spending on health also fell relative to other sectors (figure 6). Expenditure on health was overtaken by Social Protection and Economic Affairs, which constitutes infrastructure, energy, trade, industry and agriculture.

The health sector was de-prioritised because of a complex interplay between economic, political and administrative issues. These ranged from political and technical weaknesses in the National Department of Health, to difficulties of budgeting under a quasi-federal system. In addition, the Treasury did not trust the health sector's ability to deliver services efficiently. Nevertheless, sectors receiving substantial budget increases are social determinants of health, e.g. housing, water and basic income support.

Figure 6: Trends in government expenditure across sectors



About the research

- This policy brief is based on case studies from South Africa, Kenya and Nigeria, which documented country experiences of increasing the effectiveness of their tax collection services and investigated whether this contributed to increased health sector spending.
- The studies used a mixed-methods approach, combining both quantitative and qualitative data.
- Quantitative methods were used to quantify trends in general tax revenue, government spending on the health sector and on other sectors, and to compare growth in these variables relative to growth in Gross Domestic Product.
- Qualitative methods e.g. key informant interviews, were used to explore the contextual factors, tax policies, actors and processes accounting for improved tax revenue and to identify remaining challenges for sustainable tax revenue generation.

For more information about the research please visit our webpage: <http://resyst.lshtm.ac.uk/research-projects/case-studies-improving-tax-collection>

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Conclusions and recommendations

RESYST has generated new evidence showing that it is possible to substantially increase domestic tax revenue by expanding the tax base and improving the efficiency of tax collection systems.

What is more challenging, however, is persuading Ministries of Finance to allocate more funds to health. Health budgets are constrained by many factors, even in the context of economic growth and increased revenue collection.

In South Africa, at a time when total government revenue more than doubled, the amount of spending allocated towards health fell as a percentage of government expenditure. This is partly due to the misperception that health is an unproductive sector with few economic benefits.

A critical challenge for Ministries of Health is to find ways to make a better case for health during budget negotiations so as to expand the share of government spending on health.

International actors, including WHO and donor organisations, have a role in helping Ministries of Health to develop the technical and analytical capacity to effectively advocate for health and demonstrate the benefits of Universal Health Coverage.

Related resources

- Doherty J (2014) RESYST Working paper 6: Increasing tax revenue and its impact on financing public health care in South Africa.
- Powell-Jackson T, Hanson K, McIntyre D (2012) RESYST Working paper 1: Fiscal Space for health - a review of the literature.
- McIntyre D, Meheus F (2014) Fiscal space for domestic funding of health and other social services. Working group paper, Chatham House.

Specific recommendations for Ministries of Health

- Develop clear strategies for defending health budgets and negotiating larger allocations during budget negotiations at both national and provincial/state levels.
- Demonstrate the economic and social benefits of health investments, and the debilitating effects of underfunding health services.
- Given that efficiency is a key concern of Treasuries, implement wide-ranging reforms to health systems to ensure that money is well spent and that resources are distributed equitably throughout the country.
- Develop capacity to promote and document good performance and efficient use of resources.
- Invest in strong health leadership at national and decentralised levels, and develop unity around a vision for health.

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