

INFORMAL SECTOR TAXATION: THE CASE OF ZIMBABWE

By

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ABSTRACT

The economic crisis in Zimbabwe has had a profound impact on the labour market. As job opportunities in the formal sector have shrunk due to the contraction of the economy, the informal sector has been showing rapid growth. This contraction of the economy has also had a negative impact on the government's ability to collect tax revenues. It is within this context that this study seeks to analyse the Zimbabwean government's recent attempts to collect taxes from its large informal sector. The study draws on conventional tax theory from the public economics literature to inform the evaluation of the informal sector tax system. The study also draws on the political economy approach to taxation (and the state failure literature in particular) given that this analysis occurs in Zimbabwe, a failing state. The three main objectives of the work are as follows: 1) To describe the informal sector tax code in Zimbabwe and to explain how it relates to the broader tax system in the country, as well as to analyse the rationale for its introduction; 2) To investigate the challenges and successes in implementing the taxes in the informal sector in the context of the economic and political crisis; and 3) To analyse the informal tax system in terms of equity and efficiency. Given the lack of reliable official (quantitative) data on Zimbabwe, this study is primarily based on documentary evidence and qualitative work. Qualitative interviews were carried out with 16 key informants from the Zimbabwe Revenue Authority, the Ministry of Small and Medium Enterprises Development, academia and business organisations. A total of 47 informal sector operators from four activity classes (i.e. transport operators, flea market operators, hairdressing salons and cottage industries) were also interviewed. The findings presented in this thesis indicate that there have been some successes in taxing the informal sector in Zimbabwe. However, the study shows that informal sector taxes have been poorly administered. The findings also show that informal sector taxes are generally inequitable vis-à-vis formal sector taxes. Furthermore, the implementation of presumptive taxes has induced changes in behaviour among those in the informal sector in their attempts to evade these taxes, resulting in economic inefficiency. Given that very few academic studies on informal sector taxes in Zimbabwe have been conducted, it is hoped that this work will begin to fill the gap in the Zimbabwean context, as well as to contribute to the small but growing literature on informal sector taxes in developing countries more generally.

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DECLARATION - PLAGIARISM

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TABLE OF CONTENTS

| | |
|---|----|
| Chapter One – Introduction | 1 |
| 1.1 Introduction | 1 |
| 1.2 Specific research objectives and theoretical framework..... | 6 |
| 1.3 Methodology | 8 |
| 1.4 Structure of the thesis | 8 |
| Chapter Two – Tax theory and the rationale for informal sector taxation..... | 11 |
| 2.1. Introduction | 11 |
| 2.2. Sources of government revenue | 11 |
| 2.2.1. Definition and classification of taxes..... | 13 |
| 2.2.2. Developing and developed country differences..... | 15 |
| 2.3. Criteria used to evaluate a tax: Equity, economic efficiency and administrative effectiveness | 17 |
| 2.3.1. Equity | 17 |
| 2.3.2. Economic efficiency | 18 |
| 2.3.3. Administrative effectiveness..... | 19 |
| 2.3.4. Trends in tax reform in developing countries | 20 |
| 2.4. The informal sector | 22 |
| 2.5. Taxing the informal sector | 28 |
| 2.5.1. Reliance on existing taxes..... | 31 |
| 2.5.2. Indirectly through the VAT | 32 |
| 2.5.3. Presumptive taxes | 35 |
| 2.6. Rationale for taxing the informal sector: Revenues, efficiency, equity and governance | 38 |
| 2.7. Informal sector taxation in Africa, Latin America and Asia..... | 45 |
| 2.8. Concluding remarks | 54 |
| Chapter Three - The Zimbabwean crisis and the growth of the informal sector as a backdrop to informal sector taxation | 56 |
| 3.1 Introduction | 56 |
| 3.2 Background to the crisis..... | 57 |
| 3.3 The lost decade (1998 to 2008)..... | 61 |
| 3.4 The urban informal sector in Zimbabwe | 67 |
| 3.5 Political economy approach to taxation and state failure..... | 77 |

| | | |
|--------------|---|-----|
| 3.5.1 | State failure | 81 |
| 3.5.2 | Crises and their impact on the informal sector | 85 |
| 3.5.3 | State failures' impact on tax collection..... | 90 |
| 3.6 | Concluding remarks | 92 |
| Chapter Four | - Methodology | 94 |
| 4.1 | Introduction | 94 |
| 4.2 | The empirical approach..... | 94 |
| 4.2.1 | Document analysis | 95 |
| 4.2.2 | Quantitative data analysis | 95 |
| 4.2.3 | Qualitative interviews with key informants..... | 97 |
| 4.2.4 | Case studies..... | 100 |
| 4.3 | Informal sector tax research challenges in Zimbabwe | 105 |
| 4.4 | Data Analysis | 107 |
| 4.4.1 | Assessing the capability to raise revenue..... | 110 |
| 4.4.2 | Assessing equity and efficiency using qualitative interviews..... | 111 |
| 4.4.3 | Governance | 112 |
| 4.4.4 | Development | 113 |
| 4.5 | Study limitations | 113 |
| 4.6 | Concluding remarks | 114 |
| Chapter Five | – The tax system in Zimbabwe and informal sector taxation | 116 |
| 5.1 | Introduction | 116 |
| 5.2 | The tax system in Zimbabwe | 117 |
| 5.2.1 | VAT | 119 |
| 5.2.2 | Income tax..... | 120 |
| 5.2.3 | Customs and excise duties, capital gains tax and non-tax revenue..... | 122 |
| 5.3 | Informal sector taxes in Zimbabwe | 122 |
| 5.4 | Informal sector taxation in Zimbabwe: A literature review..... | 134 |
| 5.5 | Concluding remarks | 137 |
| Chapter Six | - Administering informal sector taxes..... | 139 |
| 6.1 | Introduction | 139 |
| 6.2 | Informal sector tax administration | 140 |
| 6.2.1 | Availability of information | 145 |
| 6.2.2 | Manpower levels..... | 147 |

| | | |
|---|---|-----|
| 6.2.3 | Education and awareness | 149 |
| 6.2.4 | Corruption | 150 |
| 6.2.5 | Selective tax administration | 151 |
| 6.2.6 | Commitment to enforce presumptive taxes by ZIMRA | 152 |
| 6.2.7 | Monitoring and evaluation | 153 |
| 6.2.8 | Tax morale | 154 |
| 6.3 | Complying with tax regulations | 155 |
| 6.3.1 | Transport operators | 155 |
| 6.3.2 | Flea market operators | 157 |
| 6.3.3 | Hairdressing salons | 157 |
| 6.3.4 | Cottage industries | 158 |
| 6.3.5 | Advantages and disadvantages of paying taxes | 159 |
| 6.4 | Concluding remarks | 160 |
| Chapter Seven – Equity and efficiency of presumptive taxes | | 162 |
| 7.1 | Introduction | 162 |
| 7.2 | Informal sector taxation and equity: Describing the methodology | 163 |
| 7.3 | Informal sector taxes and equity: Comparison across sectors | 168 |
| 7.3.1 | Transport operators | 168 |
| 7.3.2 | Flea market operators | 178 |
| 7.3.3 | Hairdressing salons | 182 |
| 7.3.4 | Cottage industries | 188 |
| 7.3.5 | Income, poverty and taxation in Zimbabwe | 192 |
| 7.3.6 | Comparison between different informal sector activity classes and the formal sector | 196 |
| 7.4 | Informal sector taxes and economic efficiency | 201 |
| 7.5 | Concluding remarks | 206 |
| Chapter Eight – Conclusion | | 209 |
| References | | 223 |
| APPENDIX 1: Informed consent form | | 255 |
| APPENDIX 2: Interview guide - Key informants | | 256 |
| APPENDIX 3: Key informants list | | 258 |
| APPENDIX 4: Questionnaire and interview guide – Informal sector operators | | 259 |
| APPENDIX 5: List of Informal sector operators | | 265 |
| APPENDIX 6: ZIMRA Presumptive tax schedule | | 266 |

LIST OF TABLES

| | |
|---|-----|
| Table 1: Tax levels as a percentage of GDP | 15 |
| Table 2: A typology of informal enterprises..... | 29 |
| Table 3: Presumptive tax turnover and flat rates in selected African countries, 2010 | 46 |
| Table 4: Micro, small and medium enterprises in Vietnam..... | 52 |
| Table 5: Spatial and operational features of the small scale informal sector in Harare..... | 73 |
| Table 6: Unemployment rates (strict definition) in Zimbabwe, 1982-2004 | 74 |
| Table 7: Summary characteristics of approaches to tax policy..... | 78 |
| Table 8: Key informants | 98 |
| Table 9: Informal sector activity classes..... | 102 |
| Table 10: Summary of assessed factors | 107 |
| Table 11: Percentage revenue contribution, 1999-2011 | 118 |
| Table 12: Personal income tax applicable by income bracket, Zimbabwe, 1 January 2012 . | 121 |
| Table 13: Minibus taxi turnover and profit estimates (ZW\$)..... | 124 |
| Table 14: Minibus taxi monthly average profit and tax rate of 30 per cent (ZW\$)..... | 125 |
| Table 15 Minibus taxi monthly average profit and tax rate of 18 per cent (ZW\$)..... | 126 |
| Table 16: Minibus taxi monthly average profit | 127 |
| Table 17: Minibus taxi monthly average profit and tax rate..... | 127 |
| Table 18: Minibus taxi monthly average profit and tax rate of 18 per cent (IMF US\$ rate). | 128 |
| Table 19: Taxi-cab turnover and profit estimates | 128 |
| Table 20: Taxi-cab profit and tax rate of 30 per cent (ZW\$)..... | 129 |
| Table 21: Taxi-cab profit and tax rate of 18 per cent (ZW\$)..... | 129 |
| Table 22: Taxi-cab profit and tax rate of 18 per cent (official US\$ rate) | 129 |
| Table 23: Taxi-cab profit and tax rate of 18 per cent (parallel US\$ rate)..... | 129 |
| Table 24: Taxi-cab profit and tax rate of 18 per cent (IMF US\$ rate)..... | 129 |
| Table 25: Presumptive taxes 2005 | 130 |
| Table 26: Presumptive tax 2010-2011 | 133 |
| Table 27: Presumptive and total tax revenues, 2008-2011 | 141 |
| Table 28: Personal income tax applicable by income bracket, Zimbabwe..... | 165 |
| Table 29: Income at three hypothetical levels | 166 |
| Table 30: Income tax paid by formal sector taxpayer (PIT) including AIDS levy..... | 167 |
| Table 31: Income tax paid by formal sector taxpayer (CIT) including AIDS levy | 167 |
| Table 32: Former occupations of transport operators | 169 |
| Table 33: Transport operators' gross profit per month (per vehicle)..... | 171 |
| Table 34: Taxi-cab and minibus taxi monthly taxes compared to PIT | 173 |
| Table 35: Taxi-cab and minibus taxi monthly taxes compared to CIT..... | 174 |
| Table 36: Former occupations of flea market operators | 179 |
| Table 37: Flea market operators' taxes per trip | 181 |
| Table 38: Hairdressing salon presumptive taxes compared to PIT..... | 184 |
| Table 39: Hairdressing salon presumptive taxes | 186 |
| Table 40: Former occupations of cottage industry operators..... | 189 |

| | |
|---|-----|
| Table 41: Cottage industry presumptive taxes..... | 191 |
| Table 42: Informal sector operators' profits | 193 |
| Table 43: Profit, household size and earnings per capita of informal sector operators | 194 |
| Table 44: Earnings distribution of paid employees aged 15 years and older, | 196 |
| Table 45: Comparison of informal sector presumptive taxes | 197 |
| Table 46: Comparison of informal sub-sector presumptive taxes and formal sector taxes ... | 198 |

LIST OF FIGURES

| | |
|--|-----|
| Figure 1: Trends in the composition of revenues, 1980-2009 (in percent of GDP) | 16 |
| Figure 2: Selected social indicators in Zimbabwe, 1990-2009..... | 65 |
| Figure 3: GDP and tax revenue..... | 66 |
| Figure 4: Formal sector employment in Zimbabwe, 1980-2005 (in thousands)..... | 75 |
| Figure 5: The ladder of analytical abstraction | 109 |
| Figure 6: Total revenues, 1998–2009 (as a percentage of GDP) | 119 |
| Figure 7: Presumptive taxes as a percentage of total revenues..... | 142 |
| Figure 8: Monthly presumptive tax collection, 2010-2011 | 143 |

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LIST OF ACRONYMS AND ABBREVIATIONS

| | |
|----------------|---|
| AfDB | African Development Bank |
| AFRODAD | Africa Forum and Network on Debt and Development |
| BMS | Block management system |
| CIT | Corporate income tax |
| CSO | Central Statistical Office |
| CZI | Confederation of Zimbabwean Industries |
| EI | <i>Empreededor individual</i> programme (Brazil) |
| ESAP | Economic structural adjustment programme |
| FPL | Food poverty line |
| GDP | Gross domestic product |
| GNI | Gross national income |
| ICLS | International Conference of Labour Statistics |
| ICOAZ | Indigenous Commuter Operators Association of Zimbabwe |
| IGT | Identifiable grouping taxation |
| GPRTU | Ghana private road transport union |
| IMF | International Monetary Fund |
| ILO | International Labour Organization |
| LFCLS | Labour Force and Child Labour Survey |
| LFS | Labour Force Survey |
| LTU | Large taxpayer units |
| MDC | Movement for Democratic Change |
| ODA | Overseas Development Assistance |
| OECD | Organisation for Economic Cooperation and Development |
| PDL | Poverty datum lines |
| PF-ZAPU | Zimbabwe African Peoples Union-Patriotic Front |
| PIT | Personal income tax |
| SATEP | Southern African Team for Employment Promotion |
| SME | Small and medium enterprises |
| TCPL | Total consumption poverty lines |
| TRA | Tanzania Revenue Authority |
| UKZN | University of KwaZulu-Natal |

| | |
|----------------|---|
| UNAIDS | Joint United Nations Programme on HIV/AIDS |
| UNFPA | United Nations Population Fund |
| USAID | United States Agency for International Development |
| VAT | Value added tax |
| VDP | Value for duty purposes |
| ZANU-PF | Zimbabwe African National Union-Patriotic Front |
| ZCIEA | Zimbabwe Chamber of Informal Economy Associations |
| ZIMRA | Zimbabwe Revenue Authority |
| ZIMSTAT | Zimbabwe National Statistics Agency |
| ZINCOOO | Zimbabwe National Commuter Omnibus Operators Organisation |
| ZNCC | Zimbabwe National Chamber of Commerce |
| ZCTU | Zimbabwe Congress of Trade Unions |

Chapter One – Introduction

1.1 Introduction

The informal sector constitutes a large component of the economy in many developing countries (Schneider, Buehn and Montenegro, 2010). In some of these countries, this sector has been showing rapid growth over the past few years and is now much larger than the formal sector (ILO, 2013). The growth of the informal sector has presented developing countries with a major fiscal challenge – that of collecting sufficient revenues to fund expenditure. This is due to the fact that the numerous enterprises in the informal sector are largely escaping the tax net as they are (by definition) not usually registered for tax. Governments in developing countries, given the limited tax revenues being generated from the small (and sometimes shrinking) formal sector, are therefore increasingly turning to the informal sector as a potential source of tax revenue. However, taxing the informal sector is not easy given the way that this sector is structured. Enterprises in this sector are characterised by the high physical mobility of operators (who are therefore difficult to locate), high churn rates, informal business structures (usually family based or sole proprietorships) and weak accounting systems (sometimes due to low literacy levels) (Baer, 2003).

The challenge of taxing the informal sector has recently generated interest among tax scholars (Joshi and Aye, 2002; Emran and Stiglitz, 2005; Bird and Zolt, 2008). The international literature has focused on the challenges of ‘broadening the tax base’ to incorporate the informal sector into the tax net (Shome, 2004; Gallagher, 2005; Bird, 2010). The discussions in the literature around taxing the informal sector can be distinguished into two strands, although these are sometimes conflated (Terkper, 2003; Loeprick, 2009; Engelschalk, 2007; Joshi, Prichard and Heady, 2013). Firstly, there is the approach which focuses on taxing the informal sector without encouraging the growth and formalization of these small firms. In other words, these small informal firms (the micro-enterprises) can remain in the informal sector as long as they pay the simple taxes designed specifically for those in this sector, such as the presumptive taxes.¹ In this approach, informal enterprises are those micro-enterprises that fall below a specified turnover threshold and/or whose

¹ A presumptive tax is based on an indirect assessment of income. Tax liability is based on indicators (e.g. seating capacity of a minibus taxi) that are easier to measure than the tax base (i.e. taxable income) itself (Ahmad and Stern, 1991).

employees do not benefit from social protection. The second approach to informal sector taxation focuses on the bigger informal firms (the small to medium enterprises). These are regarded as the ones with the potential to grow and move into the regular tax system. Although obtaining tax revenues from these firms may also be an important objective, there is usually a broader strategy of encouraging formalization (with a move to the regular tax system and adherence to social protection regulations).

According to the literature, there are three general approaches that can be used in taxing the informal sector. They are: the extension of the existing tax regime to informal enterprises (Bird and Wallace, 2003); the value added tax (VAT) (Bird and Gendron, 2007); and the use of presumptive taxes (Tanzi and Casanegra, 1987; Pashev, 2006). However, apart from describing the challenges and possible methods of incorporating the informal sector into the tax net, there is very little that has been written on the actual implementation of informal sector taxes. The few studies that have looked at informal sector tax implementation in developing countries have focused on the administration of these taxes with very little analysis of the efficiency and equity implications of informal sector taxes (Tanzi and Casanegra, 1987; Taube and Tadesse, 1996; Joshi and Ayee, 2002; Devas, 2011; Utaumire, Mashiri and Mazhindu, 2013; Zivanai, Manyani, Hove, Chiriseri and Mudzura, 2014).

This literature is confounded by the different conceptualizations of informality that exist. While, as Kanbur (2009) points out, this term means different things to different people, informal sector activities are usually thought of as productive activities that do not appear in a country's national accounts (Alm, Martinez-Vazquez and Schneider, 2004). However, within this broad definition, the informal sector can be classified in different ways, even in the same country. For example, Zimbabwe's statistical agency (ZIMSTAT) uses the following definition in its 2011 Labour Force and Child Labour Survey (LFCLS):

...a production unit was considered to be in the informal sector if the establishment was neither registered with the Registrar of Companies nor licensed. Households employing paid domestic workers and those involved in communal farming are excluded from the informal sector enterprises (ZIMSTAT, 2012: xxi).

However, as the next chapter will explain in more detail, it is possible for an enterprise to be registered (as a company) and still be regarded as an informal enterprise if it is not registered

for tax purposes and the definition of informality requires tax registration. Some countries have registered and licensed small enterprises which they have gone on to tax (using simple systems such as presumptive taxes), while continuing to define these enterprises as informal (Joshi and Aye, 2002; see also Bird and Wallace, 2003). This is the case in Zimbabwe, where informal businesses are regarded by the Ministry of Finance and the Zimbabwe Revenue Authority (ZIMRA) as those earning less than US\$6,000 a year and not registered for corporate income tax. These two institutions use the following definition of informality which is based on the Twenty-Sixth Schedule of the Income Tax Act (23:06) of 2010:

‘Informal trader’ means an individual who carries on a trade for his own account from which he derives a gross income of less than six thousand United States dollars (or such other amount as the Minister may prescribe by notice in the Gazette), has not, in the most recent year of assessment for which he could have done so, furnished a tax return in terms of the Act and includes a hawker or street vendor and a person who sells articles at a place commonly known as a ‘people’s market’ or a ‘flea market’ and a person who manufactures or processes any articles in or from residential premises.

According to the definition of informality used by the Ministry of Finance, a firm is regarded as being in the informal sector even if it is a registered company, as long as it generates a turnover of less than US\$6,000 a year and has not registered for formal tax purposes.² This is in contrast to the ZIMSTAT definition of informality above, where a firm is in the formal sector if it is a registered company or a licensed enterprise – tax registration is irrelevant.³

Not only are there differences in the definition of informality, there are also different reasons for taxing the informal sector. There are four main reasons given in the literature for taxing

² There is a disjuncture between the Income Tax Act’s definition of an informal trader and actual practice. The definition of an informal trader specifies a maximum gross income of US\$6,000 for presumptive taxes while many of those targeted are earning more than this amount as this study shows. Although it is clear from the Income Tax Act that the Minister of Finance, through a notice in the Gazette, may prescribe any other turnover figure, no such notice had been issued by the end of 2014. Also, none of the ZIMRA officials in this study mentioned the US\$6,000 turnover limit in their responses to questions on informal sector taxation. In practice, ZIMRA and the government seem to regard informal sector firms as all the small firms that are not registered for tax purposes (see Government of Zimbabwe, 2005).

³ However, as Engelschalk (2007) points out, it is not necessary to harmonize the various definitions of informality. A different definition by tax authorities allows them to better focus on this sector in terms of according it special treatment.

informal enterprises. The first one is based on the view that the informal sector is a potential source of tax revenue (Bird and Zolt, 2008; Sanyang, 2009). In this approach, there are no incentives for firm growth and formalization. In other words, these informal firms are taxed without any intention of formalizing them as the tax authority's objective is merely to collect tax revenue.

The second reason has to do with formalization and enterprise growth. Although there is usually the realisation that little revenue can be obtained from the informal sector, the aim is to incentivise the small firms that are complying with tax regulations (through such schemes as the preferential awarding of tenders), and inculcate a tax-paying culture. It is then hoped that these small firms will continue to pay their taxes and make a more meaningful contribution to the economy as they grow (Rachid, 2007).

The third reason is that allowing large segments of the population to go untaxed is unfair on those who are paying their taxes (Bird and Wallace, 2003). The argument is that the tax system should treat people in the same way whether they are in the informal or formal sector. Those earning similar incomes should be treated, for tax purposes, in the same way (horizontal equity) and those at different income levels should be treated differently (vertical equity). In many developing countries, and as the results of this study will show, the informal sector is not always made up of poor people (see also AFRODAD, 2011). In other words, it is an unfair system that taxes only those in the formal sector while leaving those with similar incomes in the informal sector largely untaxed.

The fourth reason has to do with governance. According to this relatively new argument from the political economy literature, by not paying direct taxes, those in the informal sector are unlikely to engage in any meaningful interaction with (and demand accountability from) those who govern them. Taxation is therefore one way of ensuring good governance, since taxpayers, according to this literature, will be motivated to hold leaders accountable – they will want to know how 'their' (i.e. the taxpayers') money is being spent (Joshi and Ayee, 2008; Prichard and Bentum, 2009; Fjeldstad and Heggstad, 2011).

Zimbabwe has been described as a failing state (Clemens and Moss, 2005). The country has experienced two major crises since independence in 1980. The first resulted from the disastrous implementation of neo-liberal reforms through the economic structural adjustment

programme (ESAP) in 1991, and the second involved the political and economic upheaval of the period 1998 to 2008 (“the lost decade”). The declining output in the formal sector, particularly as a result of the political and economic crisis which reached its zenith in 2008, has resulted in falling tax revenues and high levels of informality. Informal employment now accounts for 84 per cent of those currently employed in Zimbabwe (ZIMSTAT, 2012: xxi) compared to only 10 per cent in 1982 (Kanyenze, Chitiyo, Mahere, Makwavarara, Mbire, and Moyo (2003: 4). The informal sector has had to accommodate a wide variety of workers, from highly qualified graduates and professionals to those with just a primary education, resulting in a highly heterogeneous sector in Zimbabwe. According to Verick (2004), Zimbabwe has one of the largest informal sectors (in terms of its contribution to gross national income (GNI)) in Sub-Saharan Africa.

Zimbabwe’s semi-autonomous revenue authority (ZIMRA) has tried to extract more and more revenue from the large taxpayers using new taxes and innovative collection methods under very difficult conditions (OECD, 2012). However, this has increasingly proven to be a difficult task given the shrinking formal tax base. The economic decline has led to a situation where the revenue authority has found it difficult to meet its own revenue collection targets in recent years (ZIMRA, 2014a). It is against this backdrop of shrinking revenues and the rapid growth of the informal sector that the government decided to broaden the tax base through the implementation of presumptive taxes in the informal sector in 2005 (Government of Zimbabwe, 2005; Utaumire et al., 2013).

Despite the growing interest in informal sector taxation in the international literature, and the interesting case study that informal sector taxation in the Zimbabwean context makes, little research has been conducted on Zimbabwe specifically. Although Zimbabwe has been collecting presumptive taxes since 2005, when this research was initiated in 2010, I could find no work that collated and described the informal sector tax code itself or evaluated the effectiveness of the tax system. Since then, two studies on presumptive taxation in Zimbabwe have been published, both over the past year, by Utaumire et al. (2013) and Zivanai et al. (2014). Both these studies, as is the case with most of the international literature in this area, focus on the tax revenue authority’s effectiveness in administering informal sector taxes, leaving many gaps in knowledge.

This study set out to begin to fill some of these gaps by conducting research on a number of key aspects of the informal sector tax regime in Zimbabwe. Not only does this study seek to describe the tax system and the rationale for its introduction, it also aims to evaluate the tax according to a number of important principles. Using conventional tax theory, this study evaluates Zimbabwe's informal sector taxes using the three criteria of a good tax system developed in the public finance literature - administrative effectiveness, economic efficiency and equity. As far as I know, no other study has ever used conventional tax theory in the evaluation of the equity and efficiency of informal sector presumptive taxes. Furthermore, the analysis of informal sector taxation within the context of Zimbabwe's crisis, makes it necessary to go beyond standard public finance theory to also consider the political economy of taxation. This thesis therefore draws on the state failure literature in order to understand how and why this taxation occurs in a failing state. Indeed, it is this context that makes the Zimbabwean case particularly interesting. This thesis therefore attempts to contribute both to the literature on Zimbabwe and the literature on informal sector taxes in developing countries more generally.

1.2 Specific research objectives and theoretical framework

The broad objective of this study is to provide a critical analysis of informal sector taxation in Zimbabwe. Within this, the study has three main specific objectives. Firstly, the thesis sets out to describe the informal sector tax code in Zimbabwe and to explain how it relates to the broader tax system in the country, as well as to analyse the rationale for its introduction. Secondly, the thesis aims to investigate the challenges and successes in implementing the taxes in the informal sector in Zimbabwe in the context of the economic and political crisis. Thirdly, the thesis seeks to evaluate the extent to which these informal sector taxes are addressing the issues of equity and efficiency.

As mentioned above, the work in this thesis is informed in part by public finance theory, which identifies three criteria for evaluating a good tax system, namely economic efficiency, equity, and administrative effectiveness (Black, Calitz and Steenekamp., 2006). The first criterion for evaluating a good tax system is economic efficiency. Taxes can distort economic decisions, i.e. when faced with taxes, individuals and enterprises may change their behaviour. For example, instead of focusing on their normal (productive) activities, firms may spend an inordinate amount of time and effort in trying to avoid (or evade) taxes. These behavioural changes therefore create a loss of welfare over and above the revenues collected – the

deadweight loss or excess burden of taxation (Rosen, 1995). However, from an efficiency perspective, while informal enterprises may escape taxation, remaining informal can create inefficiencies too. These informal entrepreneurs cannot ‘afford’ to be too successful (or expand their operations) as this success (or expansion) would make them ‘visible’ to tax authorities. Informality therefore acts as a constraint on the realization of an enterprise’s full potential (Hillman, 2009).

Equity is the second criterion for evaluating a good tax system, according to conventional public finance theory. Equity issues have to do with fairness – with people at the same economic level being treated, for tax purposes, in the same way (horizontal equity) and those at different levels being treated differently (vertical equity). From an equity perspective, there have been arguments for an almost total exemption from direct taxes for the informal sector (Prichard and Bentum, 2009). However, as this study shows, those in this sector are not always poor people on the margins of society and, from the very same equity perspective, should actually be taxed (Joshi and Ayee, 2002).

The third criterion for evaluating a good tax system is administrative effectiveness. Ease of administration refers to administrative effectiveness in both tax collection and compliance. Costs are incurred by tax authorities in identifying taxpayers, assessing the amounts to be collected and enforcing tax regulations (i.e. collection costs). Taxpayers also incur costs in complying with tax regulations. Taxpayers have to register (usually a complex process that takes time in many developing countries) and also calculate the tax payable. In terms of administrative effectiveness, an important issue therefore is the ease with which informal enterprises can register so as to comply with tax regulations – if processes are too complicated, these enterprises simply may not bother to register (OECD, 2010).

This study draws on conventional tax theory from the public economics literature, briefly described above, in order to assess the informal sector presumptive tax system in Zimbabwe. However, since this analysis of informal sector taxation occurs within the context of state failure, this thesis also draws on a second theoretical framework, the political economy approach to taxation (and the state failure literature in particular). The theory can be used to explain Zimbabwe’s tax collection efforts in terms of the multi-dimensionality of the state and the critical role that institutional capability (partly explained by historical legacies) plays in the collection of taxes even in a failing state. While the insights from this theoretical

framework inform all parts of the research, they are particularly useful in achieving the second objective of this study, namely to analyse the challenges and successes in the implementation of informal sector taxes in the Zimbabwean context of economic and political crisis.

1.3 Methodology

This study is primarily based on qualitative interviews but also draws on primary document analysis and the use of quantitative secondary data where available. For the qualitative work, key informant interviews were carried out with 16 respondents from ZIMRA, the Ministry of Small and Medium Enterprises Development, academia and business organisations. A total of 47 informal sector operators from four activity classes (i.e. transport operators, flea market operators, hairdressing salons and cottage industries) were also interviewed in Harare.

The assessment of equity and efficiency issues was not conducted using conventional public finance analysis. Zimbabwe does not have reliable quantitative data to perform this type of analysis (e.g. input-output tables and a social accounting matrix are not available in Zimbabwe). Even where some data are available (e.g. the income and expenditure survey data), these data are not accessible to researchers, as ZIMSTAT only disseminates reports and is not allowed to give researchers access to the raw data.⁴ The assessment of equity and efficiency was therefore based on the qualitative interviews that were conducted with key informants and informal sector operators.

However, in spite of the somewhat unconventional approach used in evaluating equity and efficiency of the informal sector tax system, interesting findings were uncovered using this qualitative methodology, some of which would not have come to light in the analysis of purely quantitative data. Furthermore, the use of qualitative interviews allowed the researcher to probe aspects of the tax administration that related to some of the recent political economy concerns in the tax literature.

1.4 Structure of the thesis

The thesis consists of eight chapters and is structured as follows. Chapter Two begins by reviewing the literature on taxation in both developed and developing countries. Here, the tax

⁴ Personal communication with the ZIMSTAT Acting Director, 4 November 2011. The Acting Director did mention that data are available to organisations like the IMF and the World Bank.

theory from conventional public finance/economics is also explained, covering the main criteria used to evaluate a good tax system, i.e. equity, economic efficiency and administrative effectiveness. The chapter then reviews the literature on the informal sector. This review looks at the definitional issues around informality and some of the reasons for its growth in developing countries. The chapter then goes on to review the literature on informal sector taxation and the rationale for this taxation, as well as the empirical work in developing countries from Africa, Asia and Latin America, where informal sector taxes have been implemented.

Chapter Three provides the research context by reviewing the literature on the Zimbabwean crisis and the growth of the informal sector. The chapter traces the beginning of the crisis to the implementation of the economic structural adjustment programme and later, the gross economic mismanagement and political wrangling of the late 1990s. It goes on to show how this led to the economic decline that resulted in an informal sector that is now much bigger (in terms of the number of people employed) than the formal economy. The chapter then reviews the state failure literature with a particular focus on the impact of this failure on taxation, and the insights derived from the political economy approach to taxation.

Chapter Four outlines the methods that were used to address the study's research objectives. The chapter begins by describing the various data sources, with a particular focus on the key informants and the four informal sector activity classes selected for analysis (transport operators, flea market operators, hairdressing salons and cottage industries) and the reasons for their selection. It covers the sampling approach, the questionnaire and interview schedule design, and the challenges the researcher faced in conducting qualitative work on informal sector taxes in the Zimbabwean context. The chapter then goes on to describe the way in which the study data were analysed, and how the research objectives were addressed, based on the data collected.

In line with the first objective of this thesis, Chapter Five describes Zimbabwe's tax system, the rationale for introducing informal sector taxes in Zimbabwe, and the informal sector tax code itself. After a description of the main formal taxes levied, this chapter presents the results from the documentary analysis and key informant interviews on the establishment of the informal sector tax system. A summary of the research conducted by ZIMRA is provided, which attempted to determine the profitability of public passenger transport enterprises

between 2003 and 2005. The results of this research formed the basis of the recommendations that were made to the Ministry of Finance on informal sector taxation with respect to presumptive taxes in the informal transport sector levied in 2005. The chapter then goes on to describe the subsequent taxes that were introduced to raise revenue from some of the other informal sub-sectors. Finally, the chapter reviews the small literature on informal sector taxation in Zimbabwe, highlighting some useful insights from these papers.

Chapter Six relates to the second objective, the analysis of the challenges and successes in implementing informal sector taxes in Zimbabwe. It assesses one of the three criteria of a good tax system as defined in the public economics literature - the ease with which informal sector taxes are administered (i.e. administrative effectiveness). The findings are based on the interviews with key informants and informal sector operators. The extent of tax compliance and the informal sector operators' views on the advantages (and disadvantages) of tax compliance are presented here. This chapter also draws on the insights from the political economy approach to taxation and the state failure literature in analysing the challenges of implementation and compliance.

Chapter Seven relates to the third objective of the thesis. It analyses the remaining two criteria of a good tax system - equity and economic efficiency. This chapter begins by assessing the equity of informal sector presumptive taxes in Zimbabwe vis-à-vis formal personal and corporate income taxes. It considers both vertical and horizontal equity issues between the formal and informal sectors, as well as within the informal sector, across the different sub-sectors of informal activity. The chapter then assesses the tax-induced behavioural changes (i.e. economic efficiency) that resulted from the implementation of informal sector presumptive taxes. These analyses draw predominantly from the qualitative interviews with the key informants and informal sector operators.

Chapter Eight, the conclusion, provides a summary of the results and discusses the benefits and costs related to taxing the informal sector in Zimbabwe. The key concern of the chapter is to assess whether the informal sector presumptive taxes, as currently constituted, are meeting the three criteria of a good tax as specified in the public finance literature. The viability of presumptive taxation, given the various challenges uncovered by the research and the low revenues collected, is also assessed in the context of Zimbabwe's broader political and economic woes.

Chapter Two – Tax theory and the rationale for informal sector taxation

2.1. Introduction

The main objective of this chapter is to review the body of literature on informal sector taxation which informs the research objectives being addressed by this thesis. In particular, the chapter looks at the conceptualization of informality in the literature, the size of this sector in developing countries, the different methods of taxing this sector and the rationale for taxing informal enterprises. To place informal sector taxation within the framework of tax systems more generally, the chapter begins by laying out some of the tax terminology and key criteria for tax evaluation. Section 2.2 begins with a brief description of the various sources of government revenue. The second part of the section describes the different ways of classifying taxes. Section 2.3 discusses the criteria in the public finance literature for evaluating taxes (i.e. equity, economic efficiency and administrative effectiveness). Section 2.4 is divided into two parts. The first part examines the contested nature of the concept of the ‘informal sector’ in the literature, its heterogeneity and some of the driving forces behind its existence (and growth) in developing countries. The second part looks at the reasons for the tax community’s interest in broadening the tax base to include enterprises operating in the informal sector. The major approaches that can be used to tax the informal sector in developing countries are described in Section 2.5. Section 2.6 provides a discussion of the rationale for informal sector taxation, its benefits and challenges. Section 2.7 provides examples of informal tax regimes in selected African, Asian and Latin American countries and Section 2.8 concludes.

2.2. Sources of government revenue

Taxation is the main source of revenue for most governments. Taxation accounted for 82.2 per cent of total revenues collected in low-income countries in 1998 (Glenday, 2006: 23). In the European Monetary Union, tax revenues represented 91.1 per cent of total revenues received in 1997 (Glenday, 2006: 23). However, governments can also obtain (or augment) their revenue from other sources such as borrowings (from local or international sources), aid, seigniorage (benefits from printing money) and user charges.

Government borrowing is usually in the form of securities, bills and bonds. By borrowing, a government is incurring a debt that has to be financed in the future (usually via taxation). Government debt tends to be much higher in developed countries than developing countries.

In developed countries, government debt rose from 71 per cent of Gross Domestic Product (GDP) in 2000 to 104 per cent of GDP in 2011.⁵ In contrast, government debt in emerging and developing countries was much lower, moving from 49 per cent of GDP in 2000 to 37 per cent of GDP in 2011 (Nelson, 2013: 8).⁶

According to Benedek, Crivelli, Gupta and Muthoora (2012), many developing countries are highly dependent on aid (or Official Development Assistance, ODA). Benedek et al. (2012: 3) analysed a dataset of 118 countries between 1980 and 2009 and found that aid averaged 20-40 per cent of average tax revenues in developing countries in the period between 1980 and 2009. This aid represented the equivalent of between 3.7 to 6.7 per cent of GDP.⁷

The study by Benedek et al. (2012: 3) found that this dependence on aid has a negative effect on domestic resource mobilization efforts (i.e. taxation). They found that as aid (as a proportion of GDP) increased (in the period 1980 to 1995), there was a decrease in average tax revenue as a percentage of GDP. A decline in aid (as a percentage of GDP) after 1995 was accompanied by an increase in tax revenues as a percentage of GDP.

Seigniorage refers to the difference between the value of money and the cost incurred in its production. Seigniorage is regarded as revenue for a government when the money that is created is worth more than the costs incurred to produce it. Many developing countries use the revenue from seigniorage to finance part of their expenditures without resorting to taxation (McIndoe-Calder, 2009; Rao, 2011). Seigniorage revenues are an important source of government funding in developing countries. In a panel study of 100 developed and

⁵ It is important to note that although the debt-to-GDP ratios tend to be lower in developing countries, many of these countries encounter problems in servicing these debts (UN, 1999).

⁶ Much of the debt owed by many developing countries, mostly in sub-Saharan Africa, was eliminated by the heavily indebted poor countries (HIPC) initiative of the World Bank and IMF and the G8's 2005 multilateral debt relief initiative (MDRI). However, there is evidence that external debts are on the rise again in these countries (see World Bank, 2012).

⁷ The Organization for Economic Cooperation and Development (OECD, 1996: 24), defines ODA as "flows to developing countries and multilateral institutions provided by official agencies, including state and local governments, or by their executive agencies, each transaction of which meets the following test: a) it is administered with the promotion of the economic development and welfare of developing countries as its main objective, and b) it is concessional in character and contains a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent)".

developing countries for the period 1960 to 1999, Aisen and Veiga (2006: 30) found that seigniorage accounted for 14.65 per cent of total government revenues in developing countries in the 1990s, compared to only 1.64 per cent in developed countries.

User charges are prices charged for the delivery of certain public goods and services, such as toll roads, parking charges and national park entry fees. User charges are based on the principle of excludability – they are only levied on people who consume the public good or service. However, these sources usually bring in much lower levels of revenue than taxation (Easterly and Serven, 2003).

2.2.1. Definition and classification of taxes

Tax bases and rates

The tax base is the assessed value of wealth, income or consumption (i.e. money spent on consumption) that is subject to taxation (Anderson, 2006). For example, taxable income is the tax base for income tax and the retail price of a good is the tax base for sales tax. Anything that can be taxed has a tax base. A tax on people (such as a poll or head tax) can also be added to these three tax bases (Black et al., 2006).

After identifying a tax base, the tax rate can then be set. The tax rate is the percentage of the tax base (i.e. income, consumption or wealth) that is paid in the form of tax. There are three types of tax rates: proportional (or flat-rate tax); progressive; and regressive tax rates. A tax is progressive if the proportion of income paid in tax increases as income increases, regressive if the proportion of income paid in tax decreases as income increases, and proportional if the proportion of income paid in tax is constant as income increases (Black et al., 2006).

General and selective taxes

One way of classifying taxes is to divide them into two categories – broad-based taxes (also called general taxes) and narrow-based taxes (also called selective taxes). Broad-based taxes are those that tax the entire tax base without providing for exemptions. A common type of a broad-based tax is the value added tax (VAT). VAT is a tax on overall consumption. It cannot be avoided when goods are bought from enterprises (that are registered for VAT). If a VAT is implemented in such a way that there are no exemptions it can be considered as a broad-based tax on consumption (Elkins, 2006).

Narrow-based taxes are those taxes that are levied on one or a few products. Excise taxes that only tax certain products (e.g. cigarettes and alcohol) are examples of common selective taxes (i.e. they are not taxing the entire tax base). This difference between general and selective taxes is an important one in that taxpayers' reactions tend to differ based on the type of tax levied (see Emran and Stiglitz, 2000). These differences in taxpayer reactions are explained in more detail in Section 3 below.

Specific and *ad valorem* taxes

Taxes can be levied as a percentage of the price (or the value of a good or service). Such taxes are called *ad valorem* taxes. An example of an *ad valorem* tax is VAT. Another way of levying taxes is to collect a fixed amount on each unit (e.g. weight or quantity) of the good sold. Such taxes are called specific or unit taxes (Wonnacott and Wonnacott, 1990). An example of a unit tax is an excise duty levied on wheat based on weight.

Direct and indirect taxes

Another way of classifying taxes is based on whether they are direct or indirect taxes. Taxes that governments levy on an individual or organisation's income (e.g. personal income or company income tax) are called direct taxes. Taxes that are levied on consumption and expenditure (e.g. excise duties and VAT) are indirect taxes. Other indirect taxes that are an important source of revenue in many developing countries are those that are levied on imported goods (i.e. trade taxes). The difference between these two categories is based on the incidence of the tax, i.e. who ultimately bears the burden of the tax (Stiglitz, 1986). The burden of the tax can be transferred (or shifted) from those on whom the statutory (or formal) incidence falls.

For example, the incidence of an indirect tax such as the VAT can be shifted to consumers. VAT is an indirect tax on the consumption of goods and services that is levied at each stage of the production and distribution process. Using the invoice method of collection, a seller charges VAT on his/her output and sends an invoice to the buyer indicating the amount of tax charged. Buyers who pay VAT on their own sales (output tax), consider the tax on the purchase invoices as input tax and can deduct the sum from their own VAT liability. The difference between output tax and input tax is paid to the government. Although the statutory incidence of the VAT is on the seller, the effective incidence usually falls on the consumers in the form of a higher retail price (Entin, 2004).

An income tax is an example of a direct tax that is levied on individuals or companies. The personal income tax (PIT) is levied on individuals (i.e. on their earnings) while the company income tax (CIT) is levied on company profits. The burden of the income tax normally falls on the individual or entity that is being taxed and is very difficult to shift (Stiglitz, 1986).

2.2.2. Developing and developed country differences

The tax systems in developed and developing countries are similar. These tax systems derive revenues from the tax bases and tax categories discussed in Section 2.2.1 above – direct taxes on income and wealth and indirect taxes on consumption. Income taxes (personal income tax and the corporate income tax) are the most common direct taxes while sales taxes (or VAT) and excise taxes are the most common indirect taxes (Bahl and Bird, 2008).

Although all countries collect revenue from the same sources, tax levels and structures tend to differ. Revenues that developing countries raise through taxation tend to be low. The amount governments actually end up collecting in the form of tax revenue depends on a number of factors such as a country’s history, tax policy, economic structure and the level of economic development (see Gloppen and Rakner, 2002). As Table 1 shows, tax ratios (tax revenues as a percentage of GDP) in developing countries are generally lower compared to those of the industrialised and transition countries. It is important to note, however, that these average tax ratios do mask considerable variations between countries in these three groups (Bahl and Bird, 2008).

Table 1: Tax levels as a percentage of GDP

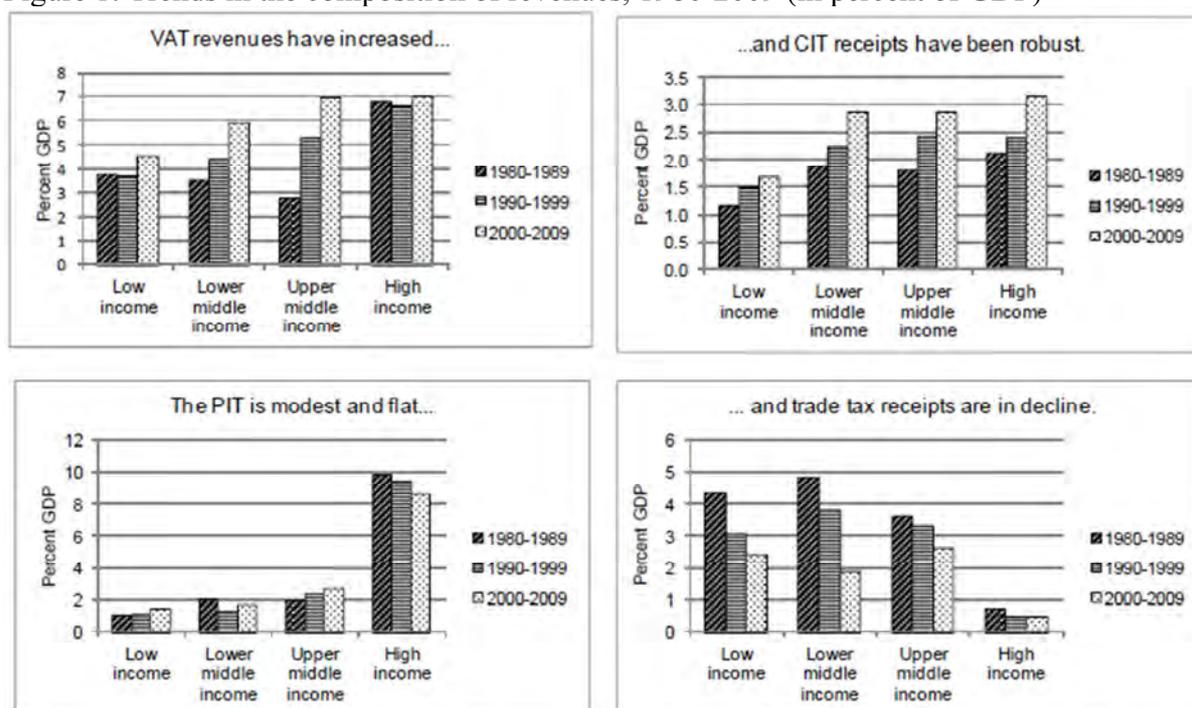
| Country groups | 1970s | 1980s | 1990s | 2000s |
|-----------------------|--------------|--------------|--------------|--------------|
| Industrialized | 30.1 | 33.7 | 35.5 | 33.4 |
| Developing | 16.2 | 17.3 | 17 | 17 |
| Transition | n.a. | 47.7 | 29.6 | 29.1 |
| Total | 19.8 | 21.6 | 22.6 | 21.8 |

Source: Bahl and Bird (2008: 280)

There are also differences in the tax structures between developed and developing countries. Developing countries get two thirds of their tax revenue mainly from indirect taxes (consumption and trade taxes) while developed countries get two thirds of tax revenue from direct taxes (Avi-Yonah and Margalioth, 2006: 2). Although the personal income tax (PIT) is the most important source of tax revenue in developed countries, it is not as important in

most developing countries (Gordon and Li, 2005). Most low-income countries tend to rely on indirect taxes because the costs of administering these taxes are lower (and because personal incomes in these countries are lower). Developed countries prefer to tax profits and personal incomes as their capacity to administer these taxes is high (and incomes are also higher). There is also typically more tax compliance and less avoidance in developed countries where informal sectors are small (Avi-Yonah and Margalioth, 2006).⁸ Indirect taxes are therefore less important in developed countries (Askari, 2007).

Figure 1: Trends in the composition of revenues, 1980-2009 (in percent of GDP)



Source: IMF (2011:16)
Group medians and dynamic income groups

The low and lower middle income countries' dependence on consumption taxes such as the VAT has increased since the 1980s, while taxes on trade have shown a steady decrease. Traditionally, many developing countries relied on trade taxes as the main source of tax revenue. As Figure 1 shows, this dependence on trade taxes has been decreasing since the 1980s. Trade liberalisation (and the consequent drop in tariff rates) has caused significant fiscal pressures in these countries, creating concerns in the tax community on how developing countries can overcome this shortfall (Baunsgaard and Keen, 2005; Glenday, 2006). This

⁸ It is difficult to tax the numerous enterprises in the large informal sectors in developing countries and this issue is addressed in more detail below.

fiscal pressure is one of the reasons, described below, for why there has been increasing emphasis on collecting revenue from the informal sector.

2.3. Criteria used to evaluate a tax: Equity, economic efficiency and administrative effectiveness

Equity, administrative effectiveness and economic efficiency are the three main principles (or criteria) that are used to evaluate a tax system in the public economics literature (Tanzi and Zee, 1996). Equity issues have to do with fairness. Administrative effectiveness refers not only to the government's ability to effectively collect taxes but also the ease with which taxpayers can comply with tax regulations. Economic efficiency refers to the tax-induced behavioural changes that usually accompany the imposition of a tax. As described in the introductory chapter, one of the key objectives of this study is to use these insights from public finance theory to evaluate informal sector taxation.

2.3.1. Equity

Equity issues have to do with fairness. Fairness is a value-laden concept and different people tend to interpret it differently. There are two principles that are used to evaluate the equity of a tax – the benefit principle and the ability-to-pay principle. The benefit principle holds that taxes should be levied in proportion to the benefits that the taxpayers receive from government expenditure (Black et al., 2006). Implementing the benefit principle is difficult as governments tend to provide goods and services of a public nature such as national defence or street lighting (i.e. where it is difficult to exclude those who have not paid). User fees such as toll charges are an example of where the benefit principle is applied.

The view that taxes should be levied according to the taxpayers' capacity to pay (measured by their income, wealth and/or consumption) is called the ability-to-pay principle. People at the same economic level are expected to pay the same amount of tax (horizontal equity) while those at different economic levels are expected to pay different amounts of tax (vertical equity). Although this ability to pay can be based on consumption, wealth or income, income tends to be the most commonly used measure. It is important to note that determining the 'same economic level' is rather contentious and requires subjective evaluations (Elkins, 2006). Black et al. (2006: 125) give the example of two individuals who earn the same hourly rate but where A works twice the number of hours of B. Based on their incomes, this would imply that A would have a greater ability to pay. Black et al. (2006) point out that in this case, the wage rate would be a fairer measure of ability to pay rather than total income. There

also has to be a consensus in society on whether everyone pays a tax or whether those falling below a stipulated income level will not be liable for taxes (i.e. a tax-free threshold).

2.3.2. Economic efficiency

Taxes can distort economic decisions. They create a loss of welfare over and above the revenues collected, referred to as the deadweight loss or excess burden of taxation (Rosen, 1995; Tanzi and Zee, 1996). When faced with taxes, individuals' and businesses' decisions on where to invest or allocate their labour may deviate from those they would have made in the absence of such taxes (Alm 1996; Slemrod, 1996). This tax-induced distortion in economic behaviour results in reduced output and growth – it represents a net efficiency loss to the economy as a whole (Barnett and Grown, 2004). Apart from lump-sum taxes, all taxes have the potential to distort economic decisions. Lump-sum taxes (e.g. a head tax paid by everyone in the country) are taxes whose liability does not depend on behaviour as they are unavoidable.

Indirect taxes such as the VAT are generally considered to be superior to direct taxes such as income taxes in terms of efficiency because taxes applied on a broad base such as consumption limit the ability of consumers to change their behaviour. There is also a relationship between tax rates and economic efficiency – increases in tax rates result in increases in inefficiency. A low tax rate on a broad base such as consumption (e.g. VAT) tends to be more efficient than a high rate on a narrow base such as a personal income tax even when both yield the same amount of revenue (Ballard, Scholz and Shoven, 1987).

There is often a trade-off across the three criteria of economic efficiency, administrative effectiveness and equity. For example, if broad-based, VAT is not only economically efficient but also administratively efficient (it can be collected from both producers and retailers). However, a VAT on all food items is considered to be regressive as the poor tend to pay a higher proportion of their income on food compared to the rich (in spite of the fact that the VAT is essentially a flat-rate tax). Many countries do incorporate zero-ratings and exemptions in the VAT system as a way of introducing an element of equity, but this tends to make the tax system more complex (Bird, 2005). Zero-rated goods and services are taxable for VAT, but the VAT rate is zero per cent. In this case, a retailer can claim input tax whereas invoices issued to consumers will show VAT at a rate of zero per cent. VAT exempt goods and services are those that are exempt from tax. There is no output or input tax. For example, in South Africa some basic food items such as maize meal, milk, fruit and vegetables are

zero-rated while accommodation rentals and certain services such education, rail and road transport are exempted (Kearney, 2003; Jansen, Stoltz and Yu, 2012).

In contrast, direct taxes such as the PIT are generally considered to be economically inefficient (a person may decide not to work when a tax is introduced). However, direct taxes are generally considered to be better at reducing inequalities – taxpayers at different economic levels can be taxed at different rates through increasing marginal tax rates in the PIT structure. Administering these direct taxes tends to be more complicated (and costly) than levying indirect taxes as taxpayers have to be identified, assessed and constantly monitored (Bird, 2004).

Although lump-sum taxes (and direct taxes such as VAT) are efficient in that they limit the taxpayer's behavioural changes, they do not pass the equity test. Many people in society would not be happy with a tax that imposes the same liability on both the poorest and the richest individuals, or worse, a greater liability on the poor. Tax administrations therefore have to carefully balance the efficiency and equity aspects of a tax, as an increase in efficiency usually results in an increase in tax inequity - the "equity-efficiency trade-off" (Black et al., 2006).

2.3.3. Administrative effectiveness

Administrative effectiveness refers to ease of administration in both tax collection and compliance. Tax collection is not a costless activity – costs are incurred by tax authorities in collecting taxes and taxpayers also incur costs in complying with tax regulations (Bird and Zolt, 2008). Compliance and collection costs should therefore be kept as low as possible although there is usually a trade-off between the two. An increase in compliance costs (i.e. submitting complete and accurate information) results in a decrease in administrative costs and vice versa (Bird and Zolt, 2003). Two phenomena are related to these costs: tax avoidance and tax evasion.

Tax avoidance consists of the actions taken by taxpayers to reduce their tax liabilities without contravening the law. These actions are not illegal and involve exploiting loopholes in the tax system. Tax evasion is an illegal practice where an individual (or corporation) intentionally avoids paying his/her true tax liability. In cases where the tax administration is weak in

monitoring and enforcing tax regulations (as is the case in many developing countries), levels of evasion will be high (Ordóñez, 2010).

2.3.4. Trends in tax reform in developing countries

Due to the low tax levels in developing countries (see Table 1), the general tax reform consensus over the past three decades has focused on the need to strengthen tax administration, simplify tax systems and the broadening of the tax base (Bird, 2010). These recommendations, whose main objective was to increase revenues and improve administrative effectiveness, are outlined below.

In many developing countries, tax bases were under-assessed by poorly paid and unmotivated civil servants who were unwilling (or unable) to enforce compliance (see Bahl and Bird, 2008). The strengthening of tax administration resulted in the creation of semi-autonomous revenue authorities and large taxpayer units (LTUs) within these organisations from the mid-1980s through to the early 2000s. The aim of establishing semi-autonomous revenue authorities was to increase professionalism, automate processes (mainly through the use of information technology) and implement modern management practices. An important aspect of encouraging professionalism was the appropriate compensation for staff in these newly-established semi-autonomous revenue authorities without being encumbered by government bureaucracy and civil service rules (see Fjeldstad and Moore, 2007; Kloeden, 2011). The results from the establishment of semi-autonomous revenue authorities have been mixed, with some countries showing improvements in administrative effectiveness while others have not (Bird, 2004; Kloeden, 2011).

LTUs were established to allow developing countries with scarce resources to focus on the large taxpayers (i.e. large corporations) – a measure that would result in immediate and visible results (Benon, Baer and Toro, 2002). According to Kloeden (2011), the results from the establishment of these LTUs were also mixed. The reasons cited by Kloeden (2011: 9) for the mixed results included ‘weak political commitment, backlash from large taxpayers, and most commonly, internal tensions caused by separate VAT and income tax departments’. The emphasis on strengthening administrative capacity has not been misplaced as this was (and continues to be) a major area of weakness in most tax administrations in developing countries (Bird, 2004; Bahl and Bird, 2008).

A number of developing countries have complex tax systems. An example of a complex tax system is one that applies different CIT rates for different sectors as is the case in Egypt, Paraguay and Zambia (Tanzi and Zee, 2000: 311). According to Heady (2001), such a tax system not only creates distortions but also increases compliance and administrative costs without an increase in the revenues collected.⁹ In developing countries, tax simplification has “been an unavoidable feature of successful tax reforms” (Gillis, 1989: 8). Examples of developing countries that have successfully simplified their taxes are Chile, Uruguay, Indonesia and Colombia (Gillis, 1989). While there has been a move towards simplifying the tax structure, introducing variable presumptive taxes results in the opposite effect.

The replacement of sales taxes (i.e. tax levied on a percentage of final sales) with the VAT has been a major component of the tax reforms in developing countries. According to Gillis (1989: 504), in these countries “the VAT has generally replaced archaic and essentially inadministrable forms of sales tax”. The VAT’s self-enforcing features (using the invoice method) make evasion difficult. Gillis (1989) goes on to argue that, in developing countries, tax reforms stand a better chance of success if the VAT is implemented as part of these reforms. Replacing sales tax with VAT, as a component of tax reforms, resulted in successful reforms in all but one of the nearly 40 countries that implemented reforms since 1967 (Gillis, 1989: 504).

Due to a lack of administrative capacity, developing countries traditionally focused on trade taxes which are easier to collect (at the border) than income and sales taxes (Fjeldstad and Moore, 2008). However, as explained in more detail in the Section 2.5.2 below, trade liberalisation (and the tax reform advice of the last few decades which focused on the importance of a broad-based tax on consumption, i.e. VAT instead of tariffs) has led to a significant drop in trade taxes and the increased usage of VAT in developing countries.

Many developing countries are characterised by large informal sectors and small formal sectors. While the tax reforms of the 1980s may have improved revenue collection from the small formal sectors in countries such as Uganda, Zambia, Ghana and Tanzania (Devas and Kelly, 2001), the large informal sectors have largely escaped taxation (see Bird and Wallace, 2003; Keen, 2007). Most of the direct tax revenues in developing countries come from the

⁹ The distortions will be created by the allocation of resources being influenced by the sectoral differences in the tax rate.

small formal sectors (Engelschalk, 2007). In Kenya, for example, 61 per cent of tax revenues in 2000 came from 600 large taxpayers, representing 0.4 per cent of registered taxpayers (Baer, 2002 cited in Fjeldstad, 2009: 198).¹⁰ The following section looks at the conceptualisation of informality in the literature and the reasons for its existence and growth in developing countries, before describing attempts to tax this sector.

2.4. The informal sector

Informal sector definition, size and causes

There are different conceptualizations of informality in the literature.¹¹ Informality means different things to different people. Some definitions of informality in the literature are vague and others are quite comprehensive. To Kanbur (2009: 2), “informality is a term that has the dubious distinction of combining maximum policy importance and political salience with minimal conceptual clarity and coherence in the analytical literature”.

Keith Hart, one of the early pioneers in the study of the informal sector, saw the distinction between the formal and informal sectors as being largely due to state regulation. Hart used the term “informal sector” to refer to employment outside of the regulated labour markets (Hart, 1973). The International Labour Organisation (ILO) defined the informal sector as a collection of small microenterprises (mainly in the subsistence economy) that were not regulated and taxed (ILO, 1972). However, according to De Soto (1989), it is not the lack of government regulation that thwart the dynamism and growth of the informal sector but the excessive and inappropriate nature of these regulations. De Soto’s argument is that too many government regulatory policies end up excluding many firms that resort to informality.

Due to the fact that those in the informal sector operate outside the purview of state regulations, there are serious challenges in not only defining but also accurately measuring these activities (Alm et al., 2004). In the literature, there are two main distinctions in the approaches used in defining this sector, the enterprise-based view and the social protection view (Perry, Maloney, Arias, Fajnzylber, Mason and Saveedra-Chanduvi, 2007; Oviedo 2009). The first approach, the enterprise-based view, looks at informality from the perspective of the firm, and focuses on the firm’s size and legal status (i.e. the number of

¹⁰ The revenues from these large taxpayers include VAT payments.

¹¹ Informality in this thesis excludes criminal activities.

people employed and whether it is legally registered or not). The firms in this approach tend to be unregistered (for tax purposes or with the company registration system) and/or unlicensed (see Gerxhani, 2004). This enterprise-based approach, has historically been widely used in the literature on informality by the ILO (1972), De Soto (1989), Schneider and Enste (2000), and Maloney (2004).

The second approach, the social protection view, analyses informality from the perspective of the employees. The concept of informality has recently been broadened to include not only informal sector firms and the self-employed but also informal wage labour. The social protection approach's focus is on the employment relationship between the workers and the firm. It recognizes that there are many firms (formal and informal) that have informal working contracts with their employees. These firms engage informal workers so as to avoid offering social security contributions or providing terminal benefits and medical aid which are usually part of a formal employment contract (Chen, 2007). This new approach to informality allows for informality to take place in both informal and formal production units.

The current definition used by the ILO looks at both types of informality. According to Chen (2007: 2) there has been a drive to:

...extend the focus to include not only enterprises that are not legally regulated but also employment relationships that are not legally regulated or protected. In brief, the new definition of the 'informal economy' focuses on the nature of employment in addition to the characteristics of enterprises.

According to the ILO, informal economic activity accounts for more than one third of non-agricultural employment in the world (ILO, 2002: 7). Chen, Vanek and Heintz (2006: 2133) report that the proportion of those in informal employment ranges from 10 per cent in Western Europe to 24 per cent in Southern Europe. In the United States of America and Canada, informal employment accounts for 8 per cent and 18 per cent of total employment respectively (WIEGO, 2006: 1). In contrast, a 2013 report by the ILO and WIEGO (Women in Informal Employment Globalizing and Organizing) shows that the proportion of people in informal (non-agricultural) employment was more than 50 per cent in the 47 developing/transition countries studied. In South and East Asia, this proportion ranged from 42 per cent in Thailand to 84 per cent in India. In Latin America and the Caribbean, the

proportion ranged from 40 per cent in Uruguay to 75 per cent in Bolivia. In sub-Saharan Africa the proportion ranged from 33 per cent in South Africa to 82 per cent in Mali (ILO, 2013: xi). In terms of geographic regions, sub-Saharan Africa has the highest level of (non-agricultural) informal employment in the world at 76 per cent (Charmes, 2009: 34), and the vast majority (72 per cent) of these who are in informal employment in sub-Saharan Africa are self-employed (Charmes, 2009: 36).

Although many governments in developing countries have sometimes resorted to forcibly registering and collecting taxes from informal enterprises (i.e. “compulsory formalizations”), Garcia-Bolivar (2006) argues that these measures are unlikely to succeed if the reasons for informality are not understood and addressed. Any attempt at registering and taxing the informal sector has to be cognizant of not only the informal sector’s heterogeneity but also its causes.

Informality is believed to reflect underdevelopment (Perry et al., 2007; Sharma, 2009; Loayza and Serven, 2010). There is evidence to suggest that large informal sectors reflect a particular stage in a country’s development. Less developed countries have larger informal sectors than more developed ones (see Schneider and Enste, 2000).. There is a large literature on the causes of informality. Most of the causes fall into two categories that Perry et al. (2007) refer to as the “exclusion” and “exit” motivations. In many developing countries, small formal sectors are unable to cater for large numbers of the unemployed so people are “excluded” from the formal economy (see also Hirschman, 1970). “Exit” occurs when people decide that the benefits of being in the informal sector outweigh those of being in the formal sector – they voluntarily decide to opt out of the formal sector (Perry et al., 2007).

The literature on informality has largely focused on exclusion. There is a large literature that argues that due to a profound lack of skills, education and capital, many people are “excluded” from the formal sector and end up in the informal sector as a way of surviving (Djankov, La Porta, Lopez-De-Silanes and Shleifer, 2002: 3). The recent literature has shown, however, that there are many entrepreneurs who choose to be informal (or “exit” the formal sector). According to Perry et al. (2007), the “exit” dimension of informality has been under-stressed in the literature.

This opting out of formality happens when firms and entrepreneurs view the benefits of formality as being low and/or the costs of remaining formal as being too high (see Maloney, 2004; Oviedo, 2009). Informality has its own costs too. Some of the costs of remaining in the informal sector are such things as the risk of being caught and having to pay penalties (or bribes), operating sub-optimally and not growing the business so as not to attract attention from tax authorities (Hillman, 2009).

The informal economy is highly heterogeneous in developing countries. In their report on informality in Latin America, Perry et al. (2007) characterize the informal economy as being made up of primarily three entities that differ in their motivations - workers, the self-employed/micro-enterprise owners, and firms. Each of these entities has a different set of reasons for being in the informal sector although some of these reasons may overlap.

The first category is made up of workers in informal employment (those working for informal firms and those working informally in formal enterprises). The majority of informal workers turn to informality as a 'coping strategy' due to unfavourable economic conditions (high levels of unemployment). These are workers who generally earn very low wages and are sometimes paid 'in kind' (in formal or informal enterprises). Here, the evidence suggests that workers, both young and old, are usually involuntarily in informal employment. Most of them would prefer a job in the formal economy with the usual employment benefits (i.e. social security, protection from summary dismissal, leave etc.) but due to their limited human capital - education, skills and experience - are unable to get one (for evidence from Latin America, see Blanchflower and Oswald, 1998).

The second group, the self-employed in the informal economy, are a very diverse group. This category is made up of survivalist self-employed workers (micro- and small enterprises) and medium-scale enterprises that are run by the non-poor, educated and skilled entrepreneurs. Most of the survivalist enterprises struggle to survive and have no intention (or potential) of growing. Many of these enterprises are short-lived due to intense competition and a lack of information and/or access to markets. These self-employed workers are usually in the informal economy due to their low level of education and skills. While most of these self-employed workers have been excluded from the formal economy, some of them choose to be in the informal economy (Maloney, 2004). This is because formal jobs (based on the qualifications they possess) would not be significantly better than their current jobs in the

informal economy (and could in fact make them worse off due to high compulsory social protection benefits) – thus implying exit. As Cunningham (2001) points out, this category is also made up of women who may choose to run small enterprises or operate independently as a way of balancing their domestic and income-earning roles. These self-employed workers may have no plans to expand their operations or “graduate” to the formal sector.

Some of the small and medium enterprises that are run by the non-poor and educated entrepreneurs record their transactions and often have bank accounts. In some cases they are registered business entities (i.e. with the company registration system) but not registered for VAT, income taxes and/or do not comply with labour regulations. These are the enterprises that hold the greatest potential for ‘graduating’ to formality (and many of them operate at the frontier of the formal/informal divide). Many of those in this category have actually left the formal sector to start their own enterprises and tend to cite flexibility and autonomy as strong motivators, coupled with their abilities as entrepreneurs – they actually prefer self-employment. In this segment are also firms that have adjusted their operations in such a way that the regulations no longer apply to them (see Kanbur, 2010).

Although the evidence from many surveys is mixed, there are indications that (in some developing countries) the informal sector self-employed entrepreneurs tend to earn more, on average, than those employed in the formal economy (for sub-Saharan Africa see World Bank, 1987; Peters-Berries, 1993; Maloney, 2004; Sandefur and Teal, 2007).¹² Some of the reasons given for continuing to operate in the informal economy by these enterprises are the high costs of registration, the low perceived benefits of formalization, ignorance of how to go about formalizing their enterprises, deliberate tax avoidance, and weak government monitoring and enforcement mechanisms (see Bräutigam, Fjeldstad and Moore, 2008).

In some cases, an enterprise can ‘blend’ formal and informal activities, i.e. some activities may be formal and others may be informal (Zinnes, 2009). This third category is made up of larger firms that are regarded as being in the formal economy but do not fully comply with all applicable regulations - a company that is registered for corporate tax may choose to declare only part of its workers’ salaries for personal income tax. In some cases, these corporations

¹² The results from comparing wages between formal and informal workers should be treated with caution – there are a myriad of other factors (apart from money) that workers take into account when making a choice between being an informal entrepreneur or a worker in the formal sector (see Maloney 2004).

may comply with all tax regulations but fail to fully cover their employees in terms of benefits such as leave, pensions and medical aid. Also in this category are firms that declare only a portion of their sales (Bird and Wallace, 2003). The reasons cited for having some of their operations in the informal sector are such things as pervasive tax avoidance (i.e. ‘other firms are doing it’), onerous legislation which sometimes punishes formal firms and weak enforcement by the state (Bräutigam et al., 2008).

Although these three categories of informal economy activities and the driving forces behind them are far from exhaustive, they serve to illustrate the heterogeneity of the informal economy. Informal economy operators in each of the examples above have different motivations for being in this sector and policy recommendations on formalization have to be informed by these differences. It is important to note, however, that these driving forces differ from country to country and even within countries, i.e. between different regions and historical periods (Maloney, 2004).

The informal sector in a developing country can be motivated by both ‘exclusion’ and ‘exit’. These two drivers of informality should therefore be treated as complementary rather than competing analytical frameworks (Perry et al., 2007). The cost-benefit analysis approach used by the exit analytical framework emphasizes the voluntary nature of informality while the exclusion analytical framework emphasizes informality’s involuntary nature, attributing it to government policy failures.¹³ According to Zinnes (2009), the underlying theme in both analytical frameworks is the same, i.e. government’s central role as the source of not only policy but also the costs and benefits of formality.

To fully understand the phenomenon of informality, the lenses of both exclusion and exit have to be used. In some countries, exclusionary mechanisms may be more important while in others exit may be more important. As Perry et al. (2007) point out, it is sometimes difficult to distinguish between the two. Even for the same firm, there may be different forces at play: registration of workers may fall under exclusion, while tax registration may fall under exit. Whichever driving force is at play, the consequences for non-participation in the formal economy are the same for the fiscus: taxes are not collected and the state loses revenues.

¹³ Although the focus of the literature is on government policy failures, the private sector’s inability to create sufficient decent jobs is an important factor in the analysis of exclusion.

Due to the focus on informal sector taxation in this thesis, the sections that follow will assess the literature on informal enterprises and the self-employed and not workers employed in the informal economy, i.e. it will use the enterprise-based approach to informality. It will use the statistical definition of informal production units based on the 15th International Conference of Labour Statistics (ICLS) of 1993 (Husmanns, 2004: 3). The ICLS defines informal enterprises as all own-account enterprises or those own-account enterprises that are unregistered under tax/social security laws. The focus on informal enterprises is, in part, due to the fact that informally employed workers are unlikely to have incomes that are sufficiently high to attract the attention of tax authorities. Also, although very little research has been conducted on the taxation of informally employed workers, most governments who attempt to tax the informal sector appear to focus on enterprises. The focus is on informal enterprises that are escaping the net of tax authorities but are regarded as a potential source of tax revenue. The terms ‘informal economy’, ‘informality’ and ‘informal sector’ will be used interchangeably in this review.

2.5. Taxing the informal sector

Informal sector firms are those that are outside the purview of regulations, mainly tax laws. Some scholars have gone to the extent of defining informality as tax avoidance (DePaula and Scheinkman, 2007). However as Kanbur (2010) points out, this exclusion from regulations (tax, labour and environment regulations) could be due to the contravention of these regulations or simply due to the fact that the regulations do not apply to them (i.e. their earnings are below the tax threshold).

The tax literature makes a distinction between large, medium and small firms. In some of the literature, a distinction is made between small and medium enterprises (SMEs) on the one hand and micro-enterprises on the other (which usually include informal sector firms – see Bodin and Koukpaizan, 2008). In terms of informal sector taxation systems, one of the most challenging issues in their design is how to disaggregate firms (in a way that avoids distortions) into small-, micro- and medium-enterprises based on their ability to keep proper financial records (IMF, 2007). Table 2 is an attempt by Joshi et al. (2013) to disaggregate informal enterprises in a manner that can be used as a starting point in designing an informal sector tax regime.

Table 2: A typology of informal enterprises

| | Subsistence enterprises | Small enterprises | Medium enterprises |
|------------------------------|--|--|---|
| Degree of informality | 100 per cent for most enterprises | High proportion of sales undeclared and workers not registered | Some proportion of sales undeclared and workers unregistered. |
| Type of activity | Single street traders, home-based micro-enterprises | Small manufacturers, service providers, distributors, contractors | Small and medium manufacturers, service providers |
| Technology | Labour intensive | Mostly labour intensive | Knowledge and capital intensive |
| Owner profile | Poor, low education, low level of skills | Poor and non-poor, well educated, high level of skills | Non-poor, educated, specialised skills |
| Markets | Low barriers to entry, highly competitive, high product homogeneity | Higher barriers to entry, highly competitive, some product differentiation | Significant barriers to entry, established market/product niche |
| Finance needs | Working capital | Working capital, some investment capital, supplier credit | Investment capital and working capital, letters of credit, supplier credit |
| Other needs | Personal insurance, social protection | Social protection, personal and perhaps business insurance | Personal and business insurance, business development services |
| Record keeping /registration | Very rudimentary records and enterprise not registered | Basic idea of turnover/gross income but poor record keeping. Mainly cash transactions but enterprise may be registered | Recorded transactions with good knowledge of turnover and profit. Enterprises usually have bank account and are registered enterprises (but not for tax purposes) |
| Tax implications | Earnings can be below minimum tax threshold, no recordkeeping, cash transactions | Liable for tax, difficult to identify and assess | Liable for tax, under-report earnings, use loopholes, escape formal tax assessments |

Source: Adapted from Djankov et al. (2002: 4), Zinnes (2009: 8) and Joshi et al. (2013: 8)

According to Joshi et al. (2013), the informal sector in developing countries is highly heterogeneous. In this sector, a distinction has to be made between: subsistence enterprises (that cannot be reasonably expected to pay taxes); small firms that can be subjected to a special regime that specifically targets informal micro-enterprises; and medium enterprises that are usually large enough to pay regular corporate income taxes but are not paying.

Although Joshi et al. (2013) focus on the taxation of small to medium enterprises, they argue for a link between the narrow quest for tax revenues and a broader strategy of formalising these enterprises.

Informal sector taxation has recently generated a lot of interest among tax scholars (see Joshi and Aye, 2002; Emran and Stiglitz, 2005; Bird and Zolt, 2005). The calls for taxing the informal sector have focused on two issues that are sometimes conflated in the literature. Firstly, there are calls that have focused on the issue of revenue collection without encouraging the formalization of these enterprises. Stated differently, these small informal firms (the micro-enterprises) can remain in the informal sector as long as they pay the simple taxes designed for those in this sector (e.g. the presumptive taxes explained below). Informal firms under this approach are those that fall below a specified turnover threshold and/or whose employees do not benefit from social protection.¹⁴ The second approach to informal sector taxation focuses on the bigger informal firms (the small to medium enterprises) that have potential for growing and moving into the regular tax system. While the issue of obtaining revenues from the informal sector is also important in this approach, there is a broader strategy of encouraging informal enterprises to grow and formalise their operations (i.e. increase turnover, move to the regular tax system and adhere to social protection regulations). Apart from revenues, the other factors driving the call for informal sector taxation are related to the issues of equity, economic efficiency, and governance. These aspects of the rationale for taxing the informal sector will be discussed in more detail after an explanation below of the types of taxes that can be levied on the informal sector.

The informal sector can be brought into the tax net through three main ways: firstly, through the application of the existing, regular, tax regime; secondly, through indirect taxes such as the VAT; and thirdly, through some special tax specifically aimed at the sector, such as a presumptive tax (Bird and Wallace, 2003). What follows is a review of each in turn.

¹⁴ While the definition of a formal enterprise (and “formalization”) tends to vary from country to country, many (but not all) developing countries that have introduced special tax regimes for the informal sector continue to refer to micro-enterprises that are not paying the CIT and/or VAT as informal enterprises (see Joshi and Aye, 2008; TRA, 2011; Carroll, 2011). The definition of informality in these developing countries tends to focus on specific turnover thresholds.

2.5.1. Reliance on existing taxes

The most obvious way of taxing the informal sector is by extending the reach of formal sector taxes, including income taxes and VAT and thereby formalising informal businesses. This could be done by strengthening enforcement - identifying small informal sector firms and ensuring compliance (see Bird and de Jantscher, 1992; Bird and Wallace, 2003). This approach can be facilitated by using various incentives for compliance, such as reduced CIT rates for microenterprises below the VAT registration threshold. A reduced CIT tax rate allows small enterprises that are below the VAT registration threshold to register as taxpayers and obtain tax clearance certificates which allow them to open bank accounts and bid for government (and private sector) tenders. In South Africa, for example, incorporated small enterprises with taxable income below R40,000 are exempted from corporate taxation. Those small firms with taxable income between R40,000 and R250,000 pay a reduced CIT rate of 10 per cent and not the standard rate of 29 per cent (Engelschalk, 2007: 54).

It is possible to extend the coverage of formal sector taxes to the larger informal sector enterprises (Bird and Wallace, 2003). However, attempting to extend this coverage to all informal sector firms with incomes above a particular level (e.g. the personal income tax-free threshold) would impose very high administrative and compliance costs. Given the informal sector's heterogeneity, a more appropriate strategy would be one that carefully targeted those larger informal firms (e.g. the medium enterprises in Table 2) that can be brought into the tax net using the regular tax system (Loeprick, 2009). All the other informal sector enterprises could then be taxed using alternative methods such as income tax withholding (Keen, 2008) described below.

As a way of improving administrative effectiveness and lowering compliance costs, many developing countries use income tax withholding on imports as a way of taxing the informal sector (Keen, 2008). This is a useful tool that is used to tax transactions that are likely to escape taxation and is implemented to increase the cost of non-compliance. Withholding taxes are levied on imports and/or domestic transactions with these taxes being credited against the tax liability of those firms or individuals that are tax compliant. This withholding tax can be credited against income tax for example. Since these taxes are borne by non-compliant firms (and those in the informal sector), this is a way of not only getting revenue from the informal sector but also encouraging tax compliance. According to Keen (2007), withholding taxes on imports have proved to be popular in many developing countries

including Argentina, Benin, Burkino Faso, Central African Republic, Gabon, Guinea, Jordan, Pakistan and Uganda. Withholding taxes can also be levied on domestic transactions. Large tax-compliant firms can be used to collect withholding taxes on transactions that they make with small businesses that may not be tax compliant.

Withholding taxes, especially those on imports, have obvious advantages in developing countries where it is relatively easy to collect taxes at the border (i.e. they reduce the cost of collection). However, in spite of the considerable revenues raised by using withholding taxes in some sub-Saharan African countries, the reliance on these taxes can discourage more fundamental reform. Also, the registered firms tasked with the collection of these taxes are not always honest and some are corrupt. The systems of crediting and refunding enterprises that have paid the withholding tax can end up being administratively burdensome for many tax administrations in developing countries (IMF, 2011).

2.5.2. Indirectly through the VAT

The tax reform advice of the past three decades which focused on the lowering of trade tariffs and the implementation of VAT was based on the fact that the base of the VAT is wider than that of import duties. Given the uniform nature of a properly designed VAT, not only will similar amounts of revenues be raised by the introduction of the VAT at a lower rate but welfare can be increased as well. This is because trade taxes distort both consumption and production decisions and have a narrow base leading to high rates (Volkerink, 2009). Tariffs meant to protect domestic industries result in welfare losses due to production inefficiency.¹⁵ A VAT does not affect decisions on the allocation of resources and it does not distort consumer choice. The introduction of a broad-based VAT at a uniform rate improves welfare compared to trade taxes, as the same revenue can be generated at lower costs (i.e. in a less distortionary manner). It is therefore argued that while the VAT may not be progressive, it is efficient (Ebrill, Keen, Bodin and Summers, 2001).

¹⁵ A tariff (tax) on imported goods increases the cost of imports. This will decrease the level of imports and increase domestic production in a protected industry. The existence of imports of a particular good indicates that at the current level of domestic demand, foreign production is more efficient than domestic production. A tariff means that domestic consumers will have to pay a higher price (from inefficient domestic producers), and receive a smaller level of output i.e. there is a loss of welfare (see Diamond and Mirrlees, 1971).

Traditionally, consumption taxes such as the VAT have been considered to be inherently more regressive than income tax due to the difficulties of implementing graduated tax rates. Issues of VAT regressivity have been challenged on the basis that it is possible to implement features such as zero-ratings and exemptions on goods consumed by the poor (Piggott and Whalley, 2001). It is also possible to increase the tax rates of luxury goods that are primarily purchased by the rich although this can complicate the implementation of the VAT system.

The conventional view has been challenged recently by a number of scholars (Piggott and Whalley, 2001; Emran and Stiglitz, 2005; Gordon and Li, 2005). Empirical work by Piggott and Whalley (2001) in Canada suggests that VAT base broadening can be distortionary as it causes producers to shift from the formal sector to inefficient home production and the informal sector. Although efficiency worsening, Piggott and Whalley (2001: 1084) conclude that a VAT may actually be progressive. This is due to Piggott and Whalley's assumption of perfect substitutability between formal and informal products - poor informal sector enterprises benefit from VAT base broadening by selling their goods to the rich at the gross of the tax price.

Theoretically, Emran and Stiglitz (2005) argue that conventional wisdom is based on a partial model that ignores the existence of large informal sectors in developing countries. The VAT's incomplete coverage in these countries means that a revenue neutral shift from trade taxes "can reduce welfare under plausible conditions" (p. 602).¹⁶ Emran and Stiglitz (2005) argue that while the informal sector does not pay VAT, it would not be able to escape import duties. This could have the effect of decreasing the base for the VAT to such an extent that welfare would be reduced (with revenue neutral reforms). Keen (2008) argues that this result depends on whether traders in the informal sector are able to get a refund for VAT levied on imports. According to Keen (2008: 1894), more than half of the gross VAT collections in developing countries are levied at the border.

However, an empirical study by Glenday (2006: 18) shows that VAT has not succeeded in recovering lost trade tax revenue. Using data from 123 countries over the period 1975-2000,

¹⁶ A revenue neutral shift occurs when the government continues to receive the same amount of money despite changes in the tax laws (World Bank, 1991). The government may lower taxes for one particular group of people, but raise taxes for another group or increase the rate for one tax base while reducing it for another. This allows the revenue that they receive to remain unchanged (i.e. neutral).

Glenday found that 101 countries experienced declines in their trade tax yields with 54 managing to raise non-trade taxes to fully offset the loss in trade tax revenues. Of the 39 developing countries in this study, only six were able to fully replace these losses with revenue from non-trade taxes. A policy challenge in developing countries therefore is how to maintain fiscal stability when liberalizing trade.

The high VAT registration thresholds (usually above US\$40,000 in sub-Saharan Africa – see IMF, 2007) improve tax administration by excluding small taxpayers (such as those in the informal sector) who generate little revenue. This focus on larger firms ensures administrative effectiveness as it lowers both compliance and administrative costs (see Ebrill et al., 2001). Nonetheless, in practice, VAT is an important way of taxing the informal sector. Despite these high VAT thresholds (that exclude informal enterprises) the VAT system ensures that many of those in the informal sector still pay taxes given the way that the VAT operates - through the non-creditable VAT paid on inputs.

The way the VAT operates is usually considered as a non-complicated way of extending the tax net to cover informal sector enterprises (Engelschalk, 2007). Many informal sector enterprises have extensive business links with formal sector enterprises as they usually obtain their inputs from them (see Devey, Skinner and Valodia, 2006). When goods are purchased by informal sector enterprises from enterprises in the formal sector, they are charged VAT (input tax). However, not being registered for VAT means that they are unable to claim a refund for the tax paid on these inputs therefore the informal sector is being indirectly taxed.

There are two major reasons why the VAT, according to the recent literature, is not the best way of taxing informal enterprises. Firstly, Fjeldstad and Heggstad (2011) argue that this method of taxing the informal sector runs contrary to the political economy approach and the global tax programme, which emphasizes the role of tax base broadening on governance and the development of state-citizen relations (i.e. accountability in exchange for taxes paid). This can be better achieved through a simple direct tax (see also Joshi et al., 2013). Secondly, while a VAT alone in certain circumstances can be fully optimal (due to the manner in which it operates as a tax on informal sector inputs), its effectiveness is unclear (Bird and Gendron, 2007). For a VAT to be effective, informal operators have to be charged VAT on all their inputs (see Keen, 2008). If informal enterprises purchase a significant portion of their inputs from other informal traders or produce these inputs themselves (and thus escape the VAT

net), presumptive taxes could be effective in getting at least some revenue from them. Presumptive taxes are discussed below.

2.5.3. Presumptive taxes

An increasingly popular way of taxing the informal sector in sub-Saharan Africa is through presumptive taxation. According to Ahmad and Stern, (1991: 276) “the term presumptive taxation covers a number of procedures under which the ‘desired’ base for taxation (direct or indirect) is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself”.

Some of the countries with presumptive tax legislation in developing countries are Angola, Cameroon, Ghana, Ethiopia, Uganda, Brazil and Vietnam (Taube and Tadesse, 1996; Bird and Wallace, 2003; World Bank, 2014). Presumptive assessment usually involves the determination of income based on various ascertainable factors. Thuronyi (1996) gives the example of a restaurant which can be taxed based on indicators such things as location, number of seats and price of menu items with the overall aim of determining the profit.

Although a presumptive tax could apply inside (i.e. replace) the VAT or income tax (PIT or CIT), it usually operates inside the income tax (Thuronyi, 1996). Most informal sector firms, being below the VAT registration threshold, are already paying VAT (on their inputs). Therefore, these traders who are already paying the VAT are expected to also pay the income tax in the form of the presumptive tax. In some countries, the presumptive tax can operate inside both the income tax and VAT. For example, for medium size enterprises (those with turnover between 100,000 and 500,000 Birr), Ethiopia levies a presumptive tax on income (based on turnover) and a two per cent flat rate on turnover instead of a VAT. In Kenya, a flat tax of three per cent is levied as a replacement for both income tax and VAT (Joshi et al., 2013). The main objectives of these presumptive taxes are to simplify the tax administration process, to collect some revenue from these firms and to educate them on tax issues with the ultimate aim of incorporating them into the regular tax system (Bird and Wallace, 2003).

Presumptive taxes can be divided into three broad categories: a) lump-sum taxes; b) taxes based on indicators of income capacity and/or business performance; c) taxes based on turnover (see Engelschalk, 2007). A distinction can also be made between those presumptive taxes that are based on negotiations with the taxpayer, those that are rebuttable, and those that

allow the enterprise owner to choose between the presumptive tax and the standard tax (Pashev, 2006).

A presumptive tax can have a single value for all informal sector firms - essentially a lump-sum tax. In its simplest form, the lump-sum tax has no relation to actual or potential income. It therefore does not affect behaviour as the amount paid is not dependent on it. Despite its superiority in terms of efficiency, it is unfair (Pashev, 2006). Most lump-sum presumptive taxes do attempt to achieve a degree of equity by applying different rates to different informal sector groups of taxpayers. For the smallest, survivalist informal sector enterprises, a simple license fee administered by a sub-national authority may be the most appropriate way of taxing them (Suharto, 2011). For the larger informal enterprises (e.g. mini-bus taxis and hairdressing salons) a presumptive tax based on indicators and/or turnover for the industry as a whole may be a more appropriate option.

Presumptive tax rates can be based on indicators of income capacity or business performance of a particular informal sector segment (e.g. turnover estimates of minibus taxis). Different tax rates can then be applied based on estimated profits within the sub-sector (e.g. based on seating capacity of the minibus taxi). This method could potentially address many of the equity concerns of presumptive taxation as rates are based on ratios developed for a particular informal sector segment. However, this method of setting tax rates requires research on turnover and profit margins for all the informal sector segments that are targeted for taxation (see Tanzi and Casanegra, 1987).

For informal enterprises that can maintain basic records on turnover, the turnover-based tax may be a more viable option (see Economica, 2013). Presumptive taxes based on turnover require an informal enterprise to keep some basic books and records of transactions. A uniform tax rate as a (percentage of turnover) may then be applied to all enterprises under such a regime. Such presumptive tax regimes are used in developing countries although their specific features tend to differ (Engelschalk, 2007). Ghana levies a three per cent flat rate turnover tax as a replacement for VAT (Joshi et al., 2013). The Tanzania Revenue Authority (TRA) has implemented a system of progressively taxing turnover but with reduced rates for those enterprises with adequate records of transactions (TRA, 2011).

The choice between the different types of presumptive taxes to levy on the informal sector in a particular developing country is not an easy one to make (Tanzi and Casanegra, 1987). From the outset, there have to be clear objectives on what the informal sector tax regime is trying to achieve: mere revenue collection, or the graduation of firms to the standard regime. An important starting point is the segmentation of informal sector enterprises into the three basic categories – those that are already keeping basic records of transactions, those that are capable of doing so, and the smallest microenterprises operating at just above or below the subsistence level. The first category could be taxed using turnover taxes. The second category could be taxed using indicator-based presumptive taxes, although various incentives could be used to encourage these firms to keep records and move to the turnover based presumptive tax. For the last category, simple levies (i.e. user charges) at local government level could be the best way of taxing them as a cost-recovery measure (see Bird and Zolt, 2003; Loerprick, 2009).

Designing turnover or indicator-based presumptive taxes, whose goal is the eventual graduation of informal enterprises into the standard system, is difficult – it involves important trade-offs. Since the informal firm's size (whether it is based on turnover or indicators such as an minibus's carrying capacity) is the main criterion used in determining the segment to which this firm belongs, this can operate as a disincentive for firm growth (see Nguyen, 2010 for the Vietnamese example).

The main objective of presumptive schemes is the reduction of both compliance and administrative costs (Thuronyi, 1996). The resultant trade-off between fairness and simplicity in these systems may introduce distortions to a country's tax system. Turnover and indicators (e.g. number of tables in a restaurant) are usually crude estimates of an enterprise's profitability. While many developing countries generally set the turnover tax rate at between two and four per cent (see Engelschalk, 2007; ILO/OECD, 2011; TRA 2011), these rates may still impose a heavy burden on firms with narrow profit margins (Pashev, 2006). While many of these presumptive tax regimes allow informal sector firms to opt for the standard regime, this may not be a feasible option for the smaller firms due to the onerous requirement of keeping proper accounting records.

2.6. Rationale for taxing the informal sector: Revenues, efficiency, equity and governance

Although there are many conceptualizations of informality, the consensus in the literature is that large informal sectors are not good for the economy (Kanbur, 2010). Informality results in both a ‘narrowing of the tax base and a potentially serious distortion of economic activity’ (Keen, 2008: 1892). The recent focus on informal sector taxation has been based on three main arguments. The first argument is that this sector represents a potential source of revenue (Bird and Zolt, 2008; Sanyang, 2009). The second argument is that not taxing this sector raises equity and economic efficiency issues (Bird and Wallace, 2003; Keen, 2008). The third argument is that taxing this sector would improve state-citizen relations and governance (Joshi and Ayee, 2008; Prichard and Bentum, 2009; Fjeldstad and Heggstad, 2011).

Revenues

The informal sector in many developing countries forms a large, and sometimes growing, component of the economy (Schneider et al., 2010). Collecting sufficient revenue to fund government expenditure therefore requires tax authorities to seek ways to collect revenues from those earning their incomes in the informal sector. The informal sector’s contribution to GDP is estimated at 24 per cent in sub-Saharan Africa, 22 per cent in Asia and 23 per cent in Latin America (Charmes, 2006: 7). By focusing on its size and the growing share of its contribution to GDP in developing countries, the informal sector does appear to be a potentially important source of government revenue (Schneider and Klinglmair, 2004; Schneider et al., 2010).

The large informal sector may also have the effect of undermining the developing countries’ growth prospects (through the loss of tax revenues) and broader development agenda (Mbaye, 2014). There have also been calls by international finance institutions for developing countries to finance their own development by mobilising domestic resources rather than by being reliant on aid or foreign loans (Gupta and Tareq, 2008). The broadening of the tax base to include the informal sector could therefore be an important part of the taxation-development nexus (IMF, 2002).

However, taxing informal enterprises is difficult (Tendler, 2002; Bird and Wallace 2003) – the sector is made up of numerous, low-income enterprises. There are very few studies that give an indication of the tax revenues collected from the informal sector - data, even on basic

revenue information, are difficult to obtain in many developing countries (see Keen, 2012). Ayee (2007: 15) reports that in Ghana in 2003, associational taxation revenue (an informal sector tax collected by the transport union) amounted to only 5.3 per cent of total revenues. In spite of these low revenues, the costs of collecting and administering informal sector taxes in developing countries can be high (see IMF, 2007).

As a result of these low revenues and high administrative costs, some tax experts tend to view informal sector taxation with scepticism. Their argument is that a sensible allocation of resources in developing countries should focus on sectors with the greatest revenue yield (Keen, 2012). It is therefore not surprising that taxing the informal sector does not yet feature prominently in many sub-Saharan Africa countries' taxation priorities.

However, taxing the informal sector goes beyond mere revenue considerations. Not only does the government lose revenues due to the non-payment of taxes by those in the informal sector, this also has the effect of raising the tax rate for those who are paying them. Also, not taxing the informal sector means that not only will the informal sector avoid growth (so as not to attract attention from revenue authorities), there is also a possibility of formal sector firms moving into the informal sector so as to avoid being taxed. Terkper (2003) provides evidence that not taxing the informal sector does reduce compliance behaviour in other sectors of the economy (see also Torgler and Schneider, 2009). Loeprick (2009) argues that instead of being viewed from a short-term revenue perspective, small firm taxation should be viewed as a first step towards enterprise formalization. Informal sector taxation is seen as building a culture of tax compliance (the low short-term revenues notwithstanding) which ensures that these enterprises continue to pay their taxes as they expand. Business expansion (as a result of greater access to markets, credit and finance) is seen as offering opportunities for micro-enterprises to move out of the "informality trap" and poverty.

Efficiency

Taxing the informal sector raises not only revenue issues, but also issues of equity and efficiency. Taxes distort economic decisions. They create a loss of welfare over and above the revenues collected – the deadweight loss or excess burden of taxation (Rosen, 1995). By remaining informal, small enterprises are therefore escaping the distortionary effects of taxation and bringing these small firms into the tax net may actually hinder their growth.

However, while informal enterprises may escape taxation (and its distortionary effects), remaining informal can create inefficiencies too – to remain invisible to tax authorities, such enterprises cannot ‘afford’ to be too successful. Firm growth and expansion would attract the attention of tax authorities and there is a growing literature that shows that informality acts as a constraint on the realization of an enterprise’s full potential (Hillman, 2009). There are other costs that informal enterprises bear – constantly devising means and ways of avoiding attention, and harassment by the police and government authorities. Informal enterprises also tend to be excluded from accessing government contracts, credit and other business training and support programmes. This failure to access credit, larger product markets, technology and other sources of innovation means that firms in the informal economy may be operating at a sub-optimal level.

Although there are few studies that look at the impact of formalization on enterprise growth in sub-Saharan Africa, evidence from Latin America does indicate that formalization may have beneficial effects for some informal enterprises. The beneficial effects seem to depend on enterprise size - tax registration by mid-size enterprises increased profitability for these enterprises but the increases were not as significant for micro-businesses (Fajnzylber, Maloney and Montes-Rojas, 2009; McKenzie and Sakho, 2010). If being in the informal sector impedes these enterprises’ growth then economic growth will be affected as well. However, Oviedo (2009) argues that there is no strong evidence in the literature of a causal relationship between informality and economic growth.

Equity

From an equity perspective, there have been arguments for an almost total exemption from direct taxes for the informal sector, particularly those taxes paid to central government. Pimhidzai and Fox (2012) argue that informal sector taxes tend to be regressive, threatening the viability of the smallest enterprises (considering that most of them are already paying local taxes such as trading licenses, operating permits and user fees). In many developing countries, informality is the only viable alternative for many people who have been “excluded” from participating in the formal sector. In such cases, attempts to reduce informality by taxing these enterprises may not only result in inequities but may also destroy informal jobs (Oviedo, 2009).

While this may be true for the smallest enterprises, the discussion above on the heterogeneity

in the informal sector has shown that those in this sector are not always poor (see ILO, 2002; Gurtoo and Williams, 2009; Kanbur, 2010). Not taxing these informal enterprises clearly gives rise to inequities and much anger from those with similar or lower incomes in the formal sector (Fjeldstad and Heggstad, 2011). Empirical evidence indicates that wage earners in developing countries do feel that they are more heavily taxed compared to people at the same level of income in the informal sector (Alm et al., 2004).

Governance

The recent literature has emphasized political and governance considerations in taxing the informal sector in developing countries (OECD, 2008). According to Fjeldstad and Heggstad (2011), informal sector taxation can increase taxpayers' participation in politics, through reciprocity and accountability in exchange for taxes paid, and therefore informal sector taxation should transcend mere revenue considerations.

The literature on the “new fiscal sociology”, the “fiscal social contract”, and “associational taxation” has, as its main theme, the idea that taxation is an important aspect of developing good governance. This literature builds on an historical account of the relationship between taxation and state building by Schumpeter (1918 cited in Di John, 2006) and later developed by Tilly (1992) - a body of literature called fiscal sociology. Although expressions of the central theme vary, the main argument is that paying taxes may encourage governance in three main ways. Firstly, the state, as a way of encouraging quasi-voluntary compliance, may be more responsive and accountable to taxpayers (Bates and Lien, 1985; Levi, 1988). Secondly, taxpayers are more likely to make demands for responsiveness and accountability if they are paying taxes (Bird and Vaillancourt, 1998; Prichard 2009). Thirdly, taxing informal sector operators may encourage bargaining between the state and informal sector associations (Joshi and Ayee, 2008; Prichard, 2009).

If this connection between taxation and governance does indeed exist, then the broadening of the tax base to include the informal sector could prove to be an important way of increasing government accountability and ensuring that those in the informal sector are heard (Moore, 2008). However, evidence for this connection is still rather preliminary. Joshi and Ayee (2009) cite a Ghanaian example of an arrangement where the largest transport union entered into a partnership with the government in 1985 and operated as an agent for state tax collection. In Ethiopia, Prichard (2010) found that expanding the taxation of small firms just

before the 2005 elections resulted in some public mobilization that prompted the government to work with the business sector in overseeing the presumptive tax regime.

Although the literature on governance makes a potentially powerful argument for taxing informal sector operators, more research needs to be done in this area as this ‘governance dividend’ from taxation remains unproven (see Keen, 2012). Tax policy advisors already face the difficult task of combining and reconciling the tax policy objectives of revenue, administrative effectiveness, fairness and efficiency. Dealing with the new area of governance (an issue generally outside the technical realm of taxation) requires further research that not only provides evidence for this link but also on how the “governance dividend” can be converted into a detailed and actionable strategy on taxing the informal sector (Keen, 2012).

Challenges

In Kenya, Kamunyori (2007) found that costly and complicated registration procedures made it difficult for informal firms to formalise. From an administrative perspective, decisions have to be made as to whether the administration costs involved in bringing the informal sector into the tax net can be justified based on the revenues collected or by other reasons such as the inculcation of a tax compliance culture (i.e. so that these businesses continue paying taxes as they grow).

Although many sub-Saharan countries have enacted legislation on informal sector taxation (see Taube and Tadesse 1996), administering these taxes has proved to be a major challenge. Most of the revenue authorities, structured to focus on large taxpayers, are ill-equipped to deal with the numerous and diverse micro-enterprises. Due to limited resources, the focus tends to be on short-term enforcement strategies rather than thorough research, confidence-building and education (see Engelschalk, 2007). The evidence shows that there is a poor knowledge of tax laws and obligations by most informal sector operators (see Carroll, 2011 on Ghana; Demenet, Rafindrakoto and Dial, 2013 on Vietnam). Informal enterprises also tend to have a fairly short lifespan and there is therefore a need to continuously educate people in this sector.

There are numerous challenges that tax authorities face when trying to tax the informal sector. The informal sector is very diverse and is made up of large and small enterprises.

There are some firms that do not warrant the attention of tax authorities as their incomes are too low (see Demenet et al., 2013). Many of the informal sector enterprises do not have bank accounts – the transactions are cash-based. Tax enforcement depends on the use of financial services by enterprises. Cash-only transactions do not leave a paper trail, making it difficult to monitor and tax these transactions.

Taxation requires information on taxpayers (Bird and Wallace, 2003). Without information, the process of identifying taxpayers and ascertaining tax liabilities becomes very difficult. There are no registers of informal sector traders in many developing countries making it difficult to collect taxes in the absence of vital statistics on these enterprises. Also, many informal sector operators do not have information on informal sector taxes and how they should pay them. This lack of information makes it easy for corrupt tax officials and the police to harass them (see Demenet et al., 2013).

A lack of administrative capacity is a serious problem in many revenue authorities. Tax authorities in many developing countries have a dedicated office to deal with large taxpayers (who make up the bulk of the revenue) but most of them do not have a dedicated office for the small taxpayers. This means that large taxpayers (who generate much higher revenues) get priority in terms of tax compliance monitoring, education and support services. High collection costs yielding very low income and capacity constraints (e.g. staff shortages) mean that, in practice, revenue from the informal sector can remain uncollected. Indeed, as a result of weak tax enforcement capacity (an important determinant of informality), the informal sector has continued to grow in many developing countries (Ordóñez, 2010).

A major problem facing many tax authorities in developing countries in the administration of informal sector taxes is that of corruption. Corruption is defined as ‘the abuse of power by public official for private gain’ (Miller, 2010: 155). Corrupt tax administrations deter formalization as informal enterprises find ways of minimizing their contacts with corrupt officials – they avoid registration and monitoring. While informal sector operators usually have to pay bribes in order to operate and avoid harassment from various authorities, such as local authorities and the police, the literature seems to indicate that some tax authorities in developing countries are often themselves corrupt (see USAID, 2005; Joshi and Ayee, 2008; IMF, 2011).

According to Tendler (2002: 3), taxing those in the informal sector may not be in the politicians' best interests. In her study of informal enterprises in Brazil, she observed what she calls a 'devil's deal' – an arrangement between politicians and informal sector operators. In exchange for not enforcing tax, environmental or labour regulations, the politicians could expect electoral support. The arrangement was in the form of 'if you vote for me, according to this exchange, I won't collect taxes from you; I won't make you comply with other tax, environmental, or labor regulations; and I will keep the police and inspectors from harassing you.' (Tendler 2002: 2). Formalization in such cases is not something that politicians would encourage because it would break their hold on voters. According to Tendler (2002), such deals, once made, are very difficult to break. This discretionary application of the taxes and regulations where some sectors are exempted can have the effect of increasing the size of the informal sector as more people get into these arrangements (see Shende, 2002).

Another challenge is that of linking taxes with clear benefits for those in the informal sector. Those in the informal sector, like all other citizens, will tend to resist paying taxes if they do not see the benefits from the taxes that they pay. Evidence shows that taxes are easier to administer when a link can be established between these taxes and projects considered useful by taxpayers (OECD, 2008). Tax collection from the informal sector will be difficult if links cannot be established between taxation and benefits to informal sector operations.

An important determinant of tax compliance behaviour, according to the theoretical literature, is the issue of penalties for non-compliance. According to the Allingham and Sandmo's (1972) theoretical model on tax compliance, rational individuals weigh the costs and benefits of evading taxes. In this model, people are motivated to pay taxes due to the adverse consequences of not doing so (if they are caught). Therefore tax compliance depends on the monitoring behaviour of the tax authorities (i.e. the possibility of detection) and the magnitude of the punishment i.e. the level of the fine (see also Cowell, 1990).

Detecting non-compliance (and punishing those evading taxes) in the informal sector is challenging for many tax authorities in developing countries. However, those in the informal sector who have been caught evading taxes have sometimes complained of harsh punishment meted out by tax authorities. This has taken the form of closure of business premises and seizure of the traders' goods (Carroll, 2011). In her study on informal sector taxation in Ghana, Carroll (2011: 11) also found that tax collectors not only asked for bribes but also asked for sexual favours from female traders who were unable to pay their taxes. The

challenge in developing countries is therefore not only how to mete out appropriate fines to non-compliant informal enterprises but also how to ensure that tax collectors do not engage in corrupt behaviour when monitoring compliance and punishing those that are not compliant.

2.7. Informal sector taxation in Africa, Latin America and Asia

Many developing countries do have regulations covering informal sector taxation. There are a number of special tax regimes that have been introduced since the late 1980s. The focus in many developing countries has been on the design and development of specialized regimes such as presumptive tax schemes (Taube and Tadesse, 1996; IMF, 2007). However, the actual implementation of these informal sector taxes has been weak largely due to the practical challenges outlined in the discussion above.

According to the IMF (2007: 27), more than 25 of the 44 countries in sub-Saharan Africa and 14 of the 17 countries in Latin America have a special tax regime for small enterprises (which includes the informal sector). In the countries reviewed, informal enterprises with turnover above a certain level (and below the VAT threshold) are subject to a tax based on turnover. The preference for using turnover is due to the fact that it is fairly well-known to many taxpayers and is based on simple accounting procedures (i.e. it is much simpler to determine sales than calculate profit). The tax liability is based on the percentage of turnover and is usually linked to the VAT threshold which varies from about USD 30,000 to around USD 80,000 per annum in sub-Saharan Africa (IMF 2007: 28). This method of taxing the informal sector, according to the IMF, can provide a way of linking small business taxes (e.g. the presumptive scheme) with the standard tax regime.

In terms of presumptive tax design features, developing countries use a number of different approaches such as charging fixed amounts that vary across turnover bands (e.g. Burkina Faso and Togo); levying the tax as a percentage of turnover (e.g. Rwanda, Tanzania, Brazil); or a standard assessment approach¹⁷ in countries such as Burundi, Gabon, Ghana, Ethiopia and Mozambique (IMF, 2007; TJN, 2012). Table 3 shows the presumptive tax rates used in a number of sub-Saharan African countries. The maximum turnover in Table 3 represents the figure above which an enterprise would have to register for the regular CIT.

¹⁷ Standard assessment is a type of presumptive tax that uses mechanical rules to determine the tax rate based on a number of indicators such as a restaurant's floor space and location (IMF, 2007).

Table 3: Presumptive tax turnover and flat rates in selected African countries, 2010

| Name of country | Maximum annual turnover | Flat rate |
|-----------------|-------------------------|-----------|
| Kenya | US\$ 62 500 | 3% |
| Rwanda | US\$ 38 000 | 4% |
| Tanzania | US\$ 16 000 | 1-3.5% |
| Uganda | US\$ 27 000 | 1% |

Source: TRA (2011: 125)

As Casanegra de Jantscher (1990: 179) pointed out, ‘in developing countries tax administration is tax policy’. Regardless of the policies that may exist, the success of any tax regime will ultimately depend on the effectiveness of the countries’ tax administration. This is especially true in the case of informal sector taxation, which, by its nature, relies heavily on regular interactions between tax collectors and taxpayers. The next section looks at the various practices and experiences in six countries that have attempted to tax the informal sector – Ghana, Tanzania, Uganda and Ethiopia in Africa, Brazil in Latin America and Vietnam in Asia.

The block management system: Tanzania¹⁸

As a way of strengthening the implementation of the informal sector presumptive tax which was introduced in 2000, the Tanzania Revenue Authority (TRA) introduced the block management system (BMS). The main objective of this system was to ensure tax compliance by identifying, registering and collecting tax information from all eligible small and medium businesses in a particular sector or geographic location.

In areas where there is a concentration of traders, city blocks are mapped and divided into small segments consisting of a few streets or a specific geographical area. This focus on small unregistered enterprises has necessitated a reorganisation of how the TRA operates – efforts have been made to develop the human resources required for this new approach to informal sector taxation. Each block, under a team leader, is tasked with managing all the tax functions (i.e. identifying, registering, educating and collecting taxes) for that particular block, with these teams being rotated after a certain period. As a way of measuring performance there are specific revenue targets that have to be met.

The evidence indicates that there has been an increase in the number of businesses registering for tax purposes as a result of the BMS. Sixteen per cent of the new enterprises that registered

¹⁸ This section draws largely from the TRA (2011).

in the period 2006-2007 did so through the BMS. This increase continued in 2007-2008 and 2008-2009 where the new registrations resulting from the BMS grew by 43 per cent and 41 per cent respectively (Joshi et al., 2013: 23). The BMS is also partly credited with the increase in the number of tax payers from 288,680 in 2005-2006 to 617,877 in 2009-2010 with the number of presumptive tax payers increasing from 199,448 in 2005-2006 to 376,673 in 2009-2010 (TRA, 2011: 81).

Although the advantages of the BMS are clear and while the system has shown some apparent success, research by the TRA indicates that there have been a number of problems. The main problem has been that of human resource constraints with some blocks only having 20 per cent of the required manpower (TRA, 2011: 75). This has also meant that a number of blocks are being administered remotely with tax officers not actually being stationed within the block. The second problem, stemming largely from the first, is that concentration of all the tax functions of identification, registration and assessment under a single tax officer (due to staff constraints) may lead not only to poor internal controls and corruption but also the arbitrary use of power.

Fiscal decentralisation: The experience of Ethiopia¹⁹

One way of taxing the informal sector is through sub-national governments (regional or local government). This devolution of tax policy and administration to the sub-national level, called fiscal decentralization, is increasingly being touted as a way of effectively taxing the informal sector (Loeprick, 2009; Joshi et al., 2013). In many developing countries, local authorities are already collecting taxes in the form of various levies and license fees. This knowledge of informal traders in their areas will not only increase the effectiveness of tax collection from this sector, but, it is argued, also increase the local government's responsiveness to local needs (Devas, 1997). This increased responsiveness not only induces broader participation in governance but also encourages quasi-voluntary compliance (Smoke, 1994; Olowu, 2000).

However, there are risks in the devolution of tax collection to sub-national authorities. Firstly, sub-national governments may lack the necessary capacity to effectively tax this sector. Secondly, in some local authorities, corruption is a serious problem (even more so than at the national level) and coercive methods are often used to induce compliance (Fjeldstad, 2004).

¹⁹ This section draws largely from Prichard (2010)

Thirdly, Loeprick (2009) argues that the coordination between central and sub-national government in tax matters is often poor. This results in a situation where informal traders are subject to multiple taxes at national and local level (double taxation) thus not only increasing compliance costs and the cost of doing business but also providing state agents with numerous opportunities for corruption (i.e. at both national and local levels).

Evidence from Ethiopia, a federal state, seems to indicate that regional governments can effectively levy taxes on small businesses. Firms, under Ethiopian law, are divided into three categories based on their turnover. Category A consists of firms with turnover above 500,000 Birr, Category B consists of firms with turnover between 100,000 and 500,000 Birr, and Category C consists of firms with turnover below 100,000 Birr. Category A firms are subject to the income tax and VAT, and are expected to keep detailed financial accounts. However, firms in Category B and C are not expected to maintain detailed financial accounts - they are subject to a presumptive tax on income and a two per cent tax on turnover. For the presumptive tax, tax liability is based on estimated turnover, the 'application of a predetermined industry-specific profit rate and then taxing this profit at the standard income tax rate' (Prichard 2010: 255).

Although this system existed before 2001, it had been weakly enforced in many areas due to a lack of government commitment. There were also problems in the estimation of turnover which was supposed to be done annually by individual assessors. Under the new system, established in 2008, local Tax Assessment Committees that include both government officials and local business representatives are tasked with the assessment of turnover every three years in the hope of not only increasing coverage but also reducing corruption. An important aspect of this new system is the devolution of responsibility for the implementation of this collection system to the regional government. As a result of the new collection system, tax collection in the regions increased from 1.12 per cent of national GDP in 1999-2000 to 1.73 per cent in 2003-04 (Prichard, 2010: 256). According to tax officials, this new system has also reduced the levels of corruption.

Tax farming: The case of Uganda

Tax farming, a process where the rights to collect taxes are auctioned to the highest bidder, has a long history and there is evidence that this system of collecting tax revenues does work (see Stella, 1993). While tax farming provides incentives for the maximisation of

enforcement and collection, it is prone to abuse and corruption. It has often resulted in overzealous tax collection. This is largely due to its incentive scheme which allows the tax collector to retain a portion of the taxes collected. It is not a system that encourages negotiation and voluntary compliance. Abuses in its implementation have often led to resentment and even rioting amongst taxpayers, a situation that does not augur well for good state-citizen relations and the “governance dividend” (see Fjeldstad and Therkildsen, 2008).

Although there are few empirical studies of the practice in sub-Saharan Africa, a study by Iversen, Fjeldstad, Bahiigwa, Ellis and James (2006) in Uganda shows that, in spite of the problems of privatising tax collection, this method can be useful in certain circumstances. The study, which looked at tax farming at the sub-national level, concludes that the practice did lead to greater and more predictable revenue collection in the short-term. Although the historical literature tends to focus on overzealous and arbitrary tax collectors trying to maximise profits, Iversen et al. (2006) point to problems at the contracting stage. The results of the study showed that one problem was that the price paid for tax collection rights by private collectors was often much lower than the actual revenue potential. The way tax collection contracts were issued in Uganda tended to change the nature of corruption by shifting the problem from the collection point (i.e. from the official actually collecting the tax) to a higher level (the district administration corruptly awarding tax collection rights). Local bureaucrats and politicians (at the district level) benefited (in the form of illicit payments) from the corruptly awarded tax collecting contracts leading to limited government revenue and high profits for companies awarded the tax collection rights (Iversen et al., 2006: 327).

Although these problems can be attributed to asymmetric information (i.e. the private tax collector having more information about informal traders in a particular area than government), Iversen et al. (2006) argue that such information problems are quite limited and that contracting problems are essentially caused by corruption among the elite (i.e. tenderers and politicians who have strong vested interests favouring the status quo benefitting at the expense of poor taxpayers). Their overarching conclusion is that privatisation can yield some revenue gains if it is well-managed. A solution that they propose involves removing the responsibility for market assessment from the district administration and establishing an independent body that would be responsible for such assessments. This independent body would not be controlled by the local elites thus ensuring a fairer process that would lead to

higher tax revenues.

Associational taxation: Identifiable grouping taxation (IGT), Ghana

While all the previously cited approaches to tax administration focus mainly on the enforcement of tax regulations, Joshi and Ayee (2009) cite a different approach that was used in Ghana to tax the informal sector. The approach involved negotiation and bargaining around taxation between the state and the largest passenger transport union, the Ghana Private Road Transport Union (GPRTU). While the coercive nature of tax collection, such as the one used in Uganda, may result in short-term increases in tax revenue, these increases are not likely to last. A more proactive approach that fosters collective action within the informal sector and opens up institutional channels so that those in the informal sector can interact with government looks more promising.

Using a strategy called identifiable grouping taxation (IGT), Ghana's Internal Revenue Service implemented a system from 1987 to 2003 that encouraged informal sector associations to collect taxes from their members, and pass them on the tax authorities. This system allowed the tax authority to keep its collection costs at 2.5 per cent of the total revenue collected because this was paid to the informal sector associations as a collection fee. The arrangement was a result of the good relations that the GPRTU had with the Rawlings regime (1981-2000). This arrangement continued even after the opposition came into power (Joshi and Ayee, 2008). The arrangement's initial success in the informal transport sector resulted in it being extended to associations in 32 other informal sector activities (Joshi et al., 2013: 24). This system of associational bargaining and negotiation around informal sector taxation was credited with increasing revenues generated from the informal sector.

However, this arrangement was not without its problems. In many instances, informal associations were not internally democratic and sometimes failed to pass on revenue collections to the revenue authority. There was also the problem of large companies claiming to be members of the informal associations (covered by presumptive taxes) in order to avoid paying their tax liabilities. This resulted in the abolition of this system in 2003 and its replacement with new informal sector taxes: the Tax Stamp, the Vehicle Income Tax (for commercial drivers), and the VAT Flat Rate Scheme for small-scale enterprises (Ayee, 2007; Prichard, 2009). These are supplemented by other informal sector taxes such as the base tax on market stall operators introduced in 2005 and an advance income tax for cross-border

traders introduced in 2007 (TJN, 2012).

Simplified taxes: Brazil's *simples nacional* tax system²⁰

The Brazilian government introduced an optional simplified tax system for small and micro-enterprises in 1996. This system, called *simples nacional*, was implemented as a way of reducing tax compliance costs and encouraging formalization (Rachid, 2007). In this system, “micro-enterprises” are defined as individuals or enterprises with turnover below US\$ 120,000 per year, and “small” enterprises are those with turnover between US\$ 120,000 and US\$ 1.2 million per year (Arnold, 2012: 15). A single consolidated tax replaced a tax system that was made up of eight different taxes. The *simples nacional* uses a progressive tax structure which taxes enterprises at differentiated but reduced rates, based on their turnover. While the enterprises in this scheme benefit from a reduced tax payment burden, they must still make the necessary social security contributions on behalf of all their employees (Arnold, 2012). This reduced tax scheme contributed to the formalization of almost half a million small and micro-enterprises, which employed two million people) between 2000 and 2005 (ILO/OECD, 2011: 2).

In 2009 the Ministry of Finance extended the *simples nacional* to cover even the smallest informal sector enterprises through the *empreendedor individual* (EI) programme. To be eligible, an individual under the EI programme has to work alone or have a maximum of one employee working for him/her. Under the EI provisions, an individual cannot earn more than US\$18,000 per year (Arnold, 2012: 15). Those on the EI programme are exempted from paying federal taxes and they only have to pay a single monthly tax (about US\$20 per month) which covers social contributions and municipal service taxes (Baumann and Kayser, 2012: 13). This contribution is reviewed annually. The EI system had registered more than 1 million micro-firms country-wide by the beginning of 2011 (ILO/OECD, 2011: 2).

An enterprise that is interested in formalizing (and is eligible), has to register online and receive a tax identification number. Entrepreneurs on the EI scheme are recorded in the National Register of Legal Entities. This makes it easy for them to open bank accounts, apply for loans and issue invoices. This system has also extended social security coverage to the self-employed as those under this scheme benefit from maternity leave, retirement pensions

²⁰ SIMPLES is an acronym for Integrated System for Payment of Taxes and Contributions by Micro and Small Enterprises.

and insurance for work related accidents (Arnold, 2012). Annual outreach programmes conducted by the government throughout the country are used to raise awareness about this scheme. Interested entrepreneurs who register during these outreach programmes also benefit from a number of training courses (Baumann and Kayser, 2012).

The *simples nacional* is considered a success in Brazil. Not only has participation in the tax system increased (70 per cent of all firms paying taxes are registered under this regime) but revenues have also shown a steady increase since 2007. Collections from the *simples nacional* increased by 12.6 per cent between 2012 and 2013 (National Treasury, 2013: 20). This system has been credited with the increased formalization of employment in Brazil – the period between 2001 and 2009 saw the proportion of workers covered by social security increase from 62.3 per cent to 66.9 per cent. It has also provided evidence that ‘reducing the tax burden on firms fosters economic growth by spurring investment and raising the opportunity cost of informality’ (ILO/OECD, 2011: 4).

Exemptions and turnover taxes in Vietnam

According to Vietnamese law, small- and medium-scale enterprises are divided into three categories: micro, small and medium enterprises as shown in Table 4. Micro-enterprises (which are unincorporated enterprises) are also called business households (Nguyen, 2010; Economica, 2013).

Table 4: Micro, small and medium enterprises in Vietnam

| <i>Sector</i> | <i>Micro-sized enterprises</i> | <i>Small-sized enterprises</i> | | <i>Medium-sized enterprises</i> | |
|--|--------------------------------|--------------------------------|----------------------------|---------------------------------|----------------------------|
| | Number of employees | Total capital (assets) | Number of employees | Total capital (assets) | Number of employees |
| I. Agriculture, forestry and aquaculture | < 10 employees | < 20 billion VND | 10 to 200 employees | 20 to 100 billion VND | 200 to 300 employees |
| II. Industry and construction | < 10 employees | < 20 billion VND | 10 to 200 employees | 20 to 100 billion VND | 200 to 300 employees |
| III. Trade and service | <10 employees | < 10 billion VND | 10 to 50 employees | 10 to 50 billion VND | 50 to 100 employees |

Source: Nguyen (2010: 4) ²¹

²¹ In 2010, US\$1 = 20,000 VND (Nguyen, 2010: 11).

The VAT registration threshold in Vietnam is VND 1 billion based on the annual turnover (World Bank, 2014: 9). There are three types of VAT payers: firms that keep proper accounting records (mainly medium-sized enterprises); those that keep basic records on sales and expenses; and those that do not keep records at all (small and micro-enterprises). Enterprises with turnover above the VAT threshold are required to keep proper accounting records and apply the invoice method to calculate VAT liability. The direct method is used for those enterprises that record their sales, and a presumptive tax (based on turnover) is levied on enterprises that do not keep records (World Bank, 2014).²²

The direct method calculates the tax liable by applying the VAT rate after estimating the value added. For those enterprises that do not keep records, a presumptive rate is applied to the turnover estimated by the General Department of Taxes and the commune authorities. The collection of tax from business households that do not keep records is done by the commune or district. This allows the tax authority to focus on collecting taxes from the larger enterprises (Nguyen, 2010). The presumptive tax rate used depends on nature of the industry but is in the range of 1-5 per cent (World Bank, 2014: 9).

According to Decree No. 96-CP of 1995, there are certain categories of taxpayers that are exempted from registering their businesses and paying the turnover tax – “the elderly, disabled and small producers and traders engaging in small and petty businesses” whose turnover is less than 50 million VND per year. The tax authority (together with the commune or district officials) is responsible for determining the eligibility for exemption (see also Decree No.88/2006/ND-CP of 2006).

The main motivation for taxing the small household businesses has been the quest for revenues by the Vietnamese government (Economica, 2013). However, according to Nguyen (2010), this small and medium enterprise tax regime has not been effectively implemented. Firstly, because of the nature of transactions in this sector (i.e. cash-based), determining turnover has been challenging and compliance levels have been low. Secondly, the low presumptive tax rates specified by the Ministry of Finance are not encouraging these enterprises to maintain proper accounting books and registering their enterprises. Thirdly, corruption is a serious problem in some of the communes with tax exemptions being granted

²² The presumptive tax is not be linked to the PIT or the CIT as all enterprises, except the small business households, are required to pay CIT regardless of size (World Bank, 2014).

to non-deserving business households (Luong, 2010).²³ Fourthly, many informal sector operators (and the police) do not know about the tax system and its system of exemptions. Most informal operators below the tax threshold try not to attract attention (and stifle growth) believing that they are operating illegally. This prevents them from expanding even when there are opportunities to do so (Demenet et al., 2013).

2.8. Concluding remarks

Many developing countries are characterised by large informal sectors and very small formal sectors. This chapter shows that the need for revenues has motivated many governments in developing countries to seek ways of incorporating these large informal sectors into the tax net. Three other reasons are usually given for taxing the informal sector. Firstly, not taxing the informal sector is unfair on taxpayers with similar incomes in the formal sector. Secondly, by evading taxes, informal sector operators tend to operate sub-optimally. Thirdly, by not paying taxes, those in the informal sector are unlikely to enter into meaningful interactions with (and demand accountability from) those who govern them.

However, taxing those in the informal sector is not easy, as is evident from the review of case studies of informal sector taxation in the last part of this chapter. This is a highly heterogeneous sector made up of numerous enterprises. Although there is a preponderance of survivalist enterprises that cannot be reasonably expected to pay taxes, the evidence suggests that there are many larger firms that could be taxed. The identification of informal enterprises, the cash-only nature of their transactions, their poor record-keeping practices and corruption are some of the challenges that governments face in trying to tax the informal sector. Governments have used three major approaches in trying to tax the informal sector - relying on the regular existing tax system, taxing the informal sector indirectly through the VAT, and applying presumptive taxes. Presumptive taxes (based on turnover) generally have proved to be particularly popular, with many developing countries using them.

This study seeks to analyse the Zimbabwean government's recent attempts to collect taxes from its informal sector. Zimbabwe is a crisis state. The next chapter, Chapter Three, focuses on Zimbabwe's political and economic crisis and the effect that this crisis has had on tax revenue collection. The chapter also outlines the political economy approach to taxation (and

²³ Luong (2010) mentions a case where a corrupt tax official added 74 households to the list of 54 tax exempt households that had been submitted by the village committee.

the state failure literature in particular) as a backdrop to the empirical work that was carried out on informal sector taxation in Zimbabwe.

Chapter Three - The Zimbabwean crisis and the growth of the informal sector as a backdrop to informal sector taxation

3.1 Introduction

This chapter turns the focus to Zimbabwe and provides the backdrop to understanding the Zimbabwean government's attempts to tax the informal sector. The economic crisis in Zimbabwe has had a profound impact on the labour market. As job opportunities in the formal sector have shrunk due to the contraction of the economy, the informal sector has been showing rapid growth. The large informal sector has had the effect of keeping the official unemployment figures low. Zimbabwe's official unemployment rate is 10.7 per cent according to the 2011 Labour Force and Child Labour Survey (LFCLS) (ZIMSTAT, 2012: 21).²⁴ Clearly, the growing informal sector has also affected tax revenue collection, since most of those in this sector do not pay direct taxes. This chapter explores why the failing state's low revenue collections have led it to look at ways of taxing this large and growing informal sector.

To provide some context for the state's move towards taxing the informal sector and the implementation thereof, this chapter begins by outlining the nature of the Zimbabwean crisis and traces its genesis in the poor economic management of the 1980s and 1990s. It explains how the newly independent state's dependence on foreign debt for the funding of its projects in health, education and infrastructure development led to a large debt burden. It shows how the economic restructuring prescriptions from the Bretton Woods institutions that were meant to recoup the money pumped into Zimbabwe made the situation worse. This economic restructuring (the Economic Structural Adjustment Programme or ESAP) triggered the first economic crisis in Zimbabwe and is largely credited with setting the stage for the more serious crisis which started in 1998. Political instability and poor economic policies during the second crisis led to massive de-industrialisation, company closures and the increased informalization of the economy (with disastrous consequences for revenue collection).

This chapter also outlines the political economy approach to taxation which is useful in understanding informal sector taxation in the context of crisis. The focus of the theoretical

²⁴ For similar estimates on low unemployment figures in Zimbabwe, see also ILO (2008) and World Bank (2014).

framework will be on a sub-branch of the political economy theory - the state failure literature. The concept of state failure within the broader political economy approach helps explain why a failing state like Zimbabwe, in dealing with its crisis, has tried to reach into sections of the economy that have hitherto been 'hidden' so as to extract tax revenues. This theory also helps to explain and make sense of how a failing state like Zimbabwe has continued to operate under difficult conditions. It sheds some light on continued tax collection efforts in terms of the multi-dimensionality of the state and the critical role that institutional capability (partly explained by historical legacies) plays in the collection of taxes, even in a failing state.

The chapter is organized as follows. Section 3.2 provides the background to the Zimbabwean crisis. It briefly outlines the colonial heritage and then goes on to focus on the 1980s and the 1990s. It shows how the newly independent state's policy of 'development with equity' served as the basis for the later crisis which began in 1998. This crisis, commonly referred to as the 'lost decade', which reached what is generally considered to be its zenith in 2008 is the subject of Section 3.3. Section 3.4 looks at the urban informal sector in Zimbabwe and the way it has evolved since the country's independence in 1980 when it was much smaller than the formal economy, to its current state where, according to the 2011 LFCLS, it accounts for 84 per cent of the workforce (ZIMSTAT, 2012: xxi). Section 3.5 focuses on the political economy approach to taxation and the concept of state failure which is a useful conceptual framework to draw on, given the Zimbabwean crisis. After explaining the concept of failure (and its causes), it shows why crude notions of chaos and disorder are rarely an accurate reflection of what goes on in failing states. Using Zimbabwe as an example, it shows that there is usually a co-existence of chaos in some sectors of the economy and order in others. Section 3.6 concludes.

3.2 Background to the crisis

Rhodesia, as Zimbabwe was called before independence in 1980, was a country that was isolated from the rest of the world. After the Unilateral Declaration of Independence (UDI) from Britain by the government of Ian Smith in 1965, the international community imposed economic sanctions (Galtung, 1967). These forced the Rhodesian government to implement an import-substituting industrialization strategy which led to a diversified economy with a relatively developed manufacturing sector by African standards. By 1980, Zimbabwe had the

second largest industrial sector in sub-Saharan Africa (after South Africa) with manufacturing contributing 25 per cent of GNP (Seidman, 1982: 14).

In spite of the economic sanctions, the Rhodesian economy generally performed well. According to Ndedzu (2013: 145), the economy grew, in real terms, from R\$11.9 billion to R\$12.4 billion from 1970 to 1975. During the period 1970 to 1973, total expenditures were almost the same as government revenue receipts. The fiscal deficit did, however, gradually increase from R\$0.25 billion in 1974 to R\$1.5 billion in 1979. Total revenue to GDP ratio averaged 17 per cent. The average inflation rate of 15.7 per cent between 1970 and 1975 rose to 24.2 per cent between 1976 and 1980 (Ndedzu, 2013: 145).

At independence from Britain in 1980, the new state of Zimbabwe was relatively developed. A commonly used measure of development is the relative contribution of agriculture and industry in a country's economy. As the country develops, the industrial sector's contribution to GDP rises relative to that of the agricultural sector. At independence, the agricultural sector's contribution to GDP, at 14 per cent, was lower than that of the industrial sector, at 25 per cent (Seidman, 1982: 13). The agricultural sector's average contribution to GDP in Sub-Saharan Africa was 31.6 per cent between 1980 and 1989, with Zimbabwe's agricultural sector contributing 12.2 per cent during the same period (Kanyenze, Kondo, Chitambira and Martens, 2011: 4).

Although Zimbabwe enjoyed one of the highest average per capita incomes in sub-Saharan Africa, the majority of its population were among the poorest in the world (Seidman, 1982). Like many newly independent countries in Africa, Zimbabwe had to deal with the issues of delivering education, health services, jobs and infrastructure to the previously marginalised majority. To this end, the government implemented the policy "Growth with Equity, 1980-1990" which had, as its main aim, the redistribution of income to the poor (Government of Zimbabwe, 1981). Among the measures that formed part of this policy were: land resettlement; rural infrastructure development; minimum wage prescriptions; price controls; black affirmative action; and indigenization (see also Zhou and Zvoushe, 2012).

There were some early successes in the delivery of social and economic development during the early post-independence period with the government of Robert Mugabe (as Prime Minister) showing a "steady consolidation of independence" (Sachikonye, 2002: 14). There

was a “post-independence boom” between 1980 and 1981 resulting from the utilization of “existing idle capacity” (Seidman, 1982: 14). The Zimbabwean economy grew by 26 per cent in real terms in the first two years of independence, 1980 and 1981 (Riddell, 1984: 464). The country also experienced another period of growth between 1986 and 1990 with real GDP growing at an average of 4.6 per cent per annum. During this period (1986-1990), “employment grew at an annual average rate of 2.7 per cent” (Kanyenze et al., 2011: 36; see also Bond, 1998: 150). Apart from its diversified economy, Zimbabwe, during this period, also had a better human resource base than most other African countries and was regarded as a middle-income country (Sachikonye, 2002).

This early post-independence period saw significant improvements in social indicators like health and levels of literacy. Between 1980 and 1990, the major achievements according to Bond and Manyanya (2003: 35) were: the reduction of infant mortality from 86 to 49 per thousand live births; life expectancy rising from 56 to 62 years; the immunisation rate increasing from 25 per cent to 80 per cent; and the doubling of primary school enrolment.

However, there were already signs during the first decade of independence that difficult times lay ahead. Firstly, many of the early development projects were largely financed using World Bank and International Monetary Fund (IMF) loans. The massive debts accrued during this period (and the debt incurred by the Rhodesian government which the new government was persuaded to take over) then “came back to haunt the country in the 1990s” (Tamukamoyo, 2009: 86). Secondly, Mugabe’s authoritarian tendencies and political intolerance were already beginning to show. For example, over 10,000 people were massacred between 1982 and 1984 (Hentz, 2004: 152).²⁵ These people, who were mainly from the minority Ndebele ethnic group in south-western Zimbabwe and perceived to be supporters of the main opposition party at the time called the Zimbabwe African People’s Union-Patriotic Front (PF-ZAPU), were massacred between 1982 and 1984 (Hentz, 2004: 152). This period also saw concerted efforts by Mugabe’s government to move towards a one-party state (Shaw, 1986).

²⁵ These massacres, popularly known as ‘Gukurahundi’, saw the unleashing of the army to quell a rebellion by Mugabe’s former war allies PF-ZAPU (and its military wing ZIPRA). Former ZIPRA members had started a rebellion in Matebeland (in Western Zimbabwe) known as the ‘dissident menace’ by the government. Civilians in the PF-ZAPU strongholds of Matebeleland bore the brunt of the fighting.

The 1990s - Economic Structural Adjustment Programme (ESAP)

Towards the end of the first decade of independence, Zimbabwe's economy was not growing at the target rate of 5.1 per cent (Kanyenze et al., 2011). Between 1980 and 1987, Zimbabwe's policy had been one of "administered prices, subsidies, redistributive transfers, and protectionism" (Brett, 2005: 93). The Zimbabwean government was now being urged to liberalise and deregulate its markets by the Bretton Woods institutions. Although there was a realisation of the need for economic reform (both inside and outside Zimbabwe) so as to boost investment, promote exports and create employment, there were disagreements between the government and the World Bank on what form this process should take and how the reforms would be sequenced. Matters came to a head in 1987 when the World Bank "refused to sign an agreement for an extension of the export revolving fund in 1987 until measures were taken to liberalise trade" (Kanyenze, 2011: 37).

The detailed ESAP package of reforms was announced in January 1991 by the Zimbabwean government in a document called the *Framework for Economic Reform, 1991-1995*. The main objectives of the programme were: to increase annual growth to five per cent; create 100,000 new jobs per year; increase exports; and reduce the budget deficit (Government of Zimbabwe, 1991). However, according to Gibbon (1995: 6), the document "opened by specifying 'front-loaded' timetables for reducing subsidies to parastatals from ZW\$ 629 million in 1990-91 to ZW\$ 40 million in 1994-95 and for reducing non-education civil service employment by 25 per cent (about 23,000 persons) over the same period".

The World Bank's 1995 assessment audit of the programme reported that ESAP's implementation had been a success (Brett, 2005: 93). Trade was liberalised, foreign exchange controls were relaxed and these measures were followed by the removal of price controls and subsidies. There was also a de-regulation of labour markets, especially in the determination of wages (see Kanyenze et al., 2011). However, Bond and Manyanya (2003: 32) argue that the programme "failed miserably". They outline the main "successes" of the programme during the implementation period (1991-1997) as follows: an estimated "18 000 government jobs were abolished and the civil service bill was reduced from 15.3 per cent of the GDP in 1990 to 11.35 per cent in 1994" (Bond and Manyanya, 2003: 37). The economic adjustment programme did not deliver on its promises. While GDP growth was 5.0 per cent in 1995 (the ESAP target) the average between 1991 and 1995 (the implementation period) was only 1.2 per cent. The inflation target of 10 per cent was never achieved with inflation averaging 30

per cent during the ESAP implementation period. The budget deficit was more than 10 per cent of GDP, i.e. double the target of five per cent (Bond and Manyanya, 2003: 32).

One of ESAP's major aims was the reduction of government expenditure. According to Bond and Manyanya (2003), this had a negative impact on the standard of living. By 1996, the annual earnings of civil servants as a percentage of the level in 1980 fell by 65 per cent, and declines in earnings were also experienced by, among others, domestic workers (-62 per cent), teachers (-50 per cent) and farm workers (-48 per cent) (Bond and Manyanya, 2003: 35).

During the ESAP period, Zimbabwe de-industrialised rapidly. The manufacturing sector that had contributed about 25 per cent of GDP in the 1980s only accounted for 17 per cent of GDP by 2000 (Hawkins, 2001: 7). The manufacturing sector's decline, according to Tekere (2001 in Kanyenze et al., 2011), was due to the fact that it had been protected and therefore had a guaranteed domestic market. Zimbabwe's industry was uncompetitive (due to protection) and exports did not increase after the liberalisation of trade. This decline in performance led to company closures (and retrenchments) and the rapid growth of the informal economy (Mhone, 1995; Mupedziswa and Gumbo, 1998).

3.3 The lost decade (1998 to 2008)

Economic decline

After ESAP, a series of other crises followed. The first one was the payment of generous (but unbudgeted) gratuities to war veterans in August 1997 which amounted to almost three per cent of GDP and dramatically increased the budget deficit. The second was the announcement by Mugabe in November that he was planning to compulsorily acquire land from white farmers.²⁶ In spite of the rapidly deteriorating situation at home, President Mugabe sent 11,000 soldiers in September 1998 to aid President Laurent Kabila of the Democratic Republic of Congo (DRC), whose country was being overrun by rebels (Kairiza, 2012: 5). However, the two major developments that are mainly credited with the rapid decline of the Zimbabwean economy from 1998 to 2008 are the political wrangling which

²⁶ These two actions are largely credited as contributing to the events of 14 November 1997 (usually referred to as "Black Friday" in Zimbabwe) when the Zimbabwean dollar crashed and lost 75 per cent of its value against the US dollar in a single day (Kairiza, 2012: 5).

followed the formation of the opposition Movement for Democratic Change (MDC), and the violent land expropriations.

In 1999, a new political party, the MDC, was formed under a former trade union leader, Morgan Tsvangirai. This party challenged the hegemony that the ruling Zimbabwe African National Union-Patriotic Front (ZANU-PF) had enjoyed in parliament since the signing of the Unity Accord with PF-ZAPU in 1987. These developments on the political front had serious consequences for the way politics were conducted in Zimbabwe thenceforth starting from the following year, 2000, thought by some to be a watershed year in Zimbabwe.

According to Raftopoulos (2004: 12), the year 2000 “constituted an important junction of political events”. Three major related events happened in that year: the rejection of the Mugabe government’s constitutional proposals in the referendum in February; the violent expropriation of land from white farmers that began just after the referendum results were announced; and parliamentary elections which were held in June. The first project that the opposition party (MDC) embarked on was the campaign for the rejection of the new constitution in the referendum of 2000. The new party was successful. The government’s constitutional proposals were subsequently rejected and many white farmers, who had openly supported this new party, were now the targets of Mugabe’s wrath. In February 2000, veterans of the 1970s liberation war against the Smith regime, supported by militant ZANU-PF youths, started the land invasions by forcibly removing the white owners from their farms (Bond and Manyanya, 2003). These farm occupations, according to Bond and Manyanya (2003: 76) can be “read as a direct response to the referendum humiliation and as political code wording for revenge against white farmers on the one hand, and emotive delivery and vote-catcher on the other”. According to Raftopoulos (2004: 12), the “vote represented the first major defeat for the ruling party since independence, and the protest threatened to translate itself into an election defeat later in the year”.²⁷

While there was a genuine concern for the need for land re-distribution (a view held even by some in the white community),²⁸ the manner in which this process was carried out by the war veterans (aided and abetted by ZANU-PF leaders) was chaotic. Despite the rising

²⁷ The rejection of this draft constitution, which gave enormous powers to the executive, according to Kagoro, (2005: 249) “presented a major step towards imagining alternative futures”.

²⁸ See Bornajee (2013).

contribution of industry to GDP (especially before and just after independence), the Zimbabwean economy has traditionally been based on agriculture. Therefore, the agricultural sector's decline from 2000 onwards, with the collapse of commercial agriculture, had serious implications for food security - severe food shortages were experienced and poverty became widespread. The farm seizures not only wrought havoc in the vibrant large-scale commercial agricultural sector but also, more importantly, negatively impacted an industrial sector that had numerous backward and forward linkages with the agricultural sector. This left many employees on commercial farms and in agro-based companies jobless (Brett, 2005).²⁹

The storm trooper tactics, developed in the land occupations, were later used in the June 2000 parliamentary elections where ZANU-PF faced a serious challenge for the first time since independence.³⁰ Although there were numerous reports of fraud and widespread violence, the MDC managed to win 57 seats with ZANU-PF getting 62 seats. After a number of court challenges, the opposition was awarded a further four seats bringing its total to almost the same number of seats as ZANU-PF in Parliament (Raftopoulos, 2004: 13).

In spite of its reduced majority after the June 2000 parliamentary elections, ZANU-PF continued to run the country as it had done before, the only difference being the persistent targeting of the MDC, the judiciary and white farmers (see Masunungure, 2004). Court orders relating to the removal of land invaders (who were deemed illegal occupiers in many court judgments) were consistently ignored by the police (see Feltoe, 2004; Goredema, 2005).

The country's infrastructure became dilapidated and the country failed to service its debts as the Bretton Woods Institutions stopped funding the country (which now also faced sanctions from some western countries as a result of the farm seizures and allegations of vote-rigging). Many donors also decided to withdraw development aid (except for a few that continued to provide humanitarian assistance through NGOs and UN agencies).

²⁹ During this early period of violent land expropriation between 2000 and 2002, GDP fell by about 26 per cent and by 2003, food production had fallen by 20 per cent (Brett, 2005: 94).

³⁰ Graduates from the national youth training program (which started in 2001), known as the "green bombers" terrorized the population and served as an informal party militia (see Hentz, 2004).

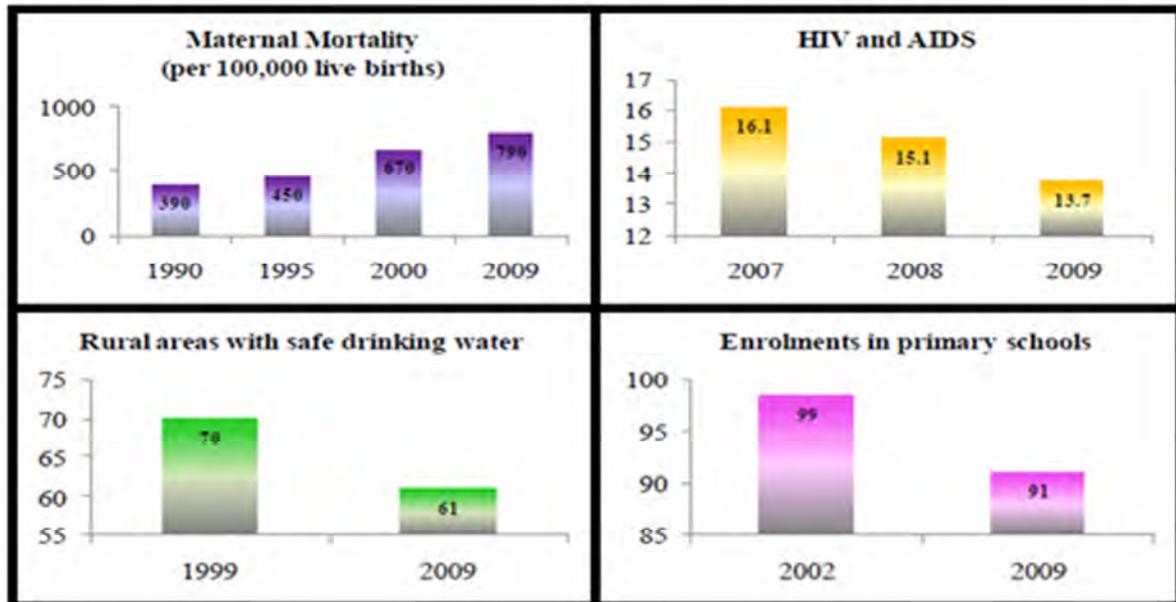
While the economies of the rest of sub-Saharan Africa were growing, Zimbabwe's economy was contracting at a rapid rate.³¹ In the period between 2000 and 2007, Zimbabwe's real GDP contracted by 40 percent (Noko, 2011: 347), resulting in a decline of tax revenues and public expenditure. The year 2008 saw the closure of many schools and hospitals, the rapid deterioration of transport and electricity infrastructure, and a water-borne cholera epidemic that claimed more than 4,000 lives (UN News Centre, 2009). Some of the problems that the country was facing during this period are shown in Figure 2. The lack of donor support, coupled with its inability to borrow, meant that the Zimbabwean government had no money to maintain its infrastructure and pay its large civil service, affecting social services (AfDB, 2011).

The only indicator showing any improvement was the one on HIV/AIDS prevalence. According to UNAIDS (2012), this was driven by strong HIV/AIDS prevention programmes and the high mortality rates towards the end of the 1990s when many people died of the disease (making people afraid and thus more willing to adopt safer sex practices) (see also Gregson, Gonese, Hallett, Tarubereka, Hargrove, Lopman et al., 2010).³² Apart from this notable success, the period between 1998 and 2008 saw the reversal of some important post-independence gains particularly in the areas of health (maternal mortality) and education (primary school enrolments).

³¹ There are a number of economic recovery plans and strategies that were devised during the crisis period (e.g. ZIMPREST, ZIMASSET). However, a full consideration of the economic and political crisis and the policies introduced are beyond the scope of this work.

³² According to UNFPA (2011), Zimbabwe recorded the largest decline in HIV infections after Uganda. The economic crisis, according to the UNFPA also played a (secondary) role in this decline. Men reported having less money to spend on sustaining multiple partnerships as well as using the services of sex workers.

Figure 2: Selected social indicators in Zimbabwe, 1990-2009



Source: 2010 Millenium Development Goals Status Report in AfDB (2011: 9).

Figure 3 shows Zimbabwe’s fiscal operations for the period 1998 to 2009. As shown in the figure, the tax ratio (i.e. tax revenue as a proportion of GDP) which has traditionally been high in Zimbabwe (see Stotsky and WoldeMariam, 1997; IMF, 2005) fell from 28 per cent in 1998 to 25 per cent in 2000 before dropping dramatically to about four per cent in 2008 (IMF, 2009: 2; OECD, 2012: 128).³³ Not only was tax as a percentage of GDP declining, but because GDP itself was plummeting over the period, the absolute value of tax revenue shrank dramatically. Tax revenue fell from almost US\$1 billion in 2005 to US\$133 million in 2008 (IMF, 2009: 2).

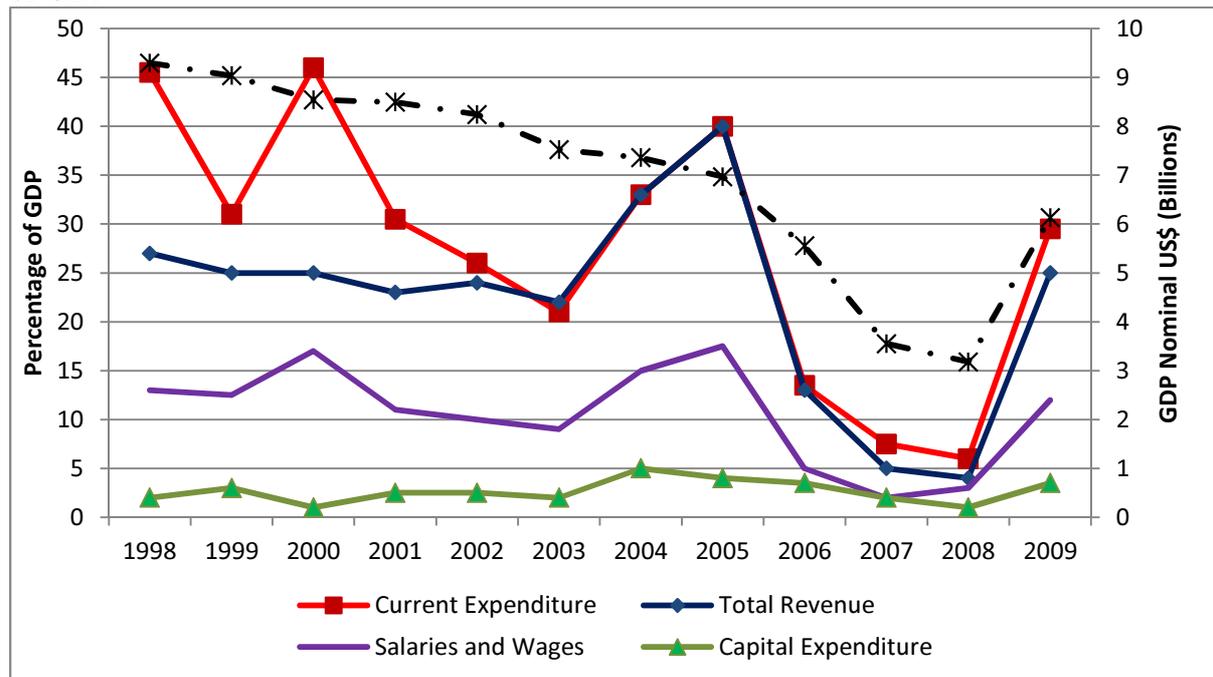
This dramatic decline in tax revenue collections, particularly over the period 2005 – 2008 is a reflection of the severe economic depression that the country was going through which resulted in high levels of informalization (see Luebker, 2008). By 2008 (usually regarded as the worst year of the crisis), tax revenue (as a percentage of GDP) was at its lowest, and at a time when Zimbabwe could not get foreign assistance from donors. This resulted in a severe cash crunch which affected the government’s capacity to deliver basic services.³⁴ The

³³ The increases in tax revenue in 2004 and 2005 resulted mainly from the introduction of the VAT in January 2004 and the “strong performance of corporate taxes, partly reflecting the shift to taxation of contemporaneous income” (IMF, 2005: 10).

³⁴ Expenditure shrank from about US\$1.4 billion (37 percent of GDP) in 2005 to US\$258 million (8 percent of GDP) in 2008 causing an almost complete collapse in the provision of public services. With public sector wages declining to US\$2–US\$3 a month, most public schools and hospitals were closed, and absentee rates among

government resorted to printing money and this resulted in unprecedented levels of inflation, reaching an officially quoted rate of 231 million per cent in July 2008 (Kairiza, 2012: 2). GDP contracted by a cumulative 50 per cent with industries operating at 30 per cent of capacity. This resulted in massive layoffs and empty shelves in most shops (Kanyenze et al., 2011: 138).³⁵

Figure 3: GDP and tax revenue, capital expenditure and recurrent expenditure as percentage of GDP



Source: IMF (2004, 2005, 2009, 2012) and ZEPARU presentation on Enhancing Zimbabwe Fiscal Space (2010 in AFRODAD, 2011: 26).

It was during this period that the ruling party ZANU-PF (in an attempt to cling to power), decided to punish those it considered to be its enemies – the urban population. The opposition MDC party received most of its support from the urban population in this early period, with ZANU-PF's support coming mainly from the rural areas. Urban voters were increasingly

civil servants exceeded 50 percent in many ministries. Lack of maintenance and investment resulted in a significant reduction in electricity generation capacity, collapse of water supply, and major disruptions in railway services (IMF, 2009: 9).

³⁵ This drop in tax revenue saw the Zimbabwean government increasingly depending on seigniorage. According to McIndoe-Calder (2009: 34), seigniorage had surpassed taxation as the government's most important source of domestic revenue by 2006, contributing over 41 per cent of total revenues between 2003 and 2007. Tax revenues which were contributing about 80 per cent of total revenues before 1997 were, by 2006, only making up about 23 per cent of government revenue. The dollarization of the economy in 2009 effectively ended this reliance on seigniorage as the government could no longer print money.

being viewed by the ruling party as “anti-struggle” and “enemies of the state”. According to Hammer (2006), the wanton destruction of informal urban dwellings in urban centres by the government (called Operation Murambatsvina)³⁶ which was carried out in June 2005 should be understood against this backdrop. Just as the farmers had been targeted in 2000 for supporting the MDC, Operation Murambatsvina’s aim was to unsettle and disorganise the main supporters of the opposition movement – the urban population.

Operation Murambatsvina adversely affected poor urban people and those in the informal sector in particular. Many of the people whose dwellings were destroyed relied on home-based work, and operated backyard industries and tuck-shops.³⁷ According to Tibaijuka (2005: 34) an estimated 2.4 million people were affected as at least 92,460 dwellings were demolished and 570,000 people lost their homes. The government maintained that this was merely part of an initiative to improve the “image” of the city by removing “illegal” dwellings (Potts, 2006: 280).

The harmonized presidential and parliamentary elections held in March 2008 failed to produce a clear presidential winner (although the two MDC parties obtained a majority of seats in parliament). The election re-run held in June 2008 was characterized by inter-party violence, leading to the withdrawal of the MDC presidential candidate, Morgan Tsvangirai. The election results, in which Mugabe was the sole presidential candidate, were met with skepticism by the international community. Political tensions continued throughout 2008 until a South African brokered “unity government” (sometimes referred to as the Inclusive Government) made up of the two factions of the MDC and the ruling ZANU-PF was installed in March 2009. In April 2009, just after the installation of the unity government, the Zimbabwe dollar was suspended as legal tender and the economy was dollarized (Noko, 2011).

3.4 The urban informal sector in Zimbabwe

Mhone (1995) argues that the pre-Independence government which had outlawed the formation of small and medium scale enterprises in urban areas meant that Zimbabwe did not have the kind of informal sector common to many developing countries (see also Peters-Berries, 1993). This prohibition of African-run small enterprises was not only to ensure a

³⁶ Murambatsvina means ‘remove filth’ in Shona, the language spoken by the majority of Zimbabweans.

³⁷ Although the destruction of working premises and cottages was the most common impact, many informal sector entrepreneurs said that this destruction also had a negative impact on demand (see Luebker, 2008).

steady pool of labour for the colonial administration, but was also meant to discourage competition that would arise from Africans having these enterprises (Mhone, 1995). This was in contrast to many African countries where the informal sector was allowed to flourish even under colonialism. At Independence from Britain in 1980, Zimbabwe's urban informal sector was small, accounting for about 10 per cent of the labour force. This grew to 20 per cent by 1987 and 27 per cent by 1991 (Kanyenze et al., 2003: 4).³⁸ According to the 2011 LFCLS, the proportion of workers employed in the informal sector which had increased dramatically to 80.7 per cent in 2004, after the implementation of ESAP, had risen to 84 per cent by 2011 (ZIMSTAT, 2012: xxi).

Five studies of Zimbabwe's informal sector are reviewed in this section. The studies reviewed are the ILO/SATEP study of 1985 (in Kanyenze, 2011), Mhone (1995), Mupedziswa and Gumbo (1998), Kamete (2004) and Luebker (2008). These studies, apart from the one conducted by Luebker (2008), did not explicitly define the concept of informality. Luebker's (2008) study, which was commissioned by the ILO, looked at both enterprises and employees in the informal sector and used both the enterprise-based and job-based concepts of informality. The other four studies (which focused on informal enterprises) allude to the enterprise-based concept of informality with a focus on regulation and registration.³⁹ The enterprises that were analyzed in these studies were not registered or licensed by local or national government (see Jassat and Jirira, 1987; Mhone, 1995).

According to Kanyenze et al. (2011), the first systematic post-independence study of the informal sector was the one commissioned by government and undertaken by the ILO/Southern African Team for Employment Promotion (SATEP) in 1984. This study, undertaken before the two major crises outlined above, provides useful insights on the state and evolution of the informal sector immediately after independence. Using case studies from

³⁸ The removal of restrictions on rural to urban migration, a main feature of the colonial administration in Zimbabwe, also had a large impact on the growth of the informal sector. The influx of people into the urban areas after independence (as shown by the increase in the urban population from 13% of the total in 1960 to 23% by 1980) created a large pool of labour that could not be absorbed by the formal economy – these people turned to the informal economy (Kanyenze et al, 2003: 4).

³⁹ Kamete's (2004) study is the only one of the five studies reviewed in this section that refers to the issue of tax registration and payment with reference to informal sector enterprises. Of the 10 informal enterprise owners in his study, only one paid taxes (Kamete, 2004: 128). It is not clear from the article whether the tax paid was personal income tax or corporate income tax.

four urban and peri-urban areas, the ILO/SATEP study included 1,017 respondents from 47 activity classes (Jassat and Jirira, 1987: 90).

The study found that more than 60 per cent of the respondents were in the informal sector due to the failure to secure formal sector employment, while 40 per cent had chosen to be in this sector. However, the study found that once in the informal economy, “these workers were reluctant to rejoin the formal economy unless the wages in the latter were double their current ones” (ILO/SATEP 1985 in Kanyenze et al., 2003: 5).⁴⁰ The average employment per enterprise was two persons and 59 per cent of those who assisted in running the enterprise were family members. The study also found that the average age of participants was between 37 and 38 years and 54 per cent of them had completed primary school. According to the study, the vast majority (80 per cent) of those in the informal sector sourced their inputs from the formal sector. In terms of earnings, the ILO/SATEP found that those in the informal sector earned ZW\$72 per month, on average (median of ZW\$50). The study also found that there were certain activities which were quite lucrative, although only a small proportion of those in the informal sector engaged in these activities. Those engaged in manufacturing (e.g. carpentry, tailoring, and metal work) earned average incomes that ranged between ZW\$192 and ZW\$268 per month which were higher than the average wages of those in the formal economy (ILO/SATEP, 1985 in Kanyenze et al., 2003: 7).⁴¹

Although the ILO/SATEP study acknowledged the important role that the informal sector was playing in the creation of employment (particularly in the short-term), its main recommendation was that of formalizing this sector. This recommendation was similar to that of many subsequent studies on informality and small-scale enterprises in Zimbabwe (Mhone and Aryee, 1985; Mkandawire, 1985; USAID, 1991). This insistence on formalization was mainly due to the Zimbabwean government’s promise to assist informal enterprises if they “formalized” or “registered” as cooperatives (see Jassat and Jirira, 1987: 89).⁴²

⁴⁰ Although the reasons for this reluctance to leave the informal sector were not explicitly stated in the ILO/SATEP study, Jassat and Jirira (1987: 88) concluded that it was due to two factors: 1) “The inability of the formal sector to offer stable, secure and attractive remuneration and employment and 2) The potential for self-employment which the sector offers”.

⁴¹ According to Jassat and Jirira (1987: 46), the average monthly wage in the formal manufacturing sector in 1980 was ZW\$196.

⁴² Jassat and Jirira (1987: 89) note that the government could assist informal enterprises by providing funds, business training, technical advice and “people’s markets”.

Portes, Castells and Benton (1989: 306) argue that “the process and profile of the informal economy are historically specific, depending on the relationship between the state, capital and labour in each country”. As described above, Zimbabwe has endured two major crises in its recent past - the first was the implementation of ESAP and the second was the collapse of the economy which started in 1998 due to the deteriorating economic conditions and political wrangling. Four studies that look at the impact of the two crises on Zimbabwe’s informal sector are reviewed below.⁴³

Using convenience sampling, Mhone (1995) interviewed 525 informal sector respondents (both enterprise owners and employees) from Zimbabwe’s three major urban centres of Harare, Bulawayo and Gweru on the impact of ESAP. According to Mhone (1995), while informal sector activities had cushioned workers from poverty, these activities had not had an impact on economic growth and productive employment. ESAP’s impact had generally been negative on this sector.

According to Mhone (1995), the typical urban informal enterprise in Zimbabwe was a one-person operation with average employment per enterprise being 1.5 persons. The average enterprise in this study had been in existence for eight years. The majority of the enterprise owners had started out in the formal sector before starting their own enterprises. Half of the respondents had completed primary school and 47 per cent had completed high school. There was little reliance on loans from financial institutions as the minimal start-up capital required was either mobilised from savings or borrowing from kinfolk (Mhone, 1995: 14). These results are largely consistent with evidence from the literature on the characteristics of the informal sector in developing countries (see *Economica*, 2013; Mkhize, Dube and Skinner, 2013).

Mupedziswa and Gumbo’s (1998) longitudinal study that had first been conducted in 1992 (with follow-up interviews in 1993 and 1995) focused on ESAP’s impact on urban women informal traders and had an original sample size of 175 respondents. This study confirmed Mhone’s (1995) findings on ESAP’s negative impact on the informal economy. While

⁴³ Most of Zimbabwe’s early research on the informal sector looked at the impact of ESAP (Mhone, 1995; Mupedziswa and Gumbo, 1998) while not much research has been conducted on the impact of the latest, more serious political/economic crisis that began in 1998.

ESAP's main impact was found to be the increased competition and declining income among informal sector respondents in Mhone's (1995) study, Mupedziswa and Gumbo (1998: 118) cited changes in household structure as ESAP's main impact. They found that women's contribution to household expenditure showed a noticeable increase which they attributed to rising unemployment levels (as a result of retrenchments) among the male breadwinners.

Kamete (2004) looked at home industries in Harare's high-density areas and focused on describing the characteristics of these enterprises. Using convenience sampling, a semi-structured questionnaire was administered to 10 randomly selected enterprise owners between 1999 and 2000. The study's aim was to assess the workings of home industries (the "informal city"), their markets, marketing characteristics and their interaction with formal enterprises and local authorities (the "formal city"). Kamete's study found that home industries had a positive impact on the urban system through employment creation and the provision of affordable goods and services (Kamete, 2004).⁴⁴ Kamete did find both forward and backward linkages between the formal and informal economies. Of the 10 business units in his study, seven obtained their raw materials entirely from the formal private sector. In the month preceding the study, four of the 10 business units had had customers from the formal private sector.

The informal economy in Zimbabwe has been characterised as being resilient and highly adaptable (Bratton and Masunungure, 2006). The activities carried out in Zimbabwe's informal economy are heterogeneous, with the main ones being small-scale manufacturing activities (knitting, crocheting and sewing), and retail and vending activities carried out mostly by women (Mhone, 1995; Mupedziswa and Gumbo, 1998). Men tend to dominate the relatively larger and more complex activities such as carpentry, repair services, metal work and construction (Kamete, 2004). According to the study by Mhone (1995: 14), men claimed that their work contributed more than 50 per cent of household income while most women tended to view their contribution as supplementary household income.

⁴⁴ The term "home industries" in Zimbabwe refers to an enterprise (meant to be formal but almost invariably informal based on regulation and taxation), usually involved in small to medium scale manufacturing and repair activities, operating in a designated area in the medium and low-income residential areas. Home-based enterprises (HBE) on the other hand are informal activities that occur "in or around the housing unit" (Kamete, 2004: 120).

In a study aimed at analysing how informal workers' situation had changed since the 2004 Labour Force Survey (LFS), Luebker (2008) interviewed a random sample of 406 residents of Harare's high-density township of Glen View in 2006. According to Luebker (2008), although the sample was small by LFS standards and was limited in its geographical scope, it provided some useful insights into what happened in the informal sector between 2004 and November 2006. Luebker (2008: 10) found that street vending was the dominant informal sector activity (with 60 per cent of respondents citing it as their primary activity), followed by manufacturing (19.7 per cent). As the previous studies on Zimbabwe's informal sector have indicated, the study also found that women were concentrated in low-end street vending and manufacturing with low returns (garments). Men tended to dominate high-end retail, repairs of cars and household goods, and cottage industries (e.g. furniture manufacturing). Cross-border trading was cited as another important source of income – it also provided inputs for other informal sector activities (e.g. manufacturing).⁴⁵

Studies on the informal sector in Zimbabwe have indicated that activities are carried out throughout the cities and the heterogeneity in the activities carried out is one of the informal sector's characteristic features. While some activities are at the frontier of the formal/informal divide (e.g. manufacturing of farm equipment and the sale and repair of electronic equipment) others are more "typical" informal sector activities (e.g. selling fruit and vegetables). Kamete (2004) provides a summary of these activities and the locations in which they are carried out in Table 5.

⁴⁵ Cross-border traders, termed the "informal aristocracy" by Gibbon (1995: 25), played an important role in the importation of various goods and commodities in Zimbabwe during the ESAP period (see also Muzvidziwa, 1998). They were to play an important role in averting the total collapse of the country during the second crisis (1998-2008).

Table 5: Spatial and operational features of the small scale informal sector in Harare

| Class | Locational features | Common activities |
|--------------------------|---|---|
| Home-based industries | In and around housing unit | Selling foodstuffs; small household goods; repairs; services |
| Home industries | Designated sites within residential areas | Manufacturing; repairs; welding; trading; engineering works; services |
| Street vending | Along busy streets, on pavements, at intersections | Sale of confectionery; cigarettes; vegetables; fruits; books; clothing items |
| Shop-front vending | Near or at the entrance of busy supermarkets | Sale of plastic bags; confectionery; cigarettes; vegetables; fruits; books |
| Bus-stop vending | At public transport termini | Sale of confectionery; cosmetics; cigarettes, vegetables; fruits; books; clothing |
| People's markets | Designated areas usually near bus-stops or shopping centres | Making and sell of crafts; confectionery; clothing; vegetables; fruits; books |
| Flea markets | Designated sites within the Central Business District and suburban shopping centres | Mixed consumer goods; clothes; appliances; fabrics |
| Roadside stalls | Along busy distributors or national roads leading out of the city | Curios; building materials; crafts; maize; vegetables; fruits |
| Designated vending sites | Sites within the Central Business District identified by planners | Confectionery; cigarettes; vegetables; fruits; books; clothing |

Source: Kamete (2004:122)

It is important to note that comparing studies on the informal sector is not easy in Zimbabwe as it is not always clear what is meant by informality. Also, as shown in Table 5, Kamete's (2004) classification of informal sector activities leaves out hairdressing salons and minibus taxis while the Zimbabwe Revenue Authority (ZIMRA), includes these activities in its conceptualization of the informal sector as will be discussed in detail in Chapter Five. In spite of these differences, the results of these studies have been largely consistent.

The overarching theme in the early studies on informality in Zimbabwe was that although the informal sector had allowed a large number of Zimbabweans to earn a living, the majority of jobs in the informal sector were not decent. Incomes from these jobs were low and working conditions tended to be poor. The results do indicate, however, that for those who are employers in this sector (especially those in manufacturing), earnings were usually higher than the average wage of those in the formal sector (World Bank, 1987; USAID, 1991; Peters-Berries, 1993).

The large informal sector has also had the effect of keeping the reported unemployment figures low. In the calculation of its unemployment statistics, ZIMSTAT uses two definitions – the “strict” and the “broad” definitions of unemployment. According to ZIMSTAT (2012: 68) “the strict definition refers to a person, 15 years and above who during the reference period was without work, available for work and was seeking work. The broad definition of unemployment excludes the condition of actively seeking employment”. Using a reference period of seven days (i.e. seven days preceding the survey), the 2011 LFCLS recorded an unemployment rate of five per cent. The unemployment rate using the broad definition with a reference period of seven days was 10.7 per cent. The official unemployment rate using the broad definition of unemployment and the longer reference period of 12 months was 12 per cent in 2011 (ZIMSTAT, 2012: 68).

Although these unemployment figures have been met with disbelief in Zimbabwe and elsewhere, the ILO, in its research papers, has always viewed them as accurate estimates of the level of unemployment (see ILO, 2008). Newspaper reports in Zimbabwe, numerous ‘analysts’ and non-governmental organizations (NGO) routinely cite much higher unemployment figures in the region of 80 per cent (see Daily Mirror, 2004; Zimbabwe Standard, 2006; Zimbabwe Online, 2006). The ILO has consistently supported these official unemployment figures, insisting that throughout the crisis period, unemployment has remained mostly below 10 per cent as the government’s figures are based on an “international definition of unemployment” which includes the formal sector and small-scale farming activities (Luebker, 2008: iii). The official unemployment figures from 1987 to 2011 are shown in Table 6.

Table 6: Unemployment rates (strict definition) in Zimbabwe, 1982-2004

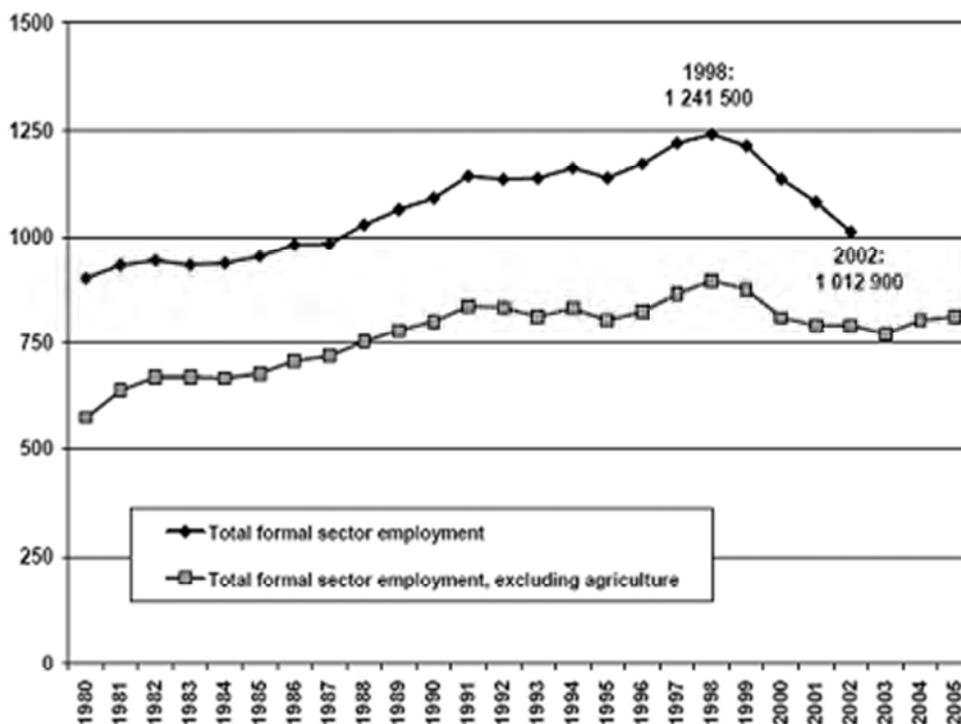
| | 1987 | 1993 | 1999 | 2004 | 2011 |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Employed | 3 026 000 | 4 056 535 | 4 665 451 | 5 428 868 | 5 775 689 |
| + Unemployed (strict definition) | 234 000 | 347 161 | 297 811 | 236 056 | 308 078 |
| = Labour force | 3 260 000 | 4 403 696 | 4 963 262 | 5 664 924 | 6 083 767 |
| Unemployment rate (strict definition) | 7.2 | 7.9 | 6.0 | 4.2 | 5.1 |

Note: The primary sources are the 2004 LFS (CSO, 2006), 2011 LFCLS (ZIMSTAT, 2012) and Luebker (2008: 25). All are based on the strict definition of unemployment, using a reference period of seven days.

The economic decline which started in 1998 makes the unemployment figures in Table 6 seem counter-intuitive (i.e. one would expect the ranks of the unemployed to swell with new entrants during the economic crisis). However, as Meagher (1995) points out, economic crisis coupled with the absence of comprehensive social security systems in many sub-Saharan countries like Zimbabwe make it incumbent on people to engage in whatever economic activities they can to sustain themselves – they create their own jobs.⁴⁶

As can be seen from Figure 4, which shows the trend in formal sector employment from 1980 to 2005, there was a steady increase in formal employment from 1980 to 1998 after which the employment figures began to fall (at the beginning of the “lost decade”). The formal sector, which was employing more than 1.2 million people in 1998, was employing only slightly over one million in 2004 (Figure 3). Formal sector employment levels in Zimbabwe by 2011 had still not reached the figures achieved in 1998 (ZIMSTAT, 2012).

Figure 4: Formal sector employment in Zimbabwe, 1980-2005 (in thousands)



Source: Luebker (2008: 19)

Note: All data exclude private domestic employees.

⁴⁶ Unemployment rates alone can be misleading. The unemployment figures in Zimbabwe indicate an improvement in the early 1990s but ignore important factors such as changes in the type of jobs and levels of underemployment. It is important, especially in the case of Zimbabwe, to go beyond the “employment / unemployment dichotomy” and look at the types of jobs that people have (see Luebker, 2008: iii).

Informal sector enterprises and households⁴⁷ made up 76.3 per cent of all employment in Zimbabwe in 2004, with the formal sector making up 21 per cent of all those that were employed (Luebker, 2008: 31). According to the 2004 LFS, the share of females in the informal sector was 53 per cent and the share of males was 47 per cent (CSO, 2006: xiii). However, by 2011, this breakdown had changed somewhat with males and females each contributing 50 per cent of those in the informal sector, according to the 2011 LFCLS. Of the employed population aged 15 years and above (estimated to be 5.4 million), 84 per cent were considered to be in informal employment and only 11 per cent were in formal employment by 2011 (ZIMSTAT, 2012: xxi).

According to the 2011 LFCLS, 51 per cent of those in the informal sector had completed secondary school and 14 per cent had a tertiary qualification (ZIMSTAT, 2012: 110), suggesting a change in the informal sector towards a more educated workforce (likely the result of formal sector workers opting to move to the informal sector and new, more educated entrants not being able to find work in the formal sector). ZIMSTATS also collected data on retrenchments and found that 240,000 people had been retrenched at least once between June 2004 and May 2011. ZIMSTATS reported that the year 2008 had the highest number of retrenchments (41,000). The retrenchments continued with 20,000 people being retrenched between January and May 2011. According to the 2011 LFCLS, those who have completed secondary school have borne the brunt of the retrenchments at 43 per cent of the total number of retrenchments (ZIMSTAT, 2012: 136).

As this section has shown, Zimbabwe has experienced and continues to experience a political and economic crisis. This crisis has had a profound impact on tax revenues. The massive decline in the formal sector which has been accompanied by the rapid growth of the informal sector (which is now much bigger than the formal sector) has meant lower tax revenues, which at the height of the crisis in 2008 were a mere four per cent of GDP. This resulted in the government's failure to provide basic services and maintain infrastructure which quickly deteriorated, bringing the country to the brink of collapse. Dollarization in 2009 also meant the loss of an important source of government revenue, seigniorage, thus creating greater financial pressure on the government. The next section looks at the state failure literature and

⁴⁷ Households refer to all domestic workers in private homes, all communal and resettlement farmers, and all those outside the formal sector who stated agriculture or paid domestic service as their main activity (Luebker, 2008: 13).

the rationale for taxing the large and growing informal sector that usually results from this failure.

3.5 Political economy approach to taxation and state failure

Apart from the public finance tax theory outlined in Chapter Two, this thesis also draws on the political economy approach, particularly a sub-branch of the political economy theory - the state failure literature. The concept of state failure and the need for revenues explain the Zimbabwean government's recent efforts to tax the informal sector – a sector increasingly viewed as a potential source of revenue.

The economic and administrative approaches have dominated scholarly and policy debates on tax policy in developed countries but there has been a growing literature on the political economy approach over the last decade, particularly with reference to developing countries (see Therkildsen, 2002; Fjeldstad and Moore, 2007; OECD, 2008; Prichard, 2010). The political economy approach posits that understanding a country's history, the power dynamics within groups in society, the government's ability to use coercion and the formation (and capacity) of key institutions is critical to understanding that country's capacity to tax effectively. The political economy approach thus puts politics at the center of tax policy analysis (Campbell, 1993; Lledo, Schneider and Moore, 2004).

The political economy approach seeks to understand how governance affects the tax systems and *vice versa*. It looks at taxation in terms of state capacity and the power relations within that state (Di John, 2006). It helps in understanding why tax systems differ between countries and why people from different countries behave differently in the face of similar taxes (i.e. have different "tax cultures"). Therkildsen (2001) points out that in some countries, such as those in Scandinavia, long-term institution building and the underlying political dynamics have increased quasi-voluntary compliance. He argues that the Swedes' comparatively high tax morality levels are due, not to a particular Scandinavian ideologically-based desire to pay taxes, but to a specific institutional factor - good governance. Table 7 presents a summary of the three main approaches used in the analysis of tax policy, which are described in further detail below.

Table 7: Summary characteristics of approaches to tax policy

| Approach | Key concerns | Typical policy advice |
|-----------------|--|---|
| Economic | Micro-economic efficiency; efficiency; equity; optimal taxation | Tax structure should be neutral ⁴⁸ ; zero tax on intermediate goods; benefit taxes and taxes on immobile tax bases should be assigned to local government; taxes on mobile tax bases should be assigned to central government; tax structure should promote accumulation for long-term growth. |
| Administrative | Administrative efficiency; effectiveness | Tax structure should be simple for both collectors and payers; tax administration should be professional and bureaucratic-rational |
| Political | Societal legitimacy; institutional capacity; political development | Tax reform requires approval from a variety of social actors; taxation should be clearly linked to expenditures and should improve equity; tax policy and administration should be transparent and accountable |

Adapted from Lledo, Schneider and Moore (2004: 2)

The economic approach to taxation

The economic approach to taxation tends to focus on two aspects: firstly, the analyses of cause-and-effect relationships between taxation and economic processes; and secondly, the analyses of redistribution and the equity goals taxes ought to be achieving in society (see Di

⁴⁸ Tax neutrality is the principle that there should not be distortions and different tax incentives between different economic activities. Tax burdens should be the same for shop-owners as well as transport operators; companies that export and those that import; households that eat potatoes and those that prefer rice. It is based “on the assumption that resources in the economy are allocated optimally and that non-neutral taxes would result in a re-allocation and therefore non-optimal allocation” (Black et al., 2006: 140).

John, 2006). The focus of the former is on how taxes affect such things as labour, investment and production decisions (i.e. the normative issues).⁴⁹ The focus of the latter is on fairness – whether the tax system is treating the different taxpayers fairly. These issues are closely related to the public finance literature on evaluating a tax according to equity and economic efficiency.

The administrative approach to taxation

The administrative approach focuses on administrative efficiency and effectiveness in the collection of taxes. Efficiency, in this approach, refers to the costs incurred in collecting taxes from taxpayers. Administrative efficiency refers to both collection costs (costs incurred in the collection of taxes from taxpayers) and compliance costs (the costs incurred by taxpayers in complying with tax laws). A tax system's effectiveness refers to such things as the predictability and transparency of taxes, accurate assessments and a fair legal system (Lledo et al., 2004). This approach is closely related to the public finance literature on administrative effectiveness described in Chapter Two.

Underlying the administrative approach has been the quest for 'technical' solutions to the problems faced by a country's tax administration authorities in collecting revenue. The formulation of technical solutions has largely focused on the notion of the tax gap (see Lledo et al., 2004). The tax gap is defined as the difference between the tax actually paid and the tax that should have been paid according to the law and is made up of such things as evasion and arrears. Administrative constraints are seen as the main limiting factor in the ability of governments to levy taxes, particularly direct taxes, on potential taxpayers (Bahl and Bird, 2008).

As outlined in Chapter Two, administrative constraints in developing countries can involve such things as: too few skilled employees, low wages, obsolete equipment and facilities in the revenue collection department, complicated tax systems and laws, and poor enforcement of tax laws. In the administration approach, the solution therefore is to establish efficient and effective revenue authorities. At a practical level this involves the establishment of

⁴⁹ Positive economics is about explaining how an economy actually works (i.e. how things are). Normative economics, using an ethical framework, determines whether an economy is producing a good result i.e. how things ought to be (Rosen, 1995).

autonomous revenue authorities that have modern technology and systems, hire competent staff, pay competitive salaries and simplify tax systems (see Taliercio, 2004).

The political approach to taxation

The economic and administrative approaches have been important in identifying the common problems faced by developing countries in trying to collect revenue. However, Lledo et al. (2004) argue that by focusing on economic theory and administrative (“technical”) approaches largely devoid of the political context in which tax policy occurs, these approaches have fallen short in explaining the differences in revenue collection found among developing countries. They have also failed to explain the stagnation in revenue collection that has occurred in many sub-Saharan countries. There is a growing literature showing that historical, political and social factors are important in analysing taxation (see Tilly, 1985; von Soest, 2007; Mkandawire, 2010). These factors have not only contributed to differences between countries in terms of revenues collected but also continue to hamper some developing countries in their efforts to increase their revenues.

According to Lledo et al. (2004: 8):

The political approach focuses on the inter-relationships between tax systems and political regimes. It is evident that taxation is not simply a technical question, and is inherently political. Proponents of what we term the political approach have a diversity of concerns. What they have in common is an emphasis on making political analysis central to the tax policy debate.

According to this perspective, the “capability” that most developed countries possess was not merely inherited but was a result of dynamic social interactions that have continuously shaped and re-shaped their history. State formation, growth and the ability to survive are related to a state’s ability to tax effectively (Tilly, 1985). As a result of bargains and conflict resolution brought about by taxation in what are today called developed countries, institutions were formed as a by-product of this process – tax systems that exist today were essentially a by-product of distributional struggles and power balances that occurred over a long period in their histories (Di John, 2006).

3.5.1 State failure

Zimbabwe has been described in this study as a failing state. However, there is no consensus as to what a failing (or failed) state is (Brett, 2006). There are, in fact, many labels that are used in describing dysfunctional states - “crisis states”, “collapsed states”, “fragile states” and “countries under stress” being some of them. The differences in the labels mainly stem from the way different researchers conceptualise the problem of state malfunction (Torres and Anderson, 2004). While the literature is replete with many definitions and categories of state failure, what is clear is that this failure can occur on a number of different dimensions. Failure can manifest itself in various ways such as economic (e.g. level of development and income distribution), social (e.g. health and education) and political (e.g. level and depth of democratisation, ability to legislate and enforce regulations) (see Di John, 2008).

The concept of state failure is based on a particular understanding of what a state is – there are various conceptualisations of the state. Eriksen (2010) identifies two main ones, the Lockean and Weberian approaches. Although there is some overlap between the two approaches, there exist fundamental differences between them in their explanations of state failure and their prescriptions for failing states.

In the first approach, which is based essentially on a contractarian view of the state (based on Hobbes and Locke), the state’s *raison d’être* is the provision of political goods and services to its citizens. These include such things as security, infrastructure (e.g. roads, bridges), the rule of law, social services such as health and education, property rights and the participation by citizens in the political affairs of the country. The main proponents of this approach are the state failure theorists Zartman (1995) and Rotberg (2002). According to Zartman (1995), a state exists to provide core political, social and economic services to its people and one that can no longer do so should be considered a failed state. Rotberg’s definition is similar as he defines failure as the state’s inability to provide “positive political goods”: “(n)ation-states fail because they can no longer deliver positive political goods to their people. Their governments lose legitimacy and, in the eyes and hearts of a growing plurality of its citizens, the nation-state itself becomes illegitimate” (Rotberg, 2002: 85).⁵⁰

⁵⁰ Rotberg (2002) focuses on security as the most important good the state should provide. He argues that security is a necessary precondition for the provision of all the other political goods.

In the second approach, the Weberian approach to state failure, the focus is on the state as an institution with a monopoly over the means of violence in a specific territory. This Weberian definition of the state therefore looks at failure as a state's inability to uphold this monopoly of violence (Bates, 2008).

The different perspectives on state failure mean that this is a contentious concept. A state can fail when looked at from one approach but not the other: there is an absence of clearly defined guidelines on what constitutes failure. In the Weberian sense, with its emphasis on the monopoly of physical force, a country like Zimbabwe has never come close to failure. However, when looked at from the Lockean perspective, Zimbabwe is, to a large extent, a failing state. The state, over the past 14 years, has largely failed to deliver goods and services to its citizens.

Some political theorists take Tilly's historical analysis of state formation in medieval Europe as a starting point in their analysis of state failure. Tilly (1985) says that there is nothing new about the phenomenon of state failure – the majority of European states after 1500 actually failed - but this record of profound failure has not really been considered by many analysts. “The disproportionate distribution of success and failure puts us in the unpleasant situation of dealing with an experience in which most of the cases are negative, while only the positive cases are well-documented” (Tilly, 1975 in Herbst, 2004: 303).

Tilly's historical analysis ascribes state failure in medieval Europe primarily to problems in the collection of taxes. A state that could not effectively tax its citizens could not survive, as tax revenues were essential to maintaining an army that could defend the country from predatory regimes. The other reasons Tilly gives for state failure in these medieval times are the primitive nature of basic transport, shifting military balances, and the inability to overcome ethnic and religious divisions.

Pre-colonial Africa was very similar – wars were waged against weaker states and those states that could exact taxes (usually in the form of tributes) from weaker ones flourished.⁵¹ According to some theorists (see Herbst, 2004), this is where the similarity between pre-colonial Africa and medieval Europe ends. They argue that unlike Europe, where there was a gradual transition from feudalism to the modern era of statehood as currently understood,

⁵¹ See Mudenge (1988) on the Munhumutapa empire of Southern Africa.

Africa experienced an abrupt shift from feudalism (in the pre-colonial era) to the new political order that started with the scramble for Africa. The demarcation of Africa into colonies was done with undue haste by the competing European countries. In pre-colonial Africa (as was the case in medieval Europe – see Tilly, 1985), states rose and fell naturally due to the various opportunities that existed at the time – they were not created from outside (i.e. by colonial powers). The European conception of the nation-state was therefore very rarely matched by the reality on the ground during the colonial period and afterwards (Herbst, 2004).

According to the radical theorists (who view failure mainly from a historical perspective), statehood was conferred on post-colonial African countries by their European colonisers. State formation that had occurred in Tilly’s medieval Europe, where taxation and wars were essential for the survival of the stronger states (the weaker ones being swallowed up by more powerful ones), simply did not occur. Therefore, while believing that pre-colonial Africa was very similar to feudal Europe, the argument by many scholars is that the post-colonial African state has essentially followed a different trajectory with poorly developed institutions and administrative capacity beyond the few urban areas (see Freund, 1998). According to Herbst (1996: 123), this “façade of sovereignty” that existed just after the dawn of independence was soon exposed, first by the early military coups of the 1960s and 1970s, the Cold War and then later by the economic crises of the 1980s and 1990s (see Dunn, 2003 on the Congo). Herbst (1996) argues that these newly independent countries were being set up for failure. Using the modern concept of statehood on these newly independent states was inappropriate in both the Weberian and Lockean sense. Some of them did not have a monopoly of violence at independence (e.g. the Congo) and many did not administer much of the country outside the capital (e.g. Angola).⁵²

⁵² Although many colonial administrative structures did not extend beyond urban centres, many colonisers, especially the British (see Bräutigam et al., 2008) required colonies and protectorate administrations to be self-financing. They used traditional leaders or native administrators to collect hut and poll taxes. In some colonies, these hut and poll taxes contributed up to 15 per cent of total domestic revenues (Bräutigam et al, 2008: 119). However, due to their association with coercive colonial enforcement, many newly-independent African countries abolished the hut and poll taxes (Kulaba, 1989: 219). This removed an important revenue source and a way of interacting with those who were governed.

To most radical theorists, the idea that Africa has ever had states, i.e. states as understood in the Western sense, is to a large extent false.⁵³ In international relations theory, a state is defined as an institution with a given territory with boundaries and a population. It also has to be recognised as such by other states (Dugard, 1987). Many African countries simply do not (and have never) satisfied all these conditions. For example, the Democratic Republic of Congo's governments since independence (and until recently, Angola's) have struggled to effectively govern and tax its territory, apart from the major urban areas (see Herbst, 1996; Freund, 1998; Vlassenroot, 2008). It is unfortunate, according to the radical theorists, that the international community is generally unwilling to acknowledge the structural problems underlying state weakness, failure and collapse in Africa (the mounting evidence of increasing state failure notwithstanding).

While there is clearly a historical context for the many failures on the African continent as the radical theorists suggest, mainstream theorists argue that state failure is largely a human creation. The many political and economic disasters that have contributed to state failure in Africa have not merely been accidental or caused (materially) by external forces, the environment, or history. African states have failed due to a failure in leadership – it is the greed, corruption and ineptitude of such leaders as Kamuzu Banda in Malawi, Mobutu Sese Seko in Zaire, Siad Barre in Somalia, Charles Taylor in Liberia and Robert Mugabe in Zimbabwe who have destroyed and continue to weaken these countries.⁵⁴

Zimbabwe serves as the mainstream theorists' quintessential example of leadership ineptitude. At independence in 1980, Zimbabwe was unquestionably one of the strongest

⁵³ Eriksen (2010) argues that it is important not to ignore the fact that many of these weak, failing and failed post-colonial states never actually enjoyed a period approximating to strong statehood – their nation building projects were never completed. Stated differently, functions formally assigned to them as newly independent countries were never fully performed. Therefore their failure today should be viewed not so much as a failure of a functioning system that existed at an earlier stage but as the result of incomplete state building. This line of reasoning dovetails with that of those radical theorists who focus on external factors and neo-colonialism as having had an impact on state failure (see Freund, 1998).

⁵⁴ Mobutu, as Rotberg (2003) notes, turned a resource-rich country into one of the poorest on the continent during his kleptocratic rule. He ran the country as his personal fiefdom and most of the mineral wealth ended up in his pocket. During his time in power, there was very little money spent on developing the country or its inhabitants. The country was poorly administered and institutions expected of a sovereign state only existed in a rudimentary form. The building of infrastructure or the provision of security was for the president and not for the Congolese.

African states. Due to political decisions that did not make economic sense, the country embarked on a path that resulted in almost total economic collapse (see Clemens and Moss, 2005). Today Zimbabwe is ranked as one of Africa's "failing states" with a government that has largely failed in almost all respects other than the monopoly of violence which, given its history, is not likely to be challenged by anyone inside the country. Mainstream theorists point at Zimbabwe, together with Liberia, Sierra Leone and the DRC as countries whose collapse has been caused largely by human agency. The mainstream view of Africa's failure has recently received support from Joyce Banda, the former president of Malawi. In 2012 (two years before she lost in the presidential elections to Peter Mutharika), she is quoted as saying "The chronic disease of third term, or chieftaincy, remains one of the greatest enemies of our efforts to achieve sustainable development. The country is constantly caught in a vicious circle of privatisation of the state where one or two people hold the fate of the country" (Mail and Guardian, 2012).

Brett (2006) argues that these two theoretical explanations for state failure (historical context and failed leadership) should not be considered as alternatives, as both factors have contributed to state dysfunction. Whether one looks at the causes of failure from a Lockean or Weberian perspective, or understands it in terms of radical or mainstream theory, the consequences of this failure are devastating for the countries concerned. As is the case in Zimbabwe, these states have deteriorating or destroyed infrastructure – road, bridges, sewer systems, schools and hospitals are in a state of disrepair. Due to high levels of neo-patrimonialism and corruption, state resources that should go into the maintenance of infrastructure are diverted to the ruling clique.

3.5.2 Crises and their impact on the informal sector

This section outlines the impact of state failure on the informal sector. The section describes how crises, like the ones experienced by Zimbabwe (particularly the recent economic crisis of 1998-2008) have created a situation, for some, where running an informal sector enterprise promises a better return than formal sector employment.⁵⁵ Using the political economy theory (and the state failure literature in particular), it shows how the informal sector has grown and

⁵⁵ It is important to note that what is being referred to in this section is a segment of the informal sector that has profited from crises. Inflation, rising unemployment and shortages during crises do have an impact on the informal sector in the form of rising input costs, contracting markets and increased competition from new entrants into the sector (see Clark and Manuh, 1991 on Ghana, and Mkhize et al, 2013 on Durban).

changed in a way that has motivated government to seek ways of taxing this sector, which is now much bigger than the formal sector.

The main impact of an economic crisis on the labour market is generally the fundamental rearrangement of a country's employment structure with an increase in informalization (see Braunstein and Heintz, 2008 on the Asian financial crisis). There is strong evidence from the literature that the informal sector tends to show strong growth during periods of economic crisis (Dimova, Gang, Landon-Lane, 2005). For example, using panel data from the 1995 and 1997 Bulgarian Integrated Household Surveys, Dimova et al. (2005: 11) found that the informal sector grew from 12.5 per cent of the population before the financial crisis of 1996 to 47 per cent of the population after the crisis.

The rapid expansion of the informal sector is also marked by changes in women's labour force participation. Although trends show a general decrease in the level of men's labour force participation and an increase in the level of women's participation in the labour force in many parts of the world (Heintz, 2006), crises tend to accelerate this. Women seem to be disproportionately negatively affected by economic crises and their participation in the informal sector usually has the effect of doubling their workload – their unpaid domestic chores coupled with increased participation in income generating activities (see also Mupedziswa and Gumbo, 1998).

State failure does result in new patterns of entry into the informal economy. In a study of Nigeria's informal sector growth due to the crisis resulting from structural reforms, a point that was highlighted was the increase in the number of entrants with a post-secondary education and university degrees (Meagher and Yunusa, 1995). These new, more educated, entrants can change the nature and scope of activities carried out in the informal sector with some new activities being clearly "atypical" in the informal sector as it is understood in developing countries. This has also been the case in Zimbabwe, where the early studies on informality (ILO/SATEP, 1985; Brand, 1986) showed that the majority of informal sector operators only had a primary education whereas the situation was very different by 2011. The 2011 LFCLS shows that almost two thirds (65 per cent) had at least completed secondary school (ZIMSTAT, 2012: 110).

Instead of the essentially supportive and supplementary role that the informal sector played after independence in 1980, there have been changes in the relationship between the formal and informal sectors in Zimbabwe. Due to rampant shortages during serious crises, there was a reliance on the informal sector to provide everything from basic commodities to foreign currency at the height of the crisis in 2008. State failure, therefore, can have consequences, both negative and positive, on the informal sector (Meagher, 1995). These changes have taken two main forms in Zimbabwe. Firstly, the increasingly dynamic relationship between the formal and informal sector, and secondly, the way in which some informal entrepreneurs have ended up profiting from the crisis as they fill the gaps created by a collapsing formal sector.

In the case of Zimbabwe, recent studies of two particular informal sector activities suggest an overall benefit from the crisis. The first is that of informal sector foreign currency dealers (especially before dollarization). In their study of Zimbabwe's informal foreign currency trading during the crisis period, Mawowa and Matongo (2010) show that the crisis created opportunities for accumulation in a segment of the informal sector. The second is that of cross-border traders. During Zimbabwe's crisis (and as a result of the serious foreign currency shortages), it was the informal sector (mainly the cross-border traders) that supplied many of the inputs required by formal sector companies and allowed these companies to survive (see Ndlela, 2006).

Central to most studies on the formal/informal sector divide in the literature is the issue of government regulation (De Soto, 1989; Hart, 2006; Kanbur, 2009). According to this literature, government over-regulation in a normally functioning state seems to have the effect of increasing transaction costs and therefore pushing companies and individuals to try and reduce these costs by moving to the informal sector. In a failing state, the government may be unable or unwilling to regulate. In some cases, the government may choose who to regulate and how (the "devil's deal" outlined in Chapter Two).⁵⁶

The growth of the informal economy in the Democratic Republic of Congo, Somalia, Zimbabwe, in some respects India and a number of other developing countries can be attributed to the state's inability (and, in some cases, unwillingness) to regulate the conduct of

⁵⁶ According to Tendler (2002), the 'devil's deal' is an arrangement where politicians promise not to enforce tax, environmental or labour regulations in exchange for electoral support from informal sector operators.

enterprises (e.g. ensuring registration and tax compliance). It represents state failure on a particular dimension, regulation. An example of over-under regulation paradox in a failing state is the implementation of strict price and foreign exchange controls that are usually implemented in an effort to keep prices low in the face of rampant inflation (as was the case in Zimbabwe at the height of the crisis in 2008). These measures almost invariably create a lucrative informal sector where scarce, controlled commodities are sold and foreign currency traded. Corruption becomes endemic as the obsession with controls on the one hand is not translated into the prosecution of influential people who break these controls on the other - regulators are bought off and this represents one of the major failures in the implementation of regulations in a failing state (see Mawowa and Matongo, 2010). Another example of over/under regulation relates to taxation, where the government decides which informal sector segments (or locations) will be regulated and which will be under-regulated: Chapter Six shows that there are segments of the informal sector that seem to be above the law in (in terms of taxation) in Zimbabwe.

Although there is strong evidence to suggest that the growth of the informal sector during crises/state failure is due to the desperation of workers who have a limited range of options, it is false to assume that all workers in the informal sector are there involuntarily; some people choose to join this sector for other reasons (Maloney, 2004). In a failing state, the wages from formal employment may be too low or too erratic to sustain livelihoods and this was indeed the case in Zimbabwe. There are also many business opportunities that may arise as a result of state failure and being tied to an employer in the formal sector may preclude an entrepreneur's participation in more lucrative income generating activities in the informal sector. Evidence shows that in Zimbabwe, some informal enterprise owners actually did better than those with jobs in the formal sector (Jamela, 2013).

A study by Dube (2010: 60) on informal sector enterprise owners in Zimbabwe found that due to the straitened circumstances, the biggest formal sector employer (the public service) only paid a monthly salary of \$115 (in 2009), and consequently a formal sector job was viewed with derision. Only 18 per cent of respondents in Dube's sample said that they would consider a job in the formal sector. These results are largely consistent with those from the

study by Mhone (1995) on the effect of Zimbabwe's first crisis (ESAP) and the one by Kamete (2004) on the post-1998 crisis.⁵⁷

In Dube's (2010) study, respondents who said that they would consider a job in the formal sector were then asked about the minimum salary that would motivate them to accept a formal sector job offer. The salaries cited as sufficient motivation for them to move out of the informal sector were higher than the going wage. This could be due to the perceived risk of formal sector employment. In a failing state where company closures and retrenchments are the norm, an 'established' informal sector entrepreneur is likely to be more circumspect about a formal job offer.⁵⁸ The salaries expected from the formal sector ranged from \$100 to \$4,000 with a median of \$250 (Dube, 2010: 55).⁵⁹ Although most of the salaries mentioned were very high compared to what most formal sector employees earn, they are reasonable, given the profit figures cited by the respondents, which ranged from \$100 to \$4,000.

By showing, as the results from the studies by Mhone (1995) and Dube (2010) do, that many of the enterprise owners are voluntarily informal does not, of course, imply that they are all well-off. The argument is that, in a failing state like Zimbabwe, it is not obvious that they would be better off as formal sector employees. The results of these studies indicate that the failing state has accentuated this preference for the informal sector by a section of the working population (as outlined above, early Zimbabwean studies on informality also found a significant proportion of entrepreneurs who were reluctant to leave the informal sector).

⁵⁷ Mhone's (1995: 25) study found that 25 per cent of respondents in Harare (and 70 per cent in the smaller city of Gweru) indicated that "they chose the urban informal sector as a superior or preferred option" to formal employment.

⁵⁸ This finding is even more surprising when one considers that formal sector jobs usually come with certain benefits that are not present in the informal sector. Those in the formal sector benefit from a compulsory pension scheme (with some also having a private pension scheme), maternity and sick leave. Civil servants also benefit from the Public Service Medical Aid Scheme (medical insurance in the private formal sector is voluntary).

⁵⁹ It is important to note that earnings of informal sector operators are notoriously difficult to estimate as many of them do not keep records and should therefore be treated as rough estimates (see also Mhone, 1995). For early Zimbabwean studies on earnings in the informal sector see Davies (1974) and Brand (1986). Brand's (1986: 69) study found that 20 per cent of those in the informal sector earned more than the average wage of those in the formal sector (in similar professions).

3.5.3 State failures' impact on tax collection

The tax collection capacity among sub-Saharan countries differs remarkably. While the differences can be partially explained by political and institutional factors, it is important to include historical factors. Different patterns of colonialism and the different institutions that the colonialists left behind have led to different tax structures among developing countries (Di John, 2006; see also Thirsk, 1997). The British in Southern Africa bequeathed the former colonies with financial, legal and parliamentary institutions of an “unusually high standard” (modelled on their own) and largely formal labour markets (Collier, 2009: 230). These strong institutional foundations partly explain these countries' higher direct tax income compared to those ruled by others - countries like South Africa, Botswana, Namibia and even Zimbabwe generally have higher tax effort indicators (Stotsky and WoldeMariam, 1997; Di John, 2006).

Generally, state fragility and crises tend to exacerbate the problem of tax collection in developing countries in two main ways. Firstly, the general collapse and decay of institutions (including tax authorities) as a direct consequence of this failure tends to drastically reduce government capacity to collect taxes. Secondly, as economic growth stagnates or falls, lower revenues are available for collection. There are a number of examples on the African continent.

Vlassenroot (2008) outlines the problems that a failing state experiences in collecting revenue using the example of Zaire under Mobutu. At the height of the crisis in the then Zaire, the already weak tax authority could not collect revenue due to capacity problems. Clapham (1996) gives the example of the phenomenal growth in the informal sector in Ghana and Uganda just before the emergence of Rawlings and Museveni respectively. In these two countries, the informal sector grew, not only as a result of traders trying to evade weak state control, but also to take advantage of the opportunities in the informal sector. Ineffectual state control meant that some of those in the informal sector could profit from “black market” activities (Clapham, 1996: 248). Indeed, as Clapham (1996) points out, state power helped to create entrepreneurial opportunities. In failing states, it allowed politically connected individuals (from the president downwards), to participate in the informal economy and accrue huge profits which were not subject to taxation (Clapham, 1996: 251).

The low revenues collected due to weak institutional capacity (i.e. the state's inability to reach the 'hidden' activities in the large and often growing informal economy) will place the

failing state under severe financial pressure. An inability to effectively administer the country (i.e. through visible tax collection, an element of state presence) is one aspect of state failure. In many failing states it means that militia and warlords may collect their own taxes thus depriving government of revenue. Although Rawlings in Ghana managed to stabilize the economy (including the use of innovative ways of taxing the informal sector – see Chapter Two on the IGT), Zaire under Mobutu and Somalia under Barre are typical examples of countries that experienced a collapse in revenue generation capacity as a result of state failure (see Callaghy, 1994).

Tax revenues as a proportion of GDP are typically lower in failing states (Collier, 2009: 223) - a failing state will usually fail to tax the majority of the population. According to a recent OECD report “on average fragile states mobilise less than 14 per cent of their GDP in tax revenues” (OECD, 2014: 11).⁶⁰ However, as the state failure literature points out, while the general trend in the failing state is one of low revenues and low tax ratios, as was the case in Somalia and Zaire, there are countries that have not followed this trend. An alternative route is for the failing state to find effective ways of mobilising domestic revenues to sustain government operations even as it faces crises and failures in other areas, as demonstrated in Ghana and Uganda⁶¹. Even a failing state can resort to innovative tax collection methods - institutional weaknesses are not always systemic. State failure, as outlined in the previous section, is usually a complex, multi-faceted phenomenon. Even a failing state can have a functioning revenue authority that continues to collect revenue that is enough to sustain the government and maintain its visibility throughout the country.

As the state formation literature shows, a state has to raise revenues in order to avert total collapse. Zimbabwe, throughout its crisis decade (1998-2008), maintained a functioning, relatively professional revenue authority (see Everest-Phillips, 2010). Zimbabwe’s revenue authority has played a crucial role in ensuring the survival of the economy even in the absence of foreign funding. It is this revenue authority that the government is relying on to ensure its continued survival through the broadening of the tax base to include the informal sector.

⁶⁰ Zimbabwe was included as one of the 51 fragile states in this report.

⁶¹ Scholars such as Mkandawire (2010: 1648) would argue that it is not mere coincidence that Ghana and Uganda are Anglophone countries as some colonisers (e.g. Britain) left a better “institutional and infrastructural residue” than others.

As predicted by the literature on state failure, when faced with crises, governments may be forced into finding ways of raising the required revenues to finance public spending (see Gloppen and Rakner, 2002). The Zimbabwean government is now turning to the informal sector as very little extra revenue can be obtained from the large taxpayers in the small formal sector. Also, other innovative tax collection measures such as the implementation of a tariff-like VAT at the border have already been implemented in Zimbabwe (see Keen, 2008).⁶² Therefore, the need for the critical financial resources has led the state to pursue a strategy, which has at times been aggressive, to tax the hitherto hidden parts of the economy.

This section presented the literature on state failure and the impact of crises on tax revenues. States, even those that are failing, need to find ways of collecting revenues to avert a total collapse. The section presented a macro-historical account of state formation in the literature that indicates that the early European states that survived were those that effectively taxed their citizens. The section went on to present the case of failing states such as the DRC and Somalia which collapsed partly due to their failure to effectively tax their citizens (a role that was quickly taken up by other entities). The section also shows that states are multi-dimensional, and that even a failing state like Zimbabwe can resort to innovative tax collection methods by leveraging functioning institutions (such as ZIMRA).

3.6 Concluding remarks

This chapter shows that Zimbabwe is a country that has been and continues to be in crisis. The chapter shows how economic mismanagement and political instability have transformed the country, which used to be one of the strongest and most diversified sub-Saharan economies, into one that has a drastically reduced formal sector. The unsuccessful implementation of ESAP, which was accompanied by massive de-industrialisation (in a country that had survived largely due to import-substitution industrialisation before independence) and retrenchments, laid the foundation for the second crisis. The second and more serious crisis, whose effects are still felt to this day, began in 1998 and reached its peak in 2008. The violent farm expropriations that followed the formation of the opposition MDC and ZANU-PF's loss in the constitutional referendum brought Zimbabwe to the brink of total

⁶² Informal cross-border trading has thrived in Zimbabwe as the citizens increasingly rely on imports for their basic needs (see Ndlela, 2006). The presumptive tax on cross-border traders, as will be explained in more detail in Chapter Six, has proven to be an innovative way of taxing the informal sector.

collapse. Not only were there widespread shortages of food, electricity and foreign currency, the government was unable to collect sufficient revenues at the height of the crisis (IMF, 2009). The tax ratio, which has traditionally been high in Zimbabwe, fell to record lows as inflation soared, rendering the Zimbabwe dollar useless.

One of the main impacts of the Zimbabwean crisis has been the shifting of economic activity from the formal to the informal economy. This informal sector has seen an influx of educated workers, a significant proportion of them with tertiary qualifications. Also, unlike the first crisis (where women were in the majority), women no longer dominate this sector with the 2011 LFCLS showing an equal split between men and women (an indication of the difficulties experienced by both males and females in getting formal employment). Although there has been a modicum of stability since the dollarization of the economy in 2009, revenues have been and are still too low to support government expenditure. This has resulted in government trying to collect revenues from the informal sector in recent times – a sector that is increasingly being viewed as a source of revenue. The next chapter, Chapter Four, outlines the methodology that was used in this study to analyse the structure of the tax system, how these taxes are being administered in Zimbabwe and their impact on equity and efficiency in the informal sector.

Chapter Four - Methodology

4.1 Introduction

This chapter outlines the analytical methods used to address the study objectives. To recap, the study has three main objectives. The first objective is to describe and provide an analysis of informal sector taxes in Zimbabwe and how these taxes relate to the broader tax system (i.e. the VAT, personal and corporate income taxes). The second objective is to investigate the challenges and successes in administering the informal sector taxes in Zimbabwe, in the context of a crisis/failing state. The third objective is to assess the extent to which these informal sector taxes are addressing the issues of equity and economic efficiency.

The chapter is organized as follows. Section 4.2 presents a description of the empirical approach and the sources used to gather information that addresses the objectives of this study i.e. document analysis, some quantitative data analysis, qualitative interviews with key informants and the case study method based on interviews with entrepreneurs in four activity classes of the informal sector. The section begins by describing these data sources and then goes on to provide a more detailed description of the four informal sector cases selected for analysis (transport operators, flea market operators, hairdressing salons and cottage industries) and the reasons for their selection. Section 4.3 provides a brief description of the context in which this data collection on taxation occurred - the crisis in Zimbabwe. Section 4.4 describes the way in which the study data were analysed – it describes how the research objectives were achieved based on the data collected. More specifically, the section explains how ZIMRA's capability to raise revenues from the informal sector and the challenges it faces in doing so were assessed. It then goes on to describe how the issues of administrative effectiveness, equity and economic efficiency were assessed. Section 4.5 provides an explanation of the study limitations and the issue of generalizability in qualitative research and Section 4.6 concludes.

4.2 The empirical approach

This is primarily a qualitative exploratory study. The study seeks to fill the gap in the literature on informal sector tax administration in Zimbabwe by assessing and describing the way these taxes are implemented. Quantitative data, where they were available, were also analysed so as to increase the validity of the findings. In order to address the study objectives, four main empirical sources were used. Firstly, documents relating to informality and taxation were analysed (i.e. tax legislation, government and ZIMRA reports, budgets and

newspaper articles). Secondly, quantitative secondary data from ZIMRA on revenue collections between 2008 and 2011 were analysed. Thirdly, qualitative interviews were carried out with 16 key informants from ZIMRA, the Ministry of Small and Medium Enterprises Development, academia and business organisations. Fourthly, the case study methodology was used to study four informal sector activity classes – transport operators, flea market operators, hairdressing salons and cottage industries. This involved qualitative interviews with informal sector operators, conducted in two parts: a structured questionnaire covering enterprise and owner characteristics and a semi-structured more open-ended interview schedule which probed issues around informal sector taxation specifically. A total of 47 informal sector operators from the four activity classes were interviewed. The following sections provide an outline of the key sources of information used in this study.

4.2.1 Document analysis

As King, Keohane and Verba (1994: 44) point out “qualitative researchers carefully try to analyze constitutions and laws rather than merely report what observers say about them”. In order to understand informal sector tax regulations and their relationship with the broader tax system in Zimbabwe, the relevant tax legislation was analysed: the Income Tax Act of 2010; the Finance Act of 2010; and the Value Added Tax Act of 2010. The study also made extensive use of written sources from ZIMRA, ZIMSTATS and two government ministries – the Ministry of Finance, and the Ministry of Small and Medium Enterprises Development. Budget speeches were also analysed as they pronounce government’s stance on public finances – they are crucial to understanding the government’s perception on raising revenue to finance its activities.

Although there is a large (and growing) literature on the informal sector in Zimbabwe, there are only two (very recent) academic studies (Utaumire et al., 2013; Zivanai et al., 2014) that have been conducted on informal sector taxation, as pointed out in the introduction. Archival newspaper articles were therefore particularly useful in analysing the way that the informal sector has evolved over time, as were the increasing number of newspaper articles and debates on informal sector taxation. This analysis of newspaper articles was supplemented by various pieces of tax legislation and reports.

4.2.2 Quantitative data analysis

Secondary quantitative data, where available, were analysed in this study. Data on revenues (including presumptive tax revenues from the informal sector) were obtained from ZIMRA.

The data were analysed not only to assess the revenues collected from the informal sector but also to ascertain trends in this revenue collection over time. Quantitative data from the research carried out by ZIMRA on informal sector turnover and profitability in 2003 were also analysed. This research was conducted by ZIMRA to inform the setting of tax rates in line with profitability in this sector.

Accessing the various pieces of legislation on taxation and the various government reports on the informal sector was not difficult – these are available online and from government printers. However, accessing data from the country’s statistical agency posed some challenges. Zimbabwe’s statistical agency, ZIMSTATS, virtually collapsed in 2004. This means that not only is there a shortage of good quality data but there are also huge gaps in the data available. As has been noted by a number of researchers (see IMF, 2010; Kanyenze, 2011), data in Zimbabwe have serious shortcomings that significantly impede research due to the capacity constraints at ZIMSTATS (IMF, 2010).

Although ZIMRA is much better at collecting data on revenues, the quality of data on informal sector tax revenues was not very good. For example, while the presumptive tax schedule outlines the various informal sector taxes levied on the different activity classes, it is not possible to determine the amount of tax that was collected from each informal sector activity class – all presumptive taxes collected are put into a common account. This means that there is no way of telling how much a particular informal sector activity class contributed as a proportion of total revenue collected from the informal sector. Clearly, it is difficult to then have targeted efforts (aimed at collecting from non-compliant informal sector activity classes) if these activity classes are not being assessed separately.

The problem in Zimbabwe relates to gaps in economic data (for example, there are no input-output tables and the last social accounting matrix was produced in 1991). In addition to the gaps, the Ministry of Finance (which controls ZIMSTATS) does not implement international best practice in the dissemination of statistics and the accessing of existing data. This means that data from studies such as the income and consumption expenditure survey cannot be easily accessed by researchers. The problems in accessing data make it difficult to perform value added tax incidence analysis, for example, which depends on data from income and consumption expenditure surveys. These limitations and their implications for the analysis will be discussed further in the relevant sections below.

4.2.3 Qualitative interviews with key informants

Given the lack of large-scale nationally representative secondary data for Zimbabwe, much of the analysis in this study had to rely on qualitative interviews. Fieldwork for this study was carried out between August 2011 and May 2014. All of the 16 key informants were interviewed during the first round of interviews conducted from August to November 2011. Qualitative interviews were carried out with four respondent groups as shown in Table 8. The first group, made up of ZIMRA officials, provided insights on the capability to levy presumptive taxes. Government employees from the Ministry of Small and Medium Enterprises Development formed part of the second group and they provided information on the informal sector's potential as a revenue source and its contribution to the economy. The third group (business organisations and trade unions) represents formal enterprises and workers (the largest contributors to direct taxes in Zimbabwe). Their views on informal sector taxation were also sought given that the informal sector's growth in Zimbabwe has affected them (not only are there are linkages between the informal and formal sectors but the two sectors do often compete). The views of these three groups are particularly useful as they represent some of the most influential groups on taxation issues in Zimbabwe. The fourth group, academics, was included to provide additional insights on the potential of the informal sector as a revenue source and their views on the equity and economic efficiency implications of presumptive taxes in Zimbabwe. Table 8 shows the four key informant groups and the reasons for their inclusion.

Table 8: Key informants

| Respondent group | Number interviewed | Epistemological interest |
|--|---------------------------|---|
| ZIMRA officers: junior, middle level and senior management | 7 | Views on capability to collect income tax from informal sector, success and challenges faced in collecting tax, revenue projections |
| Ministry of Small and Medium Enterprises Development | 2 | Perceptions of informal sector's potential as a revenue source, views on formalization, strategies for sustainable revenue collection from this sector and enterprise growth |
| Business organisations / trade unions: | 4 | Views on informal sector taxation and how payment/non-payment of presumptive taxes affects their business operations, suggestions on how to effectively and efficiently tax the informal sector |
| Academics | 3 | Assessment of current presumptive taxes and analysis of the tax administration / informal sector relationships, governance issues, suggestions on how to effectively and efficiently tax the informal sector, equity issues |
| TOTAL | 16 | |

Adapted from von Soest (2007: 48)⁶³

In interviewing respondents from the country's tax authority, ZIMRA, the approach used in this study was that of ensuring both internal and external control of information provided by interviewees. To this end, tax officers who were interviewed from ZIMRA were drawn from the junior, middle and senior management levels. As von Soest (2009) points out, it is reasonable to expect officers at different levels in the organisation to have different perceptions on the organisation's effectiveness and capability. The study's comparison of the responses from the officers at different hierarchical levels at ZIMRA therefore serves as an internal control. The interviews held with other key informants (i.e. business organisation representatives, trade unions and informal sector operators themselves) operated as an external control. These interviews with other key informants served as an external method of assessing the responses given by ZIMRA on, for example, its ability to effectively levy presumptive taxes.

⁶³ von Soest (2007) carried out a qualitative comparative study on the tax administrations' ability to raise revenue in two Southern African countries, Botswana and Zambia.

The key informants were selected purposefully as there was a need to include specific respondents who have an in-depth understanding of the issues that were being studied. In the case of ZIMRA, after obtaining the necessary permission to conduct the study, the researcher then worked with the human resources department in identifying officials who were involved in informal sector taxation at the junior, middle and senior management levels. It was made clear to each interviewee that participation in the study was voluntary. Interviewees were asked to show their consent by signing the informed consent form (Appendix 1).

The interview guide that was used to interview the respondents in Table 8 was first piloted with two people - a former ZIMRA employee and an academic. This pilot was conducted to get an overview of how well the questions captured information pertaining to the three main objectives of the study. From the pilot study, two semi-structured questionnaires were then prepared, one for the ZIMRA employees and the second one for all the other key informants (Appendix 2).

For the ZIMRA employees, the final semi-structured questionnaire that was used in the study had 40 questions that covered three themes – tax administration challenges and successes, equity and economic efficiency. Seven tax officers from the junior, middle and senior management levels were interviewed. Taxation issues are sensitive. Questions posed in this study required ZIMRA officials to comment on the internal operations of the tax authority and present views on its capacity and capability to raise revenues from the informal sector. To protect the respondents from potentially unpleasant consequences, interviews were not recorded. Since the interviews were not recorded, all the quotations used in this study contain an element of paraphrasing based on the notes taken by the researcher as the interview progressed. Clearly, a scientific study has to substantiate the information used and balance this with the respondents' need for confidentiality. In this study, this balance was struck by using a numbering system for the key informants interviewed (see Appendix 3). Where quotations are used in the thesis, the remarks reflect the responses of the respondent identified by a respondent number (e.g. Key Informant 1, 2 etc.), the organisation and the date of the interview. Some studies on taxation have gone as far as making quotations completely anonymous for some respondents (see von Soest, 2009).

The other nine key informants' semi-structured interview schedule had 13 questions. These ranged from administrative and equity issues to whether the informal sector is viewed as a

viable source of revenue (see Appendix 2), respondents' perceptions of the effect of informal sector presumptive tax on formal firms, and the role the informal sector plays or could play in Zimbabwe's economy. Of these nine respondents, three were academics, two were drawn from business organisations (the Confederation of Zimbabwean Industries, CZI, and the Zimbabwean National Chamber of Commerce, ZNCC), one was from a tax consultancy firm (Ernst and Young), one was from the country's largest trade union, the Zimbabwe Congress of Trade Unions (ZCTU) and two were drawn from the Ministry of Small and Medium Enterprises Development. The list of the respondents and their positions in these organisations appears in Appendix 3. Two respondents (one key informant and one informal sector operator) were re-interviewed telephonically in 2014. In the case of the key informant, the purpose of the interview was to seek clarity on how the profit and tax/turnover ratios were calculated by ZIMRA in 2005. In the case of the informal sector operator, the reason for the second interview was to seek clarity on turnover targets that are normally set for employees by transport operators.

4.2.4 Case studies

In addition to the qualitative interviews with key informants, a case study methodology based on qualitative interviews was used to analyse four informal sector activity classes. The case study is the empirical strategy of choice when we want to answer "why" or "how" questions for a particular person, group or event (i.e. the case) without the ability to control events (as is the case with an experiment). Using qualitative and/or quantitative methods, the case study methodology then describes or explains these uncontrolled events as they occur within some real-life context (Yin, 1994).

In any empirical study, it is important to explain the conceptual principles guiding the selection of cases and clarify the way data are analysed. This not only outlines the method's strengths and weaknesses but also provides an indication of its explanatory power (von Soest, 2005). In empirical research, there are three basic methods for selecting units of analysis – convenience, purposive and probability. In the convenience sample, the units of analysis are selected based on availability. The purposive sample uses the researcher's skill in selecting the most "appropriate" units that are most relevant to the study. In probability sampling each unit has a known and equal chance of being included in the study and, for statistical generalization, this is usually the method of choice (Yin, 1994).

For case study research, only rarely can the convenience sample be useful (there should be specific reasons why certain groups were selected and not others), and generally the purposive selection of cases is the most appropriate method (Ragin, 1987; Yin, 1994; Seawright and Gerring, 2008). With most multiple case studies such as the one used in this study, the major decision is on the criteria used to determine the inclusion of cases in the study - random selection of units in small-N research is rarely an option as it risks omitting important cases and generating bias. A particular problem with using probability samples in case study research is that the laws of probability operate on large numbers – fewer than 30 selected cases will not likely allow for reliable generalizability to the population (Morra and Friedlander, 1999).

For the purposes of this study, informal sector activities in Zimbabwe were categorized into four activity classes (i.e. groups or units of analysis) shown in Table 9. The cases were chosen due to the fact that these are some of the activity classes mentioned in the informal presumptive tax legislation (i.e. not all informal sector activity classes are mentioned in the presumptive tax schedule). The preliminary document analysis also indicated a particular focus on two of these activity classes - transport operators and flea market operators. The inclusion of the other two cases (hairdressing salons and cottage industries) which did not seem to be a focus of tax collection efforts (from the preliminary document analysis) ensured that the study results would incorporate the views of a broad cross-section of informal sector operators in Harare (and not only focus on activity classes that are more closely monitored by ZIMRA).⁶⁴

The actual number of informal sector operators from each class that were interviewed is shown in the Table 9. The study was conducted in Harare, Zimbabwe's largest city. Of the total of 47 informal sector operators, there were nine women and 38 men. It is important to note that the proportion of females and males in this study is not broadly representative of the gender distribution in Zimbabwe's informal sector. This is due to the fact that males tend to dominate the cottage industry and transport sub-sector while females tend to dominate the hairdressing salon activity class and street vending sub-sectors. Street vendors were not part of this study as they are not included in the presumptive tax schedule. The method and criteria used to select the operators within these classes is outlined later in this section.

⁶⁴ Details from this documentary research and the tax structure itself are the subject of Chapter Five.

Table 9: Informal sector activity classes

| Class | Location | Tax payment monitoring | Number |
|---------------------------|---|-------------------------------|---------------|
| Urban transport operators | Designated points, busy intersections | High | 23 |
| Flea markets | Designated sites within the Central Business District and suburban shopping centers | Medium | 9 |
| Cottage industries | Designated sites in high density residential areas | Low | 7 |
| Hairdressing salons | Rented building in shopping mall, city centre, in and around housing unit | Low | 8 |
| TOTAL | | | 47 |

Source: Own representation

The data collection instrument that was used to obtain information on informal sector taxation consisted of two parts. The first part was a structured questionnaire made up of 44 questions that made no mention of taxation. This part looked at enterprise owner details and enterprise characteristics. The second part consisted of a semi-structured interview guide on informal sector user fees (which were included to get an idea of the other taxes that informal sector operators paid apart from presumptive taxes) followed by a more detailed section on presumptive taxes. The data collection instrument used is shown in Appendix 4. The questions in the interview guide explored six themes: site/user fees; the impact of these fees; knowledge of taxes and tax payment behaviour; the impact of taxes; the way taxes are collected; and the informal sector operators' perception of governance. For respondents who claimed that they were tax compliant (i.e. paid these presumptive taxes), further questions were asked on registration and payment procedures.

The data collection instrument was piloted on two informal sector operators in the transport sector. The pilot study showed that this approach of starting with non-tax related questions before delving into the more serious tax issues was probably a better way of eliciting participation from respondents. Feedback from the pilot also indicated that instead of informing respondents that this was a study on taxation, it was more prudent to present the study as one on the financial concerns of the informal sector operators.

A total of 34 informal sector operators were interviewed during the first round of interviews conducted between August and November 2011. In order to address the research objectives, the focus of this study was on those informal sector operators that had paid presumptive taxes before. This focus was necessary in order to assess, not only administrative effectiveness but also the equity and efficiency impact of informal sector taxes. Informal sector operators were selected through purposive and snowball methods. An attempt was made to include at least six participants from each of the four activity classes in order to ensure that operators in the various informal sector activities were represented.

While the informal enterprise owners interviewed knew about taxes in general, most of them (18 respondents or 53 per cent) did not know anything about presumptive taxes. Even educated informal enterprise owners (i.e. those with a tertiary education) who were not in the highly targeted sectors (e.g. transport and flea-markets) did not know about these taxes. Given the low numbers of participants who knew about presumptive taxes (and an even lower number that actually paid them - six operators), a decision was made to include operators who had never paid presumptive taxes as long as they provided information on profitability. This was done so as to at least obtain information on profitability (used in the assessment of equity) even in activity classes where none of the respondents had ever paid presumptive taxes before (e.g. the cottage industry class). This resulted in a total of 21 informal sector operator interviews from the first round of interviews. Thirteen informal sector operators who had never paid presumptive tax and did not provide information on profitability were therefore excluded from the study. Of the 13 excluded informal sector operators, three were urban transport operators, two were flea market operators, five were hairdressing operators, and three were cottage industry operators.

Two further attempts were made to collect data from those in the informal sector who had paid presumptive taxes before. This was done to ensure that the views of those operators who were actually paying (or had at least paid these taxes before) were represented so as to address the research objectives. These additional interviews were conducted in two further rounds. The first round was from March to April 2013 with 12 operators being interviewed (10 transport operators and 2 hairdressing salon owners). The second round of interviews was held between April and May 2014 where 14 informal sector operators were interviewed (eight transport operators and six hairdressing salon operators). The list of the 47 informal sector operators is shown in Appendix 5. The following section provides a description of the selected cases and the sampling method used in selecting the respondents in each activity

class. An informal sector enterprise in this study was defined as an enterprise that was not registered for corporate income tax or VAT.

Transport operators

Within the urban transport operators' activity class, there are five distinct types of operations – minibus taxis, taxi-cabs, driving schools, goods vehicles of more than 10 tonnes and goods vehicles below 10 tonnes. While this study focused on omnibus (minibus taxi) operators who have borne the brunt of tax monitoring, taxi-cab operators and goods transporters were also included as part of this case. The two goods vehicle operators whose trucks were below 10 tonnes (without a trailer, and therefore not subject to presumptive tax) also formed part of this study. This particular category does not appear in the presumptive tax schedule. However, the respondents from this category were included so as to get an understanding of this sub-sector with a view to assessing the possible equity and efficiency impacts of not taxing these operators.

After obtaining a letter of recommendation from the Ministry of Small and Medium Enterprises Development, the Ministry of Transport was then approached for a list of organisations representing the commuter omnibus operators and two of these associations, the Zimbabwe National Commuter Omnibus Operators Organisation (ZINCOOO) and the Indigenous Commuter Operators Association of Zimbabwe (ICOAZ), were contacted. Face-to-face interviews were then conducted with willing participants recommended by these organisations. After interviewing a participant, the referral technique was employed to obtain further respondents. A similar method was used with taxi-cab operators (without going through their associations). Although interviewees in the minibus taxi sub-sector were initially selected from the recommendations made by the transport associations, only five of the 16 minibus taxi operators who formed part of this study were from these two associations. Five taxi-cab operators and two goods vehicle transporters (with vehicles under 10 tonnes) were also interviewed. The two goods vehicle transporters were selected using purposive and snowball methods.

Flea markets

Most flea market operators in Harare are also cross-border traders (See Mupedziswa and Gumbo, 1998; Tamukamoyo, 2009; Jamela, 2013). They usually employ part-time employees to man their stands while they focus on sourcing goods from countries such as Botswana,

China, Dubai and South Africa. While there are a number of flea market operators who are making high profits by selling these imported goods, many of them are petty traders who import cheap Chinese goods from Botswana. In this particular activity class, there were no gatekeepers and snowballing was used to get new participants. The nine flea market operators interviewed were all cross-border traders.

Hairdressing salons

Operators of hairdressing salons were the most difficult to interview as they do not seem to be organised (in terms of associations or committees). While there are a number of hairdressing salons in the up-market shopping complexes with a steady (and high paying) clientele (and employing permanent employees), the vast majority of hairdressing salons in Harare's central business district use the 'rent-a-chair' system. This is where the registered owner of the salon rents out chairs to independent hairdressers and barbers. In most of these establishments there are usually about 10 to 20 hairdressers and around five to 10 barbers (who are not registered for tax). Eight hairdressing salon operators were interviewed in this study.

Cottage industries

The term 'cottage industries' (sometimes referred to as 'home industries' in Zimbabwe) refers to enterprises usually involved in small to medium scale manufacturing and repair activities.⁶⁵ These enterprises are meant to be formal but are almost invariably informal (i.e. not registered for corporate income tax). Most of these small enterprises tend to operate in a designated area in the medium and low-income residential suburbs. The majority of the stalls at cottage industry sites are owner-operated. There are usually a number of employees (family and non-family members) who work on a full-time or part-time basis. In Harare, the cottage industry site where the research was conducted was managed by a committee. Purposive and snowballing methods were used to select participants from this activity class and a total of seven cottage industry operators were interviewed.

4.3 Informal sector tax research challenges in Zimbabwe

Collecting data on tax issues is a challenging task in any country (see Gerxhani, 2007). Conducting research on informal sector taxation in Zimbabwe, a politically polarised society,

⁶⁵ Cottage (or home) industries in Zimbabwe should not be confused with home-based enterprises (HBE) which are informal activities that occur in and around the housing unit.

is particularly difficult. This is a sector that does not want attention and getting people to participate was not easy. In two particular cases, the informal sector gatekeepers (who, in both cases, were aligned to the ruling party, ZANU-PF) were actually hostile. The committee managing goods transporters (part of the transport operators' activity class) made it clear that the researcher was not welcome once they established the true nature of the study (the letter of recommendation from the Ministry of Small and Medium Enterprises Development notwithstanding). Interviews were still conducted with goods transporters from this site but they were not done on-site.

At the cottage industry site, the researcher was detained for more than an hour in spite of having a letter from the Ministry of Small and Medium Enterprises Development. These gatekeepers (i.e. the committee members managing the site) claimed that they were trying to establish the veracity of the researcher's claims (i.e. that he was a *bona fide* researcher and not a political activist). The gatekeepers also tried to advise the researcher on what questions not to ask (i.e. politically sensitive issues on governance). The Ministry of Small and Medium Enterprises Development intervened and the researcher was able to proceed with the study.

The gatekeepers were not the only challenge. Informal sector operators themselves were very suspicious of the researcher and the nature of the study. Many of the interviewees refused to participate and a number of those that did initially give their consent changed their minds later. This problem of the low response rate was more prevalent among hairdressing salon operators and cottage industry activity classes, reflected in the lower numbers of respondents.

Getting permission to conduct research in a politically volatile environment is also difficult. Zimbabwe is a highly divided society and these divisions were evident even at the highest level of government during the transition period (i.e. 2009-2013 when most of the field work for this study was conducted). Although permission was granted, in writing, by the Minister of Finance (a member of the opposition MDC), the senior official in charge of administration refused to see the researcher. Without this official's cooperation, the researcher could not interview any of the officials from the Ministry of Finance.⁶⁶ The only views on informal sector tax policy from this ministry were obtained from a former Ministry of Finance employee who had moved to ZIMRA (Key informant 16, ZIMRA, 11 November 2011) and

⁶⁶None of the officials responsible for informal taxation was willing to talk to the researcher without this particular person's permission for fear of being identified with "an MDC project".

an academic who had worked as an adviser to the Ministry of Finance (Key informant 3, ZIMCONSULT, 26 October 2011).

4.4 Data Analysis

Data analysis involved the evaluation of data obtained from the various sources (i.e. document analysis, analysis of data from ZIMRA and the interviews conducted with key informants and informal sector operators). Different sources of information were used to support the balance of evidence and satisfy the multi-method approach adopted in this study. The factors assessed and their operationalization is shown in Table 10.

Table 10: Summary of assessed factors

| Factors | Operationalization |
|-----------------------------|---|
| Tax administration | ZIMRA's capability, willingness to pay, corruption, collection strategy, amount of revenue collected from informal sector, number of informal operators taxed, penalties for non-compliance |
| Equity | Perceived fairness of presumptive tax vis-à-vis the formal sector and within the informal sector activity classes |
| Economic efficiency | Observed and reported change in behaviour as a result of presumptive taxes |
| Knowledge of relevant taxes | Informal sector operators' knowledge of presumptive taxes |
| Governance | Perceptions of government legitimacy and service provision, value for money, fairness, cost/benefit analyses |
| Development | Strategies/plans for integration of informal sector into formal sector, incentives for formalization, level and depth of consultation between government and informal sector |

Source: Adapted from von Soest (2005: 69)

Document analysis began before the field work commenced and continued during and after its completion. The initial document review process enabled the researcher to identify the key themes, and later during the interviews it helped in restructuring and refining the questions in order to better capture information related to the study's key objectives. This part of the study also included the assessment of quantitative data in the form of tax revenue data obtained from the tax authority. This allowed the researcher to analyse trends not only in revenue

collection between 2008 and 2011 but also trends in collection from the informal sector (in the form of presumptive taxes). However, there were gaps in the data obtained from ZIMRA (e.g. lack of disaggregation according to informal sector activity class).

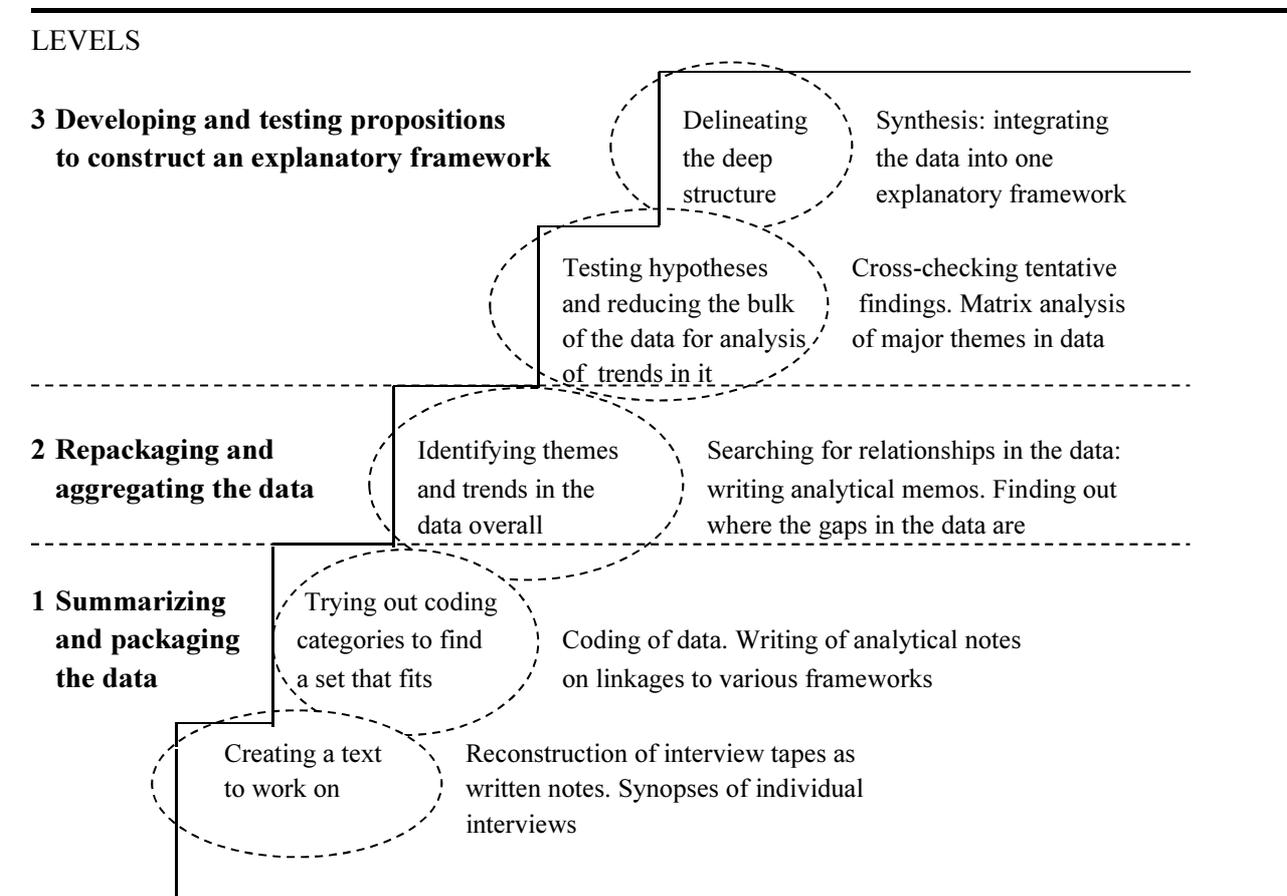
Government budget reports, ZIMRA revenue collection reports and IMF documents provided quantitative data in the form of statistical tables and figures which enriched the analysis and complemented the information obtained from interviews. The information obtained from the qualitative interviews was transcribed and summarised according to the major themes (Table 10) and the three objectives of the study. The analysis of the qualitative data was a continuous process that started after the first few interviews and continued as the fieldwork progressed.

For informal sector operators, the first part of the data collection instrument consisted of a structured questionnaire on enterprise and owner characteristics (see Appendix 4). The responses to the questionnaire were captured using IBM SPSS version 21. Descriptive statistics for, among others, age, level of education, reported profit and source of inputs were generated. For the second part of the data collection instrument with informal sector operators and all the qualitative interviews with the other key informants, notes were taken by the researcher as the interview progressed (given the reluctance to have interviews recorded). The interview notes made by the researcher were then transcribed for analysis and categorized. This categorization, an iterative process, was based on a conceptually clustered matrix (Miles and Huberman, 1994) that grouped interview questions into similar clusters based on *a priori* ideas on which questions are related, forming the same theme (see Table 10 for the six themes).

The analytical approach adopted was based on pattern-matching using the “ladder of abstraction” (see Figure 5) first outlined by Carney (1990 in Miles and Huberman, 1994). In this approach, after the categorization of information and the identification of patterns and themes, a “deep structure” of the data is then generated i.e. how the results are related to the explanatory framework on tax administration, equity and economic efficiency. A process that integrates the data into the explanatory framework then follows this process. This process involves the transcription of written notes, searching for themes and patterns in the responses and the analysis of relationships in the themes. This is essentially a process of “data transformation”. Information is condensed, categorized, sorted, and linked as we go up the

abstraction ladder (Miles and Huberman, 1994). Figure 5 shows Carney’s analytical ladder of abstraction.

Figure 5: The ladder of analytical abstraction



Source: Carney 1990 in Miles and Huberman, 1994: 92

Guided by the analysis structure in the Figure 5 above, the text from the interviews conducted with the 16 key informants and the 47 informal sector operators was captured into NVivo, a qualitative data analysis package. NVivo was mainly used to identify and categorize parts of the transcribed text and assist in executing search and retrieval operations. The software package was also used to identify frequently occurring words which were then used to build the themes emerging from the transcribed text. These themes were then analysed in the context of the research objectives. Supplemented by documentary data, a narrative case report focusing on the patterns emanating from the study and how these patterns were related to the research objectives was then generated for each of the informal sector cases.

Triangulation

To increase validity, the cross-checking of results from one aspect of the case study (for example, interviewing) was carried out with two other sources (for example, ZIMRA reports,

newspaper articles and data obtained from ZIMRA on presumptive tax revenues) through a process of both inter-method and intra-method triangulation. Essentially, triangulation is the combination of methods or data in the study of phenomena and has been described and used by many researchers (Sayer, 2000; Danermark, 2002; Carter and New, 2003). The aim, with this process of cross-checking results from one method with those from another method, is to achieve high levels of reliability and validity (Yin, 1994).

Different methods were used as part of the triangulation process and the need to balance the evidence provided by the various sources. Interviews with key respondents were conducted to elicit data from key informants. For these face-to-face interviews, interview guides were used and these guides consisted of the themes to be covered for a particular group of respondents. The interview method was chosen as it was judged to be the most appropriate research method for this type of research. As part of the triangulation process, document review involved the analysis of existing published and unpublished material related to informal sector taxation in Zimbabwe and comparing these documents with information emanating from the interviews. Secondary data obtained from ZIMRA on the research it carried out in 2003 on informal sector turnover and profitability were also analysed. This information was then evaluated and compared with the primary data gathered from informal sector operators on their current profits so as to support the balance of evidence and interpretations made in the study.

4.4.1 Assessing the capability to raise revenue

This study assesses ZIMRA's ability to raise revenue from the informal sector by analysing three interrelated dimensions on the basis of von Soest's (2007) model of the capability to raise revenue - the process, the output and the environment,. According to von Soest (2007), the process dimension analyses how the tax authority goes about its business of collecting tax revenue. In this study, the process dimension was assessed from the responses given by ZIMRA employees on how they go about collecting presumptive taxes from the informal sector, i.e. how they identify taxpayers, collect revenues from them and monitor compliance. The process dimension has an impact on the output dimension, which is about assessing the tax revenue collected (see Tanzi and Pellechio, 1995; also Eriksen, 1999). The output dimension was assessed from the data provided by ZIMRA not only on total revenues collected but also the revenues collected from the informal sector in the form of presumptive taxes. The environment (termed external factors in this study) is made up of the political and economic factors which have an overarching effect on any tax collection effort (i.e. the

underlying reasons for taxing the informal sector). Information obtained from the ZIMRA respondents on the tax authority's capability to raise revenues (and the challenges it faces) was compared with information from ZIMRA's own reports, newspaper articles and information from other key informants.

4.4.2 Assessing equity and efficiency using qualitative interviews

As pointed out earlier, equity and efficiency issues were not assessed using conventional public finance analysis. There is a paucity of economic data required for such an analysis in Zimbabwe (e.g. input-output tables and income/expenditure data). The assessment of equity and efficiency was therefore based on information from the tax code and the qualitative interviews that were conducted with ZIMRA officials and other key stakeholders such as informal sector operators, government officials, representatives of business organisations and academics.

To assess fairness, as will be described in more detail in Chapter Seven this study compares informal sector presumptive taxes with formal sector taxes - both personal and corporate income taxes. The issue of tax administration weaknesses was also explored. These weaknesses have not only resulted in a huge tax gap (the difference between potential tax revenues and actual revenues collected) and corruption but also different opportunities for evasion within the informal sector - a major source of inequity.

The analysis of horizontal and vertical equity in this study uses a method similar to the one used by Grown and Valodia (2010). While following essentially the same methodology as Grown and Valodia, who based their analysis on gender, taxpayers in this study were analysed based on whether they were in the formal or informal sector. For the comparative analysis of informal sector presumptive taxes vis-à-vis the formal sector income taxes, hypothetical examples were used, based on two types of taxpayers (drawn from both the formal and informal sector). The analysis of equity involves a comparison between individuals in the formal and informal sector at a hypothetical minimum level of earnings, twice this minimum and three times the hypothetical minimum. These earning levels were informed by the profits reported in the interviews with informal sector operators. The aim, with vertical equity, is to ascertain whether there are differences in the tax burden between taxpayers with the different levels of earnings. In terms of horizontal equity, the comparison is used to determine whether individuals with similar incomes have similar tax burdens. The analysis of equity also compared the presumptive taxes paid by the four different informal

sector activity classes. This was done to ascertain whether these taxes are fair even within the informal sector itself i.e. are some informal sector activities treated more harshly than others?

In addition to this analysis based on Grown and Valodia (2010), key informants were asked questions about their perceptions of presumptive taxes and whether these taxes were promoting equity. Key informants from ZIMRA were asked the questions “Are these taxes promoting equity vis-à-vis the formal sector (i.e. compared with formal sector income taxes)?” and “Are these taxes promoting equity within the informal sector?” The other key informants from academia, business organisations and the Ministry of Small and Medium Enterprise Development were asked the following question: “Do you feel that informal sector taxes have introduced a measure of equity vis-à-vis the formal?”

As explained in Chapter Two, taxes distort economic decisions creating an excess burden – a loss in welfare over and above the tax revenues collected. The excess burden is difficult to measure directly although it is real – there are usually observable tax-induced changes in behaviour when a tax is introduced. The assessment of economic efficiency therefore looked at whether there have been changes in the behaviour of informal sector operators in Zimbabwe since the introduction of presumptive taxes. This assessment was based on reported and observed behavioural changes by key informants and informal sector operators. In order to assess behavioural changes, informal sector operators were asked the questions “How has the payment of presumptive taxes affected your business?”, “Has this had any effect on where you operate from?” and “Has this had an effect on how you conduct your business?”. ZIMRA officials were asked the following question on observed behavioural changes as a result of presumptive tax implementation: “Have there been noticeable changes in behaviour among informal sector operators as a result of these taxes?” and “What changes have you noticed?”.

4.4.3 Governance

The literature mentions the importance of taxes being linked to benefits (services, broadly defined) in exchange for taxes paid (Therkildsen, 2006; Coolidge and Ilic, 2009). Quasi-voluntary tax payment is likely to be higher if taxpayers feel that they will get ‘value for money’ for the taxes that they are paying. This comes in the form of services and this study assessed the extent to which informal sector entrepreneurs felt that taxes were being used correctly - that they are getting appropriate services and accountable government in return for

the money that they are paying (see Prichard and Bentum, 2009 on Kenya National Taxpayers' Association). To what extent do informal enterprise owners feel that they are dealing with a legitimate government that represents their interests? The literature shows that high quasi-voluntary payment is possible when the government is perceived to be legitimate (Haggard, 1990 in von Soest, 2005: 55). While legitimate states use penalties as a viable way of reducing evasion, illegitimate ones rely on these penalties to collect taxes from reluctant citizens. To assess the issue of governance, informal sector operators were asked the following questions – “Are there any benefits for your business in paying these taxes?” and “Do you feel that taxes are put to good use by the government?”

4.4.4 Development

Apart from collecting revenues from the informal sector, the study assessed whether there was a role that the informal sector could play in the nation's development. Respondents from the Ministry of Small and Medium Enterprises Development (and other key informants such as trade unions and business organisations) were asked whether there were any strategies in place to encourage the growth and formalization of informal sector firms apart from merely taxing them. Key informants were asked the following question – “Other than contributing to the fiscus, do you feel that the informal sector has a role to play in the economy?”

4.5 Study limitations

Due to the fact that probability sampling is not used in the selection of cases, statistical generalization is not possible. A major study limitation was that a purposive sample is obtained according to the discretion of the researcher who is familiar with the relevant characteristics of the population. The sample of informal sector enterprise owners is obviously prone to bias and its adequacy is limited by the ability of the individual who selects the sample to accurately perceive the factors of interest.

The high refusal rates noted in Section 4.3 (particularly in the hairdressing salon and cottage industry sub-sectors) point to other possible ways in which the sample may be biased. In a study of tax payment behaviour, respondents will have different motivations for refusing to participate. For instance, more successful hairdressing salon operators who are not paying informal sector taxes are less likely to participate in such a study. Informal sector operators that are not registered with the municipality (e.g. unregistered minibuses and taxi-cab operators) are also unlikely to participate (as was the case in this study) as they are operating illegally.

Another potential source of bias was the study location. This study was conducted in Harare, Zimbabwe's largest city. The self-employed in Harare are more likely to be higher earners than the self-employed located elsewhere due to such things as a larger market, a wider range of goods, a better transport network and the "invisibility" that a large city may offer (i.e. they may be more difficult to locate by tax authorities). All these factors have implications on the study's findings on administration, equity and efficiency.

The methodology used does not therefore allow for the extrapolation of the findings to a wider population and the conclusions drawn do not necessarily apply to the urban informal sector enterprise owners as a whole. While it is possible to generalize and draw some inferences from the sample, the fact that random sampling was not used means that the findings from this study will, strictly speaking, describe the conditions of only these respondents.

However, in spite of the numerous articles pointing to the limitations of case study results in terms of their generalizability, Yin (2003) argues that the results from case studies are generalizable – analytically so. Clearly, because probability sampling is not used in the selection of cases, statistical generalization is not possible. The form of generalization that can be used is "analytic generalization" where the results obtained are analysed within the context of the theoretical approach (in this particular study, this involves analysing the results on institutional capability and other aspects of the tax system within the context of a crisis/failing state).

4.6 Concluding remarks

Although this is primarily a qualitative study that explores and describes how informal sector presumptive taxes are implemented, their equity and efficiency implications, and their relationship to formal sector taxes, use was also made of documentary analysis and, where possible, quantitative sources of data. This was done to increase the validity of the findings by providing data related to the research objectives from different sources. The information gathered from the 63 interviews (16 key informants and 47 informal sector operators) was compared with the quantitative data and documentary evidence through a process of triangulation. This made it possible to compare data on presumptive taxes collected between 2009 and 2011 and compare these data with ZIMRA's reported capability to effectively

collect taxes from the informal sector (i.e. assess its ability to administer informal sector presumptive taxes).

The next chapter is the first of the three results chapters of the thesis, which correspond with the three main objectives of the study. Chapter Five provides a detailed description of the informal sector tax system in Zimbabwe and how these taxes fit into Zimbabwe's broader tax system. The chapter draws predominantly on documentary analysis of tax legislation, the Ministry of Finance's economic policy statements and fiscal policy reviews and ZIMRA reports.

Chapter Five – The tax system in Zimbabwe and informal sector taxation

5.1 Introduction

The crisis in Zimbabwe has had a negative impact on many of the country's institutions. The country's infrastructure is in a terrible poor state and the health and education sectors are on the brink of collapse. However, as pointed out in Chapter Three, states are multi-dimensional. Although Zimbabwe is a failing state, there are institutions that are functioning, such as its financial system and the country's tax authority, ZIMRA. Even at the height of Zimbabwe's crisis in 2008, ZIMRA continued to operate and collect taxes under very difficult circumstances although, according to its own reports, ZIMRA has recently been failing to achieve its revenue targets (see ZIMRA, 2014a).

It was against this backdrop of falling revenues that ZIMRA was motivated to look at ways of taxing the informal sector in 2003 and presumptive taxes were introduced in 2005. The initial focus of informal sector taxation was on the transport sector which was made up of minibus taxis, taxi-cabs, driving schools and haulage trucks. ZIMRA's research team went around the country and collected data on the operations of these enterprises (i.e. their operational costs, turnover and profitability) with a view to taxing them. This research formed the basis of the recommendations on informal sector taxation that were submitted to the Ministry of Finance (which is responsible for setting tax rates).

Tax systems are complex. The way the different parts of the tax system work in conjunction with each other is also complicated. One of the main contributions of this thesis is the attempt to explain the way the tax system works with particular reference to the informal sector in Zimbabwe. I was unable to find any other research on this, hence the need for original documentary analysis, with additional clarification sought from key informants where possible.

This chapter is organized as follows. Section 5.2 describes Zimbabwe's tax system, the main taxes levied, namely, VAT, PIT and CIT, and the tax revenues collected after independence. Section 5.3 describes, in detail, the informal sector taxes that are levied in Zimbabwe. This section begins by presenting a summary of the research that was carried out by ZIMRA on public passenger transport operators between 2003 and 2005 in order to determine the profitability of their enterprises. The rest of this section details the other informal sector taxes

introduced after 2005. No research was conducted by ZIMRA on these sectors and, as will be explained below, the Ministry of Finance set these rates without consultation. Section 5.4 reviews the very limited literature on informal sector taxation in Zimbabwe, highlighting some useful insights from these papers. Section 5.5 concludes.

5.2 The tax system in Zimbabwe

The Zimbabwe Revenue Authority (ZIMRA), a semi-autonomous body that was formed in 2001, is responsible for collecting taxes in Zimbabwe. It was created from the merger of the former tax and customs departments (which were both departments in the Ministry of Finance). ZIMRA derives its authority from the Revenue Authority Act (Chapter 23:11) of 2010. The creation of ZIMRA meant that revenue collection, previously a core state function, was now effectively outsourced to a semi-autonomous organisation. However, while ZIMRA enjoys a degree of autonomy (with its own board of directors), it still reports to the Ministry of Finance. The Ministry of Finance is responsible for tax policy and ZIMRA's role is mainly that of implementing this policy through tax administration. ZIMRA also advises government on fiscal and economic matters (ZIMRA, 2014b).

The main statutory acts for the collection of tax revenue in Zimbabwe are the Income Tax Act (Chapter 23:06) of 2010, the Value Added Tax Act (Chapter 23:12) of 2010, the Capital Gains Act (Chapter 23:01) of 2003, the Finance Act (Chapter 23:04) of 2010, the Estate Duties Act (Chapter 23:03) of 2007 and the Customs and Excise Act (Chapter 23:02) of 2003. The taxation of the income of corporations, individuals, trusts as well as withholding taxes is covered by the Income Tax Act. Periodic changes to the tax acts are included in the Finance Act which also specifies changes in the tax rates (AFRODAD, 2011).

Other pieces of legislation related to taxation are the Urban Councils Act (Chapter 29:15) of 2008 and the Rural District Councils Act (Chapter 29:13) of 2010. These two acts do not fall under the direct ambit of the Ministry of Finance. However, they not only provide for the establishment and operation of local authorities but also stipulate how the financing of these councils' operations through taxes such as rates, water tariffs, levies and fines should be done. In Zimbabwe, local authorities also get grants from central government for health, water and sanitation and for capital expenditure.

According to the Income Tax Act of 2010, income is taxed on the basis of origin with tax levied on sources within Zimbabwe. Parastatals and state owned enterprises are exempt from corporate income tax (AFRODAD, 2011). There are a number of tax incentives for formal sector companies. These incentives are meant to promote exports and attract investment in sectors such as mining and tourism. The personal income tax has historically been the biggest source of revenue in Zimbabwe, contributing nearly 40 per cent of the tax revenue between 1996 and 2004. The sales tax (which was replaced by VAT in 2004) was in second position contributing an average of 24 per cent of the total tax revenue during the same period (AFRODAD, 2011: 16). However, VAT has become the major contributor to total revenue collected since dollarization in 2009. As shown in Table 11, personal income tax has remained lower than its historical level with VAT now the largest contributor to government revenues (contributing between 37 and 42 per cent of total revenues between 2009 and 2011). The “Other Taxes” revenue head includes revenues from domestic dividends, presumptive taxes, various levies and non-tax revenue (ZIMRA, 2010).

Table 11: Percentage revenue contribution, 1999-2011

| Year | VAT/Sales tax | Income tax ^a | Customs | Excise | Other taxes | Total |
|------|---------------|-------------------------|---------|--------|-------------|-------|
| 1999 | 22 | 53 | 15 | 5 | 4 | 100 |
| 2000 | 19 | 63 | 10 | 5 | 2 | 100 |
| 2001 | 23 | 57 | 14 | 4 | 2 | 100 |
| 2002 | 27 | 56 | 10 | 7 | 1 | 100 |
| 2003 | 29 | 55 | 7 | 7 | 2 | 100 |
| 2004 | 31 | 53 | 12 | 4 | 1 | 100 |
| 2005 | 30 | 49 | 10 | 3 | 8 | 100 |
| 2006 | 30 | 42 | 13 | 3 | 12 | 100 |
| 2007 | 32 | 47 | 6 | 4 | 11 | 100 |
| 2008 | 24 | 32 | 34 | 5 | 5 | 100 |
| 2009 | 42 | 25 | 24 | 8 | 2 | 100 |
| 2010 | 37 | 30 | 16 | 8 | 9 | 100 |
| 2011 | 40 | 33 | 12 | 11 | 4 | 100 |

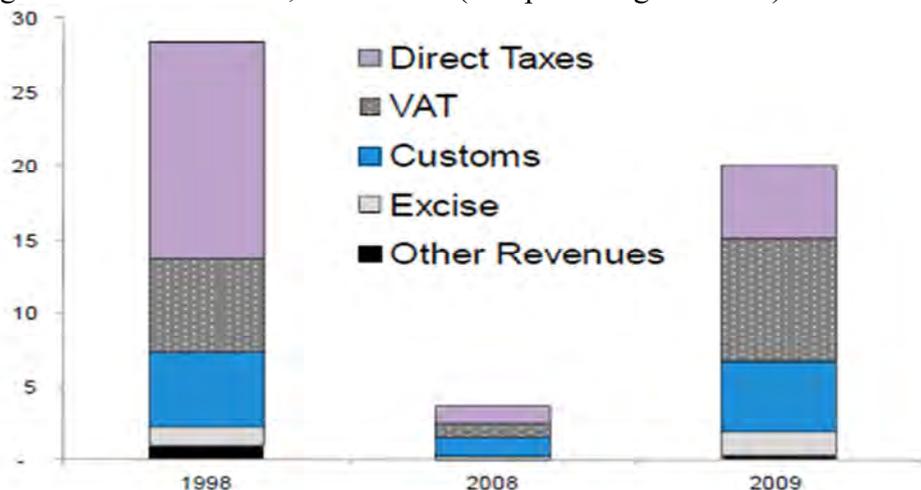
Source: IMF (2004: 18, 2005: 87, 2009: 25) and ZIMRA (2010, 2011, 2012)

^a Corporate and personal income tax

After dollarization and the new government’s economic recovery program of 2009, revenues showed signs of recovery, although they had not reached their pre-crisis (i.e. before 1998) levels by 2011 (two years after dollarization). The recovery of revenues, according to the IMF (2010), was largely due to price stability and a well-established and well-functioning revenue administration infrastructure that had existed before the crisis (and had continued to operate even during the crisis). Figure 6, which displays the contribution of the various

revenue heads (as a percentage of GDP) between 1998 and 2009, shows how revenue as a percentage of GDP did recover somewhat after 2008. However, direct taxes (PIT and CIT) remained low as a percentage of GDP, with the recovery driven mostly by the increase in VAT revenues as a percentage of GDP.

Figure 6: Total revenues, 1998–2009 (as a percentage of GDP) ^a



Source: IMF (2010: 52)

^a Other Revenues include presumptive taxes

5.2.1 VAT

Traditionally, sales tax revenues as a percentage of total government revenues have been low in Zimbabwe, averaging less than 24 per cent in the period 1980 to 1986 (Chelliah, 1986). Post-independence sales tax reforms began in 1985 with an increase in the general sales tax from 10 per cent to 20 per cent and another increase (to 25 per cent) in the same year. This rate was later lowered to 17.5 per cent in 1989, and again to 15 per cent in 2009. Changes to the Sales Tax Act were: the inclusion of sales tax on services (in 1998); and the adoption of VAT in January 2004 as a replacement for sales tax (Ndedzu et al., 2013: 146). VAT was introduced not only to replace sales tax but also several small taxes such as gaming, betting and some stamp duties.

VAT is levied on transactions rather than persons. It is charged every time a transaction is carried out by VAT registered operators, and will not depend on the profitability of the business. In Zimbabwe, VAT is also payable on the value of goods imported into the country (but some exemptions are allowed).

One of the reasons for the introduction of the VAT in Zimbabwe was to reduce the rampant evasion that existed under the sales tax. Many consumers were evading the sales tax in

Zimbabwe by either purchasing goods from wholesalers or by purchasing goods through an employer. The introduction of VAT has been largely successful in improving revenue collection by closing these loopholes in Zimbabwe's tax system (Zhou and Madhikeni, 2013).⁶⁷

Any person or business with taxable supplies exceeding US\$60,000 per year is liable to register for VAT. Those enterprises that have taxable supplies of less than US\$60,000 per year can opt for voluntary registration. The VAT to be refunded or payable to ZIMRA at the end of the month is calculated by the registered operator. The calculation involves the subtraction of input tax from the output tax. Input tax is the tax paid by the registered operator when goods or services that carry VAT are purchased. The output tax is the VAT charged by the registered operator on sales of taxable goods and services.

VAT is not a redistributive tax as it is payable at a flat rate by everybody and it can be regressive if the poor spend a larger share of their income on VAT-rated items. Zimbabwe, like many countries in the region, also has a long list of goods that are zero-rated or exempt from the VAT, including most agricultural items, basic foodstuffs, transportation of passengers and their goods by public roads, fuel, domestic water and electricity (IMF, 2010).

5.2.2 Income tax

Personal income tax in Zimbabwe is levied through the Pay as You Earn (PAYE) system. This tax on an individual's income from employment is based on the Income Tax Act (Chapter 23:06) of 2010, which was first enacted in 1967. The Act specifies the employee's earnings that are subject to tax and the rates that apply. The tax payable is calculated using the tax table in Table 12. After dollarization in 2009, the PAYE tax-free thresholds were adjusted on several occasions to reflect the constantly changing economic conditions in the country. The tax free threshold for income from employment was set at US\$150 a month when the economy was dollarized in 2009. This has been raised a number of times since: to US\$160 a month in 2009; to US\$175 a month in 2010; to \$225 in 2011; and to \$250 in 2012.

Zimbabwe's personal income tax system is progressive – the amount of tax paid as a proportion of income, increases with an increase in income. After dollarization, the maximum

⁶⁷ As a way of improving VAT collection from registered enterprises, the government has recently (2011) made the use of fiscalised electronic registers mandatory.

rate of tax was adjusted downwards from 37.5 per cent in 2009 to 35 per cent in 2010 (AFRODAD, 2011: 18). The maximum tax rate was increased to 45 per cent in 2012 (Table 12). Although employment benefits are taxable, ZIMRA allows deductions for such things as pension contributions and subscriptions to professional associations. ZIMRA also allows a number of credits to be offset against the income tax payable and these include medical expenses credit, incapacitated person credit and elderly person credit. The employer is responsible for calculating and collecting the income tax payable on behalf of ZIMRA. Individual returns are only submitted in the case of individuals with income from more than one source. Table 12 shows the PIT tax table in Zimbabwe as from 1 January 2012.

Table 12: Personal income tax applicable by income bracket, Zimbabwe, 1 January 2012

| Monthly table | | | | | | | |
|----------------------|-----------|-----------|--------|-------------|-----|--------|-------|
| Taxable income bands | | | | Rate | | | |
| from | - | to | 250 | multiply by | 0% | | |
| from | 250.01 | to | 1 000 | multiply by | 20% | Deduct | 50 |
| from | 1 000.01 | to | 2 000 | multiply by | 25% | Deduct | 100 |
| from | 2 000.01 | to | 5 000 | multiply by | 30% | Deduct | 200 |
| from | 5 000.01 | to | 7 500 | multiply by | 35% | Deduct | 450 |
| from | 7 500.01 | to | 10 000 | multiply by | 40% | Deduct | 825 |
| from | 10 000.01 | and above | | multiply by | 45% | Deduct | 1 325 |

Source: www.zimra.co.zw (Accessed 4 June 2012)

The other tax paid by individuals in Zimbabwe is the AIDS levy (paid by the employee and employer, each paying three per cent of the income tax payable). The income tax does not have a system of allowances for children and dependants. Tax deductions are therefore carried out according to the schedule in Table 12 (with an additional compulsory three per cent AIDS levy).

The corporate income tax in Zimbabwe is levied, according to the Income Tax Act (Chapter 23:06) of 2010, on business profits. Corporate income tax rates have, until recently, generally been high in Zimbabwe, hovering above 40 per cent of profit in the first two decades after independence (Zhou and Madhikeni, 2013: 53). The tax rate was reduced to 37.5 per cent in 2009.

Further tax reforms were implemented in 2010. The Income Tax Act used to allow for the deduction (from income) of expenses incurred in the earning of income and in carrying on a trade. These were dropped in the revised Income Tax Act to broaden the tax base (AFRODAD, 2011: 19). The corporate income tax rate was reduced to 35 per cent in 2010

before being further reduced to 30 per cent in 2011, and 25 per cent in 2012 (Zhou and Madhikeni, 2013: 53). This reduction in the CIT is notable given the fact that the government was trying to extract revenue from the informal sector. According to Zhou and Madhikeni (2013), the reduction in the corporate income tax rate, particularly after 2009, was due to the inclusive government's effort to attract foreign investors. In fact, many companies (both domestic and foreign owned), pay a much lower tax rate due to various incentives. According to ZIMRA (2014b), these incentives are meant to encourage employment creation and skills transfer, export promotion, small business development and income generation.

5.2.3 Customs and excise duties, capital gains tax and non-tax revenue

Customs duties are charged on most imports with basic commodities attracting lower rates than luxury items. Excise duties are levied on certain locally manufactured goods and some imported goods specified in terms of the Customs and Excise Act (23:02) of 2003. Excise duties are levied on goods such as alcoholic beverages, tobacco products, soft drinks. Capital Gains Tax (CGT), a tax levied on the capital gain arising from the sale or disposal of a specified asset, is levied at a rate of 20 per cent. Specified assets refer to immovable property (e.g. land and buildings) and any marketable security (e.g. debentures, shares, unit trusts, bonds and stock). This tax should be remitted by the seller or the agent. Fees for government services, mining royalties, toll gate fees and dividends contribute to non-tax revenue.

5.3 Informal sector taxes in Zimbabwe

As outlined in Chapter Two, the four main reasons in the literature for taxing the informal sector are: revenue, efficiency, equity and governance. In Zimbabwe, the focus by the Ministry of Finance and ZIMRA has been almost exclusively on the first of these, raising revenues. When the presumptive tax was introduced by the government on 16 August 2005, the Minister of Finance in his Mid-Term Fiscal Policy Review said:

In the 2005 Budget Statement, I alluded to the need to broaden the revenue base, in view of the increase in informal business activities. I am, therefore, proposing implementation of presumptive taxation on selected sectors of the economy during the course of the year, targeted at ensuring the participation of informal businesses in tax payment. This will be in line with the experiences of other developing countries (Government of Zimbabwe, 2005).

The interviews with key informants from ZIMRA provided a similar rationale for taxing the informal sector. The first question asked in these interviews was "What was the main

motivation for introducing informal sector taxes in Zimbabwe?”. All seven respondents cited revenue collection as the main motivation for informal sector taxation. According to one key informant “There was a realisation that the informal sector was performing well and that it also had to contribute through the payment of taxes” (Key Informant 10, ZIMRA, 6 September 2011). Another key informant said “There was a dramatic increase in the informal sector as a result of the economic meltdown. This is an attempt to widen the tax base by incorporating the informal sector” (Key informant 14, ZIMRA, 14 September 2011).

The Zimbabwean government’s attempts to tax the informal sector have taken the form of presumptive taxes. A presumptive tax is based on an indirect assessment of income. Tax liability is based on indicators (for example seating capacity of a minibus taxi) that are easier to measure than the tax base itself (i.e. taxable income) (Ahmad and Stern, 1991). Although a presumptive tax can apply inside the VAT or CIT systems, in Zimbabwe it operates inside the CIT. Most informal traders, being below the VAT registration threshold of US\$60,000 are already paying VAT (on their inputs). Therefore, these traders who are already paying VAT are expected to also pay the CIT (in the form of presumptive tax). The main objectives of these presumptive taxes are to simplify the tax administration process and collect some revenue from these firms. In Zimbabwe, presumptive taxes are a proxy for tax on business income. This is the reason why the methodology used for ‘presumption of tax’ in each of the informal sub-sectors had the same basis as that of CIT assessment, as will be explained in more detail below.

In describing the informal sector tax system in Zimbabwe, this section begins by explaining the research conducted by ZIMRA in order to inform the setting of the presumptive taxes in the transport sector. It details the resultant rates determined by the Ministry of Finance. It then goes on to detail the rates for the other affected sub-sectors, namely, cross-border traders, hairdressing salons, cottage industries, restaurants and bottle-stores.

Transport sector

The Zimbabwe Revenue Authority (ZIMRA) carried out research on various sub-sectors of the transport sector (i.e. minibus taxis, taxi-cabs, driving schools and goods vehicles) with a view to taxing them in 2003.

The research on informal sector presumptive taxes started in 2003. We treated every business as formal, estimated its level of profits using simulations. The results were then submitted to the Ministry of Finance who then pegged these [amounts] well above our recommendations, especially after dollarization - probably as a way of encouraging informal sector operators to formalise (Key Informant 15, ZIMRA, 29 September 2011).

Although the research that was done by ZIMRA covered transport operators i.e. public passenger transport operators (minibus taxis and taxi-cabs), driving schools and haulage trucks, this thesis focuses on public passenger transport operators (i.e. minibus taxis and taxi-cabs) as haulage trucks usually operate between cities and are therefore not as easily accessible. It is therefore the research that was conducted by ZIMRA on public passenger transport operators which is presented in detail in this section.

Table 13 contains the data that were obtained by ZIMRA from randomly sampled informal entrepreneurs that operated minibus taxis.⁶⁸ For each entrepreneur, the data on the number of minibus taxis that were owned, the size (i.e. seating capacity), the number of daily trips, maintenance and service costs, estimated turnover and estimated profits are shown in the table. Estimates of the enterprise's turnover were then calculated based on the number of trips and fares charged. The profit figure was then estimated after taking all of the enterprise's operational costs into account (this is the profit before tax).

Table 13: Minibus taxi turnover and profit estimates (ZW\$)

| # of buses | SEATING CAPACITY | | | | No of daily trips | Daily fuel litres /car | Monthly service | Monthly repairs | Cost of servicing \$ | Cost of repairs \$ | Est. monthly gross turnover | Monthly profit est. \$ | Monthly profit est. % |
|------------|------------------|-------|-------|-------|-------------------|------------------------|-----------------|-----------------|----------------------|--------------------|-----------------------------|------------------------|-----------------------|
| | 0-16 | 17-20 | 21-30 | 31-36 | | | | | | | | | |
| 1 | X | X | 1 | X | 2 | 140 | 2 | 1 | 6 000 000 | 4 000 000 | 48 000 000 | 12 000 000 | 25% |
| 1 | X | X | X | 1 | 2 | 120 | 4 | 1 | 8 000 000 | 6 000 000 | 64 800 000 | 15 000 000 | 23% |
| 1 | X | 1 | X | X | 23 | 40 | 3 | 1 | 2 000 000 | 6 000 000 | 18 400 000 | 9 000 000 | 49% |
| 4 | 4 | X | X | X | 16 | 60 | 2 | 1 | 2 000 000 | 1 000 000 | 13 248 000 | 7 000 000 | 53% |
| 3 | 3 | X | X | X | 2 | 200 | 2 | 1 | 1 000 000 | 5 000 000 | 18 000 000 | 3 000 000 | 17% |
| 2 | 2 | X | X | X | 12 | 45 | 3 | 1 | 2 500 000 | 1 000 000 | 12 000 000 | 7 000 000 | 58% |
| 4 | X | X | 4 | X | 16 | 35 | 1 | 1 | 6 000 000 | 4 000 000 | 50 000 000 | 10 000 000 | 20% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

⁶⁸ The information in this section on the research carried out by ZIMRA was obtained by the researcher from ZIMRA's research department in 2012.

Table 14 shows the tax calculations using the turnover and profit data from Table 13. The turnover and profit figures used in Table 14 for each of the minibus taxis of different sizes were generated by calculating the average turnover and profit figures from Table 13. For example, the three entrepreneurs who had a total of nine minibus taxis with a carrying capacity of 0-16 (highlighted in Table 13 using a thick border) had a combined estimated monthly gross turnover of ZW\$43,248,000. The estimated total profit from Table 13 for the three entrepreneurs was ZW\$17,000,000. This results in an estimated average turnover of ZW\$14,416,000 (i.e. total turnover ZW\$43,248,000 divided by three entrepreneurs) and an estimated average profit of ZW\$5,666,667 (i.e. estimated profit of 17,000,000 divided by three entrepreneurs) per month per minibus taxi. The initial simulation used a tax rate of 30 per cent (which was the CIT rate in 2005 when these simulations were done). This resulted in a tax payable amount of ZW\$1.7 million and a tax/turnover ratio of 12 per cent (for the minibus taxi with a carrying capacity of 0-16 passengers) shown in Table 14. The same method was then used to calculate the tax payable and tax/turnover ratios for the other minibus taxi sizes (i.e. those with a carrying capacity of over 16 passengers).

Table 14: Minibus taxi monthly average profit and tax rate of 30 per cent (ZW\$)

| Omnibus size | Monthly Averages | | | | | |
|--------------|-----------------------|------------|------------|-----------|---------------------|------------------------|
| | Service /repairs cost | Turnover | Profit | Tax @ 30% | Tax /turnover ratio | Profit /turnover ratio |
| 0 - 16 | 4 500 000 | 14 416 000 | 5 666 667 | 1 700 000 | 12% | 39% |
| 17 - 20 | 8 000 000 | 18 400 000 | 9 000 000 | 2 700 000 | 15% | 49% |
| 21 - 30 | 10 000 000 | 48 000 000 | 12 000 000 | 3 600 000 | 8% | 25% |
| 31 - 36 | 14 000 000 | 64 800 000 | 15 000 000 | 4 500 000 | 7% | 23% |
| | | | | Average | 10% | 34% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

The estimated turnover and profit figures from Table 14 were also used with a tax rate of 18 per cent, giving a tax payable amount of ZW\$1.02 million and a tax/turnover ratio of seven per cent for those minibus taxis with a carrying capacity of 0-16 passengers. Table 15 shows these figures based on a tax rate of 18 per cent.

Table 15 Minibus taxi monthly average profit and tax rate of 18 per cent (ZW\$)

| Omnibus size | Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
|--------------|-----------------------|------------|------------|-----------|---------------------|------------------------|
| 0 - 16 | 4 500 000 | 14 416 000 | 5 666 667 | 1 020 000 | 7% | 39% |
| 17 - 20 | 8 000 000 | 18 400 000 | 9 000 000 | 1 620 000 | 9% | 49% |
| 21 - 30 | 10 000 000 | 48 000 000 | 12 000 000 | 2 160 000 | 5% | 25% |
| 31 - 36 | 14 000 000 | 64 800 000 | 15 000 000 | 2 700 000 | 4% | 23% |
| Average | 9 125 000 | 36 404 000 | 10 416 667 | 1 875 000 | 6% | 34% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

According to ZIMRA, the rate of 18 per cent was chosen on “fairness grounds”. According to one key informant:

The use of 18 per cent was after realising that this was the average rate of tax on registered corporates after taking into account some allowable deductions that the informal operators would never be able to claim for deduction given that they are not registered for CIT. Hence, on fairness grounds, we presumed that if allowable deductions were to be claimed and granted to these informal operators like the formal business would before we tax them at 30 per cent, then using the Tax:Taxable Income ratio of 18 per cent instead of using the Tax:Taxable Income ratio of 30 per cent was the fairest thing to do (Key Informant 15, email, ZIMRA, 22 October 2014).

Due to the high rate of inflation in 2005, ZIMRA also converted the Zimbabwe dollar figures used in its calculations to United States dollars⁶⁹. There were two exchange rates during the period of hyper-inflation in Zimbabwe – the official rate and the ‘parallel’ (i.e. black market) rate. In July 2005, the official exchange rate was US\$1 to ZW\$10,800 while the parallel market rate was US\$1 to ZW\$35,000 according to ZIMRA. The IMF also calculated its own estimate of “the exchange rate that would prevail under a unified exchange rate regime” (the equilibrium nominal exchange rate) of US\$1 to ZW\$16,187.80 for June 2005 (IMF, 2005: 40). Table 16 shows the calculations from Table 14 using the official exchange rate of US\$1 to ZW\$10,800.

⁶⁹ This was done for purposes of simulation only as taxes were paid in Zimbabwe dollars during this period.

Table 16: Minibus taxi monthly average profit and tax rate of 18 per cent (official US\$ rate)

| Monthly averages (US\$) | | | | | | Official exchange rate as @ 25 July 2005: 10 800 |
|-------------------------|----------------------|----------|------------|-----------|--------------------|---|
| Omnibus size | Service /repair cost | Turnover | Net profit | Tax @ 18% | Tax/turnover ratio | Profit /turnover ratio |
| 0 - 16 | 417 | 1 335 | 525 | 94 | 7% | 39% |
| 17 - 20 | 741 | 1 704 | 833 | 150 | 9% | 49% |
| 21 - 30 | 926 | 4 444 | 1 111 | 200 | 5% | 25% |
| 31 - 36 | 1 296 | 6 000 | 1 389 | 250 | 4% | 23% |
| Average | 845 | 3 371 | 965 | 174 | 6% | 34% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

The turnover, profit, tax payable and tax/turnover ratio from Table 14 using the lower parallel market rate of US\$ 1 to ZW\$35,000 are shown in Table 17. The same figures from Table 14, using the IMF estimated unified rate of US\$1 to ZW\$16,187.80, are shown in Table 18. The two tables are included here even though the ratios are the same because the research for this thesis, which was conducted between 2011 and 2014, produced similar absolute values of profitability to the IMF United States dollar rate, which is useful for comparison purposes. I will refer to this again below.

Table 17: Minibus taxi monthly average profit and tax rate of 18 per cent (parallel US\$ rate)

| Monthly averages (US\$) | | | | | | Parallel exchange rate as @ 25 July 2005: 35 000 |
|-------------------------|----------------------|----------|------------|-----------|--------------------|---|
| Omnibus size | Service /repair cost | Turnover | Net profit | Tax @ 18% | Tax/turnover ratio | Profit /turnover ratio |
| 0 - 16 | 129 | 412 | 162 | 29 | 7% | 39% |
| 17 - 20 | 229 | 526 | 257 | 46 | 9% | 49% |
| 21 - 30 | 286 | 1 371 | 343 | 62 | 5% | 25% |
| 31 - 36 | 400 | 1 851 | 429 | 77 | 4% | 23% |
| Average | 261 | 1 040 | 298 | 54 | 6% | 34% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

Table 18: Minibus taxi monthly average profit and tax rate of 18 per cent (IMF US\$ rate)

| Omnibus size | Monthly averages (US\$) | | | | Parallel exchange rate as @ June 2005: 16 187.8 | |
|--------------|-------------------------|----------|------------|-----------|---|------------------------|
| | Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
| 0 - 16 | 278 | 891 | 350 | 63 | 7% | 39% |
| 17 - 20 | 494 | 1137 | 556 | 100 | 9% | 49% |
| 21 - 30 | 618 | 2965 | 741 | 133 | 5% | 25% |
| 31 - 36 | 865 | 4003 | 927 | 167 | 4% | 23% |
| Average | 564 | 2249 | 643 | 116 | 6% | 34% |

Source: Own calculations based on ZW\$ figures from ZIMRA

The ZIMRA research team noted a number of issues that had a negative impact on the operations of those in the public passenger transport sub-sector. The main issues noted were: the expensive spare parts; police bribes; bad roads that lead to frequent repairs; low fares paid by customers; and variations in income (based on the time of the month).

A similar method to that used for minibus taxis was also implemented in analysing the operations and profitability of taxi-cabs. Table 19 shows the calculations that were used by ZIMRA to determine the profitability of the 37 taxi-cabs in the study.

Table 19: Taxi-cab turnover and profit estimates

| No of cabs | No of daily trips/cab | Daily fuel usage /car (litres) | Monthly services | Cost of servicing (ZW\$ Mill.) | Cost of repairs (ZW\$ Mill.) | Monthly profit est. (ZW\$ Mill.) |
|------------|-----------------------|--------------------------------|------------------|--------------------------------|------------------------------|----------------------------------|
| 22 | 15 | 135 | 1 | 2.5 | 2.5 | 6 |
| 3 | 10 | 35 | 1 | 1.4 | 2.5 | 2.5 |
| 12 | 8 | 10 | 1 | 0.2 | 2 | 5 |
| Average | | | | 1.366667 | 2.333333 | 4.5 |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

The average estimated monthly profit of ZW\$4.5 million from Table 19 was used for the tax calculations in Table 20. Table 20 uses a tax rate of 30 per cent (the CIT rate in 2005) which results in a tax payable amount of ZW\$1.3 million and a tax/turnover ratio of 11 per cent. The average estimated monthly profit of ZW\$4,500,000 from Table 20 is used in Table 21 but with a tax rate of 18 per cent, resulting in a taxable amount of ZW\$810,000 and a tax/turnover ratio of seven per cent. Table 22 shows the turnover, profit, tax payable and

tax/turnover ratio at a tax rate of 18 per cent in United States dollars at the official rate of US\$1 to ZW\$10,800. Table 23 shows the turnover, profit, tax payable and tax/turnover ratio from Table 20 using the parallel market exchange rate of US\$1 to ZW\$35,000. Table 24 shows the turnover, profit, tax payable and tax/turnover ratio from Table 20 using the IMF exchange rate of US\$1 to ZW\$16,187.80, which is useful for comparison purposes.

Table 20: Taxi-cab profit and tax rate of 30 per cent (ZW\$)

| Service /repairs cost | Turnover | Net profit | Tax @ 30% | Tax /turnover ratio | Profit /turnover ratio |
|-----------------------|------------|------------|-----------|---------------------|------------------------|
| 3 700 000 | 12 000 000 | 4 500 000 | 1 350 000 | 11% | 38% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

Table 21: Taxi-cab profit and tax rate of 18 per cent (ZW\$)

| Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
|-----------------------|------------|------------|-----------|---------------------|------------------------|
| 3 700 000 | 12 000 000 | 4 500 000 | 810 000 | 7% | 38% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

Table 22: Taxi-cab profit and tax rate of 18 per cent (official US\$ rate)

| Monthly averages | | | | | |
|--|----------|------------|-----------|---------------------|------------------------|
| Official exchange rate as @ 25 July 2005: 10 800 | | | | | |
| Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
| 343 | 1 111 | 417 | 75 | 7% | 38% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

Table 23: Taxi-cab profit and tax rate of 18 per cent (parallel US\$ rate)

| Monthly averages | | | | | |
|--|----------|------------|-----------|---------------------|------------------------|
| Parallel exchange rate as @ 25 July 2005: 35 000 | | | | | |
| Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
| 106 | 343 | 129 | 23 | 7% | 38% |

Source: ZIMRA, Research department (2012) based on 2003-2005 analysis

Table 24: Taxi-cab profit and tax rate of 18 per cent (IMF US\$ rate)

| Monthly averages | | | | | |
|---|----------|------------|-----------|---------------------|------------------------|
| Parallel exchange rate as @ June 2005: 16 187.8 | | | | | |
| Service /repairs cost | Turnover | Net profit | Tax @ 18% | Tax /turnover ratio | Profit /turnover ratio |
| 229 | 741 | 278 | 50 | 7% | 38% |

Source: Own calculations based on ZW\$ figures from ZIMRA

The operational challenges noted by the ZIMRA research team for taxi-cab operators were: few customers; expensive spares and tyres; and the unavailability of loans for the purchase of new vehicles.

The recommendations made to the Ministry of Finance in 2005 on presumptive tax amounts for minibus taxis and taxi-cabs were based on these research findings (i.e. Table 15 for minibus taxis and Table 21 for taxi-cabs at the lower rate of 18 per cent). The presumptive taxes announced by the Minister of Finance in August 2005 are shown in Table 25. The initial list of informal sector activities that were covered by the presumptive tax was fairly short. As can be seen from the table, the presumptive taxes announced by the Ministry of Finance were much higher than those recommended by ZIMRA. However, it is important to note that taxes were being set in an extremely volatile hyperinflationary environment. This is likely to have been part of the reason why the Ministry of Finance felt it necessary to set much higher rates than had been recommended by ZIMRA. According to Zhou and Madhikeni (2013: 53), the inflation rate for 2005 was 622.8 per cent.

Table 25: Presumptive taxes 2005

| Operators of: | Description | Presumptive tax (ZW\$) | Presumptive tax (US\$) @10 800 |
|---------------|---------------------|------------------------|--------------------------------|
| Omnibuses | 15 to 24 passengers | 6 000 000 | 556 |
| | 24 to 36 passengers | 12 000 000 | 1111 |
| | Up to 37 passengers | 18 000 000 | 1667 |
| Taxi-cabs | All | 6 000 000 | 556 |

Source: Compiled from Government of Zimbabwe (2005). Own calculations of presumptive tax in US\$

Apart from the transport operators' taxes in Table 25, presumptive taxes in 2005 were also introduced for small-scale miners (presumptive tax of 5 per cent, based on gross value of mineral, precious metals and stones) and informal traders (an amount equal to 10 per cent of the rent paid for business premises by informal traders).⁷⁰ In 2007, goods vehicle operators were added to the presumptive tax schedule (as pointed out earlier, ZIMRA did carry out research on the operations of goods vehicles although details are not provided here).

A number of other informal sector activity classes were added in 2008, namely, hairdressing salons and cross-border traders. Due to hyperinflation, the presumptive tax amounts were

⁷⁰ The informal traders' tax on rent was actually introduced in 1998 although it was not called a presumptive tax. The presumptive tax introduced in 2005 was meant to replace this informal traders' tax on rent (Finance Bill, 2005).

revised yearly. In 2009, the cottage industries and bottle stores were also added. Table 26 shows the presumptive tax schedule used in 2010 and 2011. As mentioned earlier, apart from the transport operators, there were no data collected by ZIMRA on the operations and profitability of these other informal sector activities. The presumptive tax figures were set by the Ministry of Finance without consulting ZIMRA. All the presumptive taxes that were levied in Zimbabwe in 2011 are shown in Table 26 and are described below.

Cross-border traders' presumptive tax

According to the Income Tax Act (Chapter 23:06) of 2010, cross-border traders are persons who import goods with the intention of carrying on trade in the goods. These traders are charged a 10 per cent presumptive tax on the value of the imported goods, called the value for duty purposes (VDP). According to ZIMRA (2014b) "The only exception is cases where the trader is registered with ZIMRA for Income Tax purposes and is up to date with submission of tax returns and payment of all taxes due". Cross-border traders' presumptive tax was introduced in 2008.

Hairdressing salon operators

According to the Income Tax Act (Chapter 23:06) of 2010, a hairdressing salon is an establishment that has one or more hairdressers whether or not the salon itself or the hairdressers in that salon are licensed with the municipality. According to ZIMRA (2014b), the operator of a hair dressing salon is required to pay presumptive tax amounting to US\$1,500 per quarter. Any presumptive taxes that are not paid by the due date are subject to interest charges. Hairdressing salon presumptive tax was introduced in 2008.

Cottage industry operators

Cottage industry operators, whether or not their operations are licensed with the municipality, are expected to pay a presumptive tax of US\$300 per quarter according to the Income Tax Act (Chapter 23:06) of 2010. Interest is charged where taxes are not paid by the due date. Cottage industry presumptive tax was introduced in 2009.

Presumptive tax on rental income

All informal traders are supposed to pay presumptive tax to the landlord for the premises that they use for their business operations. According to ZIMRA (2014b):

All persons in receipt of rental income from an informal trader in respect of residential accommodation, premises or a place on which trade is carried on are required to withhold an additional amount of Presumptive Tax equal to 10 per cent of the rental and remit to ZIMRA. This includes local authorities. Failure to recover or remit the Presumptive Tax renders the lessor personally liable for the payment of the Presumptive Tax and a penalty of 100% of the amount due.

There are exemptions for those informal sector operators who have paid presumptive taxes. According to the Income Tax Act (Chapter 23:06) of 2010, “Provided that the lessor shall not recover any such amount where the informal trader produces to the lessor a valid tax clearance certificate in respect of the income received by or accruing to him from his trade”. Informal traders’ presumptive tax on rent was introduced in 2005.

Small-scale miners’ presumptive tax

Agents who buy precious minerals from small-scale miners are required to withhold two per cent of the amount payable as presumptive tax unless the small-scale miner can produce a valid tax clearance certificate. Failure by the agent to collect the presumptive tax from the miner “renders the agent liable for payment of the tax, penalties at 100% and interest charges” (ZIMRA, 2014b). Small-scale miners’ presumptive tax was introduced in 2008.

Operators of restaurants or bottle-stores

According to the presumptive tax schedule, the operator of a restaurant or bottle store is required to pay presumptive tax amounting to US\$300 per quarter. Interest is chargeable on all amounts not paid by the due date. The restaurant and bottle-store presumptive tax was introduced in 2009.

Table 26: Presumptive tax 2010-2011

| Type of activity: | Description | Presumptive tax (USD per quarter for each vehicle) 2010 & 2011 |
|----------------------|--|---|
| Omnibuses | 8 to 14 passengers | 150 |
| | 15 to 24 passengers | 175 |
| | 25 to 36 passengers | 300 |
| | From 37 passengers and above | 450 |
| Taxi-cabs | All | 100 |
| Driving schools | Class 4 vehicles | 500 |
| | Class 1 and 2 vehicles | 600 |
| Goods vehicles | More than 10 tonnes but less than 20 tonnes | 1 000 |
| | More than 20 tonnes | 2 500 |
| | 10 tonnes or less but with combination of truck and trailers of more than 15 but less than 20 tonnes | 2 500 |
| Cross-border trading | 10 per cent of value of goods imported | |
| Informal traders | 10 per cent of rental amount | |
| Hairdressing salons | | 1 500 |
| Cottage industries | | 300 |
| Bottle-stores | | 300 |
| Small-scale miners | 2 per cent of value of minerals | |

Source: www.zimra.co.zw (Accessed 11 November 2011)

Finally, all enterprises in Zimbabwe that fail to produce the ITF 263 are liable to a withholding tax. An ITF 263 is a tax clearance certificate. ZIMRA issues this certificate to those who are fully tax compliant (i.e. those businesses or individuals whose income tax, Value Added Tax and PAYE returns are up to date). Although not specifically aimed at informal traders, the withholding tax for those who fail to produce the ITF 263, which was introduced in 2005, is paid when goods and services are sold to formal sector companies. There is a requirement for all tax registered firms purchasing goods and services from non-registered business to withhold 10 per cent of the price as tax and remit this to ZIMRA. According to Section 80 of the Income Tax Act (23:06) of 2010:

All registered business operators including Government quasi-government and statutory corporations who enter into any contracts which result in an obligation to pay any amounts totalling or aggregating US \$250.00 or more are required to withhold 10 per cent of each amount payable to payees without a valid tax clearance certificate.

The non-registered firms that have been charged this tax can then offset this tax against the taxes owed to ZIMRA, although in many cases this ends up being a final tax.

5.4 Informal sector taxation in Zimbabwe: A literature review

As explained in the introduction, when this research began, there were no other studies on informal sector taxation in Zimbabwe. In the last year, two papers have been published. The first study by Utaumire et al. (2013) is on the effectiveness of the presumptive tax, and the more recent study by Zivanai et al. (2014) is on the impact of the presumptive tax on minibus taxi operators. This section summarises the methodology and findings from these two studies. It also highlights useful insights from this work and how some of the findings are in line with the research of this thesis. Lastly, it identifies how this thesis contributes further by addressing issues not dealt with in these two papers.

The aim of the study by Utaumire et al. (2013) was to evaluate the effectiveness of the presumptive tax system in Zimbabwe, using ZIMRA's Region One (Kariba, Chinhoyi, Kurima House Station and Municipality of Kariba) as a case study.⁷¹ The study purposively selected 100 ZIMRA officials, 180 informal traders and 20 local authority employees and used questionnaires and interviews to obtain information. The informal traders in the sample were chosen, according to Utaumire et al. (2013: 117), because "the selected [participants] were presumed to be the most knowledgeable participants since they are the major payers with regard to presumptive tax." Utaumire et al. (2013) do not explain how they arrive at this assumption as informal sector tax revenues are not disaggregated by sub-sector.⁷²

Utaumire et al. (2013: 114) assert that Zimbabwe's informal sector is a potential source of tax revenue, given this sector's contribution to GDP (which they put at 60 per cent). However, their findings indicate that the revenues generated through presumptive taxes have been low due to the high levels of non-compliance. The results showed that many of those in the informal sector did not know about presumptive taxes. According to Utaumire et al. (2013: 118), the lack of "stakeholder" participation in the determining of tax rates resulted in "spirited resistance" from those in the informal sector. They also found that ZIMRA was weak in monitoring compliance and educating informal sector operators about presumptive

⁷¹ The authors do not explain what is meant by "effectiveness". Kariba is a town in northern Zimbabwe which is about 278km from the capital, Harare.

⁷² The article was less than five pages long and therefore very little detail was available on methods and results.

taxes. Many of these findings from ZIMRA Region One support the findings of this thesis from Harare as detailed in the next chapter.

However, this study by Utaumire et al. (2013) does not provide any indication of the extent of tax compliance among the respondents in the study (i.e. apart from reporting that “most” respondents were ignorant of these taxes). It is also not clear what these 180 informal traders were doing (i.e. which activity classes they belonged to). There are different informal sector activities in Zimbabwe which pay different presumptive tax amounts, with some being more “visible” (to tax authorities and the police) than others. It is also clear that Utaumire et al.’s (2013) initial assumptions on the knowledge of presumptive taxes and the tax payment behaviour of these 180 respondents (that were purposefully selected to participate in the study) were wrong since, as it turned out, most of them did not know about these taxes. Furthermore, 100 ZIMRA officials were interviewed in this study although the paper does not elaborate on the responses about the challenges faced (by ZIMRA) in administering these taxes.

The recent study by Zivanai et al. (2014) assessed the effect of presumptive taxes on the viability of minibus taxi operators in Bindura,⁷³ and the effectiveness of ZIMRA’s awareness campaigns (i.e. the relationship between awareness and compliance). The study found that although the vast majority of minibus taxi operators knew about the existence of presumptive taxes, ZIMRA could do more to educate those in this sector about these taxes. The study also found that while presumptive taxes were poorly administered, the effective implementation of these taxes would have a negative impact on taxpayers. A questionnaire was administered to a simple random sample of 40 respondents (five of whom were also interviewed) from a target population of 67 minibus operators in Bindura. The data suggest that the majority of these minibus taxi operators were not paying the presumptive tax (Zivanai et al., 2014: 15).⁷⁴ Consistent with this, the study found that 95 per cent of the respondents thought that presumptive taxes were high or too high and two-thirds of the respondents said that they should not pay these taxes given the other fees that they were paying such as license fees and

⁷³ Bindura is a town about 88km north-east of Harare.

⁷⁴ It should be noted that Zivanai et al (2014) do not explicitly state that none of the respondents in the sample were paying presumptive tax. I inferred the level of tax compliance from the responses to the question – “If your business has not been paying presumptive tax, what is the reason for avoidance?”. All the minibus taxi operators responded to this question giving various reasons for this non-compliance. I took this to mean that none of them were paying these taxes as questions in tax compliance research tend to be indirect (see Gerxhani, 2007).

toll fees (Zivanai et al., 2014: 14). When asked why they were not paying presumptive taxes, 40 per cent said that it was because others were not paying, 35 per cent said that they did not know where to pay, and 15 per cent said that paying these taxes would increase their “operating costs”. Only 10 per cent of those who were not paying said that they did not know about presumptive taxes (Zivanai et al., 2014: 14). The results on the knowledge of presumptive taxes in this study seem to contradict those from Utaumire (2013). However, it is important to note that Zivanai et al. (2014) focused on minibus taxi operators, an informal sector activity class that is highly targeted by ZIMRA and the police in terms of presumptive tax compliance monitoring whereas Utaumire (2013) focused on informal traders.

A major recommendation by Zivanai et al. (2014), based on the results from the study, is that of lowering the presumptive tax amounts. The respondents were asked the question “Which one of the following measures do you think should be used by ZIMRA to encourage improved presumptive tax payments?” which had four responses, each with a five-item likert-type scale: 1) Conduct tax seminars 2) Reduce presumptive tax 3) Prosecution and 4) Engage tax agents. Thirty-eight respondents (95 per cent) either agreed or strongly agreed with the response on the reduction of presumptive taxes and only 18 per cent either agreed or strongly agreed with the response on prosecution. This led Zivanai et al. (2014: 18) to conclude that this “indicates that taxpayers would pay more tax to ZIMRA if taxes were reduced (38/40) than any other method to encourage payment. Prosecution drew the least encouragement (7/40) because taxpayers would still evade presumptive tax”.⁷⁵ The other recommendations were the involvement of transport operators in determining the presumptive tax amounts, increasing tax awareness campaigns, and better monitoring methods (especially through the use of technology).

Although the study by Zivanai et al. (2014) suggests that few of the respondents were paying tax, they go on to conclude that the effective implementation of these taxes would have a negative effect on minibus taxi operators (based on the responses from the respondents). However, this conclusion was arrived at without any attempt being made to ascertain these operators’ profit or turnover levels. Also, one of the aims of the study was to assess the relationship between awareness and tax compliance. While the results do indicate that many (35 per cent) of the respondents reported that they were not paying because they did not know

⁷⁵ Of course this is speculative as most taxpayers would like to see tax rates reduced and none want to be prosecuted.

where to pay, the majority of respondents (40 per cent) said that they were not paying because others were not paying. This finding was not analysed in any meaningful way in the article with the authors choosing to focus instead on awareness. These issues that were not developed further relate to the equity implications of these taxes, which this thesis hopes to contribute to in Chapter Seven.

5.5 Concluding remarks

This chapter described Zimbabwe's tax system and the tax revenues collected after independence. The chapter began by describing the main taxes in Zimbabwe i.e. the VAT, PIT and CIT. It then went on to show how the amounts collected from these taxes had changed after dollarization in 2009 and how the VAT has become Zimbabwe's most important tax. It was the low tax revenues from the small formal sector that have motivated the government to increasingly view the growing informal sector as a source of tax revenue. The chapter then went on to describe the informal sector tax structure in Zimbabwe. The research that was carried out on public passenger transport operators by ZIMRA between 2003 and 2005 with a view to taxing them was described first. This description outlined the method and the calculations that ZIMRA used in determining the turnover and profitability of transport operators and the simulations used to derive the various tax/turnover ratios. The chapter showed how even though the results of this research were supposed to be used to inform the first presumptive taxes that were announced by the Ministry of Finance in 2005, the Ministry of Finance set rates much higher than those recommended. The chapter then went on to show how the other informal sector activity classes were added to the presumptive tax schedule without any data on turnover and profitability being collected and the tax rates/amounts that were levied.

Finally, the chapter reviewed the recent work on informal sector taxation in Zimbabwe. The chapter shows that this small literature, which has focused mainly on the challenges in the implementation of presumptive taxes, has found that the levels of non-compliance are very high. Among the reasons cited for these high levels of non-compliance are such things as the lack of awareness of these taxes by informal sector operators, the culture of non-compliance, the perception that these taxes are too high and the lack of stakeholder involvement. These findings are consistent with the description of how the Ministry of Finance set the tax amounts provided in Section 5.3 of this chapter. They are also consistent with many of the findings laid out in the next chapter, which details the results based on key informant and

informal sector operator interviews with respect to the implementation and administration of informal sector taxes in Zimbabwe.

Chapter Six - Administering informal sector taxes

6.1 Introduction

This chapter looks at one of the three criteria of a good tax system as defined in the public economics literature - the ease with which informal sector taxes are administered (i.e. administrative effectiveness). The other two criteria of a tax system i.e. economic efficiency and equity will be the subject of Chapter Seven. Although most public finance analyses on what constitutes a good tax system list the issue of administrative effectiveness after economic efficiency and equity, it will be analysed first in this study. This is due to the fact that the way informal sector taxes are administered in Zimbabwe (e.g. the selective application of tax regulations) also has an impact on both equity and efficiency. This chapter presents the findings based on the analysis of quantitative data from ZIMRA on the size of revenues collected as well as those that emerged from the primary sources, interviews and case studies with key informants and informal sector operators. To recap, the 16 key informants were drawn from ZIMRA, the Ministry of Small and Medium Enterprises Development, academia and business organisations, and 47 informal sector operators were drawn from the transport, flea market, hairdressing salon and cottage industry sub-sectors. While the informal sector does pay other taxes such as the VAT (which operates as an input tax, see Chapter Two) and withholding tax for those who fail to produce the ITF 263 tax clearance certificate (see Chapter Five), this chapter will focus mainly on presumptive taxes as these were designed specifically to target this sector.⁷⁶

This chapter is organised as follows. Section 6.2 looks at the way informal sector taxes are administered by ZIMRA - the challenges that it faces and some of its successes. In particular, this section highlights the increases in the amount of revenue collected from the informal sector since dollarization in 2009. It also covers both the internal and external challenges that ZIMRA has faced in taxing the informal sector. Section 6.3 analyses the challenges the informal sector operators face in complying with tax regulations including the high tax rates,

⁷⁶ Note that an analysis of the characteristics of the informal entrepreneurs and their enterprises will be dealt with in the next chapter, Chapter Seven, on equity and efficiency. This chapter draws on the informal sector interviews to assess the extent to which informal sector operators in this study complied with and their views on the advantages (and disadvantages) of being tax compliant.

harassment from touts and low tax morale due to high levels of non-compliance. Section 6.4 concludes.⁷⁷

6.2 Informal sector tax administration

Administering informal sector taxes involves a number of procedures. It involves identifying informal sector operators, collecting taxes from them based on the existing tax law and imposing penalties on recalcitrant ones. Tax administration, therefore, covers a wide area of study, encompassing aspects such as the registration of taxpayers, assessments, collection and monitoring and evaluation. All this should be done in a way that does not result in the incurring of costs that are higher than the amounts that are due – a major challenge given the nature of the informal sector. In Zimbabwe, the presumptive tax legislation places the onus on informal sector operators to comply voluntarily with the tax regulations.

Taxes that are due have to be remitted timely (i.e. every quarter) and when taxes are collected, there should be systems in place to account for all the monies received. These systems should also have the ability to determine who has paid and who has not. This system of cross-checking and reporting on payments received allows the tax administration to regularly monitor taxpayers. It allows the revenue authority to ascertain the extent of non-compliance and then take appropriate remedial action to ensure compliance. This action can be in the form of penalties for arrears incurred and also, in the case of the informal sector tax administration in Zimbabwe, the seizure of goods and the closing of business premises (see The Herald, 2009).

The informal sector tax collection system should be regularly reviewed. Any loop-holes in the system should be addressed so as to prevent bribery, corruption and other forms of rent-seeking behaviour by those entrusted with the responsibility of collecting these taxes (e.g. ZIMRA officials, landlords and the police).⁷⁸ In the absence of effective collection systems,

⁷⁷ Part of the work presented in this chapter has recently been published as a peer-reviewed journal article as per the requirements for doctoral graduation by UKZN. This published work is cited as follows:

Dube, G. (2014). Informal Sector Tax Administration in Zimbabwe. *Public Administration and Development*, 34, 48-62.

⁷⁸ According to the Income Tax Act (23:06), the police are empowered to enforce presumptive tax compliance in Zimbabwe. The police are usually deployed with ZIMRA officials at roadblocks or when tax evaders' premises are raided (see The Zimbabwean, 2009).

the level of evasion will grow as informal sector operators soon realise that they can get away with non-compliance.

ZIMRA is responsible for collecting taxes from the informal sector. Table 27 shows the amount of revenue that was collected in the form of presumptive taxes from the informal sector between 2008 and 2011. Although informal sector presumptive taxes were being collected before 2008, the figures were largely meaningless due to hyper-inflation (Key Informant 15, ZIMRA, 29 September 2011). As can be seen in Table 27, there was an increase in the total tax revenue and the presumptive tax revenue collected between 2009 (when the economy was dollarized) and 2011. Revenue from presumptive taxes increased from US\$1.39 million in 2009 to US\$5.2 million in 2010, representing a 275 per cent increase in revenue from the informal sector.⁷⁹ For 2011, there was an increase in presumptive tax revenue collection of 151 per cent over the 2010 figure of 5.2 million dollars. This shows that this trend of increased revenue collection continued in 2011 although in a less dramatic fashion. The increase in revenues collected has been attributed to two main factors - the improved economic conditions prevailing in the country leading to, for example, increased cross-border trade on which a 10 per cent presumptive tax is levied at the border (the value for duty purposes or VDP), and increased monitoring (ZIMRA, 2010).

Table 27: Presumptive and total tax revenues, 2008-2011

| Year | Total tax revenue | Presumptive tax |
|------|-------------------------------|------------------|
| 2008 | 14,963,656,261,387,400,000.00 | 1,488,345,043.71 |
| 2009 | 988,478,183.97 | 1,391,153.70 |
| 2010 | 2,238,240,231.58 | 5,220,196.66 |
| 2011 | 2,816,378,833.71 | 13,143,213.53 |

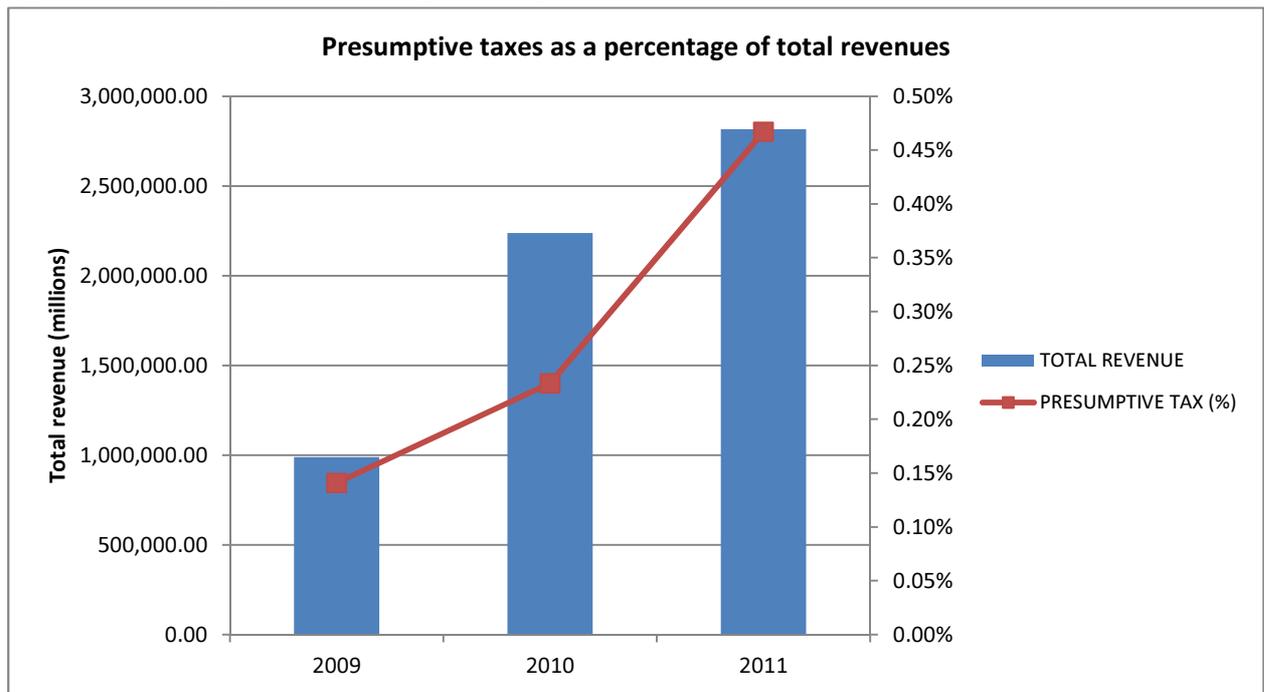
Source: ZIMRA research department
2008 figures are in ZW\$ while the rest are in US\$

However, informal sector presumptive taxes are actually very low when compared to total revenues. As shown in Figure 7, ZIMRA collected a total of US\$2.2 billion in 2010 of which only 0.2 per cent came from presumptive taxes up from 0.14 per cent in 2009. In 2011, the total revenue collected increased to US\$2.8 billion, and presumptive taxes as a percentage of total tax revenue increased to 0.45 per cent. Although there were high percentage increases in presumptive tax revenue from 2009 to 2011 (see Table 27), the low figures (as a percentage of total tax revenue) clearly indicate that presumptive taxes collected are, according to

⁷⁹ All the figures in this chapter are in United States dollars unless otherwise stated.

ZIMRA, way below the potential revenue from this sector given the extent of informality in Zimbabwe. According to one respondent “We are only collecting taxes from about 10 per cent of people who should be paying. The revenue collection from the informal sector is low given the large number of informal traders in Zimbabwe” (Key Informant 12, ZIMRA, 7 September 2011).

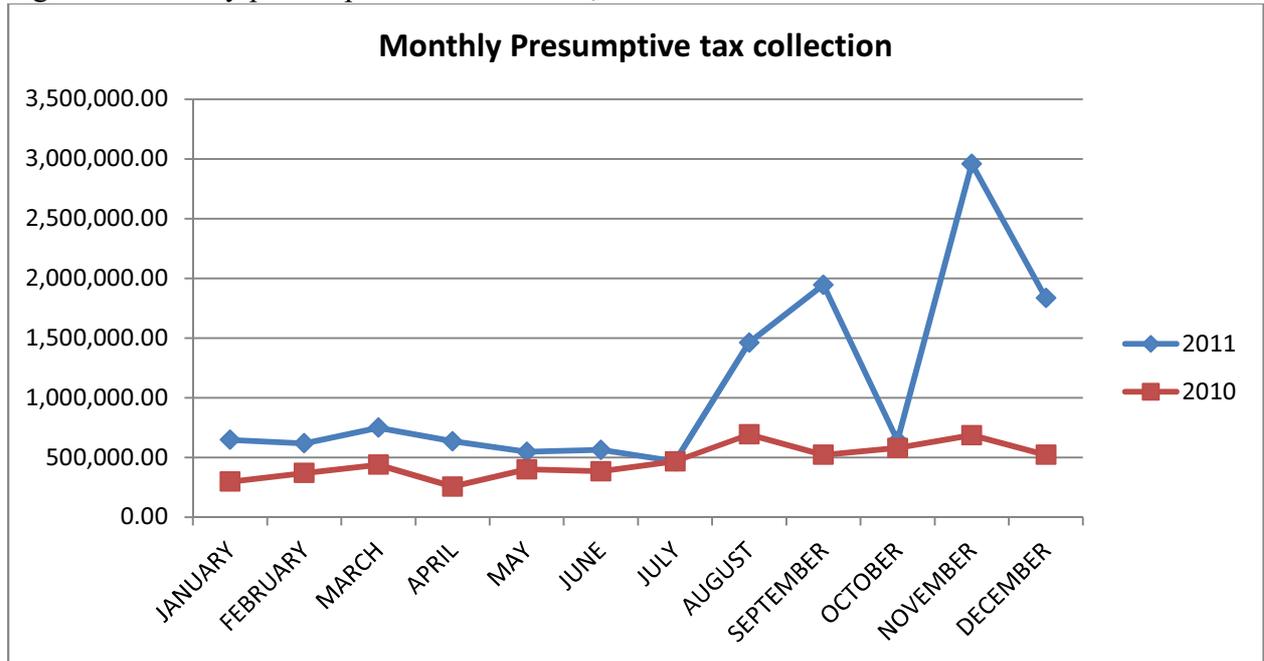
Figure 7: Presumptive taxes as a percentage of total revenues



Source: Own calculations based on figures from ZIMRA research department

In spite of the much higher presumptive tax revenue amount in 2010 and 2011, the general trend is one of low revenue collections throughout the year with a few months (towards the end of the year) showing some increases. Figure 8 shows the monthly presumptive tax collection for 2010 and 2011. As shown in the figure, for both 2010 and 2011, the amounts collected for the first seven months were fairly low but stable, hovering around \$500,000 per month with increases in the second half of the year.

Figure 8: Monthly presumptive tax collection, 2010-2011



Source: Own calculations based on figures from ZIMRA research department

Although the improved presumptive tax collections were attributed to the improved economic conditions prevailing in the country, some of the ZIMRA officials interviewed also felt that increased monitoring had had a positive effect on collections. According to one respondent “Some informal traders are easier to monitor than others and produce more revenues, such as omnibuses. Sometimes our officials implement door-to-door campaigns” (Key Informant 10, ZIMRA, 6 September 2011). It is likely that the general increase in tax revenue collected had to do both with the economic stability that Zimbabwe experienced after dollarization in 2009 and the better monitoring by ZIMRA (as claimed by ZIMRA officials). However, there are two other possible explanations for these increases in presumptive tax revenues and the specific spikes towards the end of the year in 2011. The first one has more to do with increased imports before Christmas when one would expect increased value for duty purposes (VDP) presumptive tax collections at the border. According to the respondents from ZIMRA, VDP is a major source of informal sector tax revenue as explained later in this chapter. The second possible explanation for the dramatic increase in collections for August and September 2011 could be the uncertainty surrounding the banning of second-hand car imports from Japan (Statutory Instrument 154 of the Road Traffic Act of 2010). This ban (affecting all imported cars older than five years), that was supposed to have taken effect in early 2011, had been postponed and was supposed to be implemented from 1 November 2011. This

created a rush to beat the deadline (see The Zimbabwean, 2011). These imports would also have been subject to the VDP.⁸⁰

Clearly, as the revenue collection results show, there have been some successes in taxing Zimbabwe's informal sector since 2009. Revenues from the informal sector have increased (both in absolute terms and as a percentage of total revenues). There were different views within ZIMRA on what this increase could be attributed to, with some officials citing increased monitoring while others said that this was merely due to increases in VDP collections as a result of increased imports. One key informant said "For people in the informal sector, we get most of our revenue from VDP, from cross-border traders" (Key Informant 14, ZIMRA, 14 September 2011). Nevertheless, this increase in revenue collection from the informal sector can be viewed as a success for the revenue services. In fact, ZIMRA's report for the first half of 2010 points out that revenue targets were exceeded and special mention is made of the role that presumptive taxes played in the increased total revenue amount (ZIMRA, 2010). However, the collection of these taxes has not been without its challenges, which are discussed in detail below.

ZIMRA's capacity to fulfil its functions of taxing the informal sector depends on a number of internal and external factors. Internal factors are those that lie within the revenue authority's control and external factors are those that lie largely outside its control. Internal factors are such things as the availability of information on informal sector operators, manpower levels, ZIMRA's ability to launch education and awareness campaigns, and corruption. External factors are such things as the tax rates (determined by the Ministry of Finance), the tax culture in the country, perceived benefits from paying taxes by informal sector operators, and governance issues (especially the way people feel about government legitimacy and spending). Although the ministry has the final say on the rates to be used, ZIMRA can (and should) provide professional advice on what rates are reasonable (and what is feasible in terms of implementation). What follows is an examination of these internal and external factors as they affect informal sector tax administration in Zimbabwe.

⁸⁰ It should be pointed out that VDP does not only affect those in the informal sector as it is paid by all importers who are not registered for income tax.

6.2.1 Availability of information

Without information, the process of identifying taxpayers and ascertaining tax liabilities becomes difficult. Also, without information, taxpayers do not know what taxes they should pay and how these taxes are to be paid. There is no comprehensive register of informal traders in Zimbabwe. According to a key informant “There is no capacity to tax this sector - they do not even have basic registers of these firms. Only the ones that are easy to identify are taxed” (Key Informant 6, CZI, 26 September 2011). According to one key informant “We only started compiling a database of informal sector operators and organisations in 2010” (Key Informant 8, Ministry of Small and Medium Enterprises, 12 September 2011).⁸¹

In the absence of vital statistics such as registers and bank accounts, there has been a tendency to focus on those informal activities that are ‘visible’ such as cross-border traders/flea market operators and urban transport operators.⁸² These sub-sectors are sporadically raided by ZIMRA officials with the objective of enforcing tax regulations. According to ZIMRA officials, a raid of this nature is called a “revenue project”. One respondent said “When we have to meet a revenue target we launch a revenue project. We end up focusing on omnibuses and flea markets. We dispatch our officers to the flea markets and set up roadblocks for omnibuses” (Key Informant 11, ZIMRA, 6 September 2011). Another key informant said “We are not collecting much because of the method of collection. We are focusing mainly on flea markets and omnibuses” (Key Informant 12, ZIMRA, 7 September 2011).

In the case of minibus taxis (also called commuter omnibuses or kombis in Zimbabwe), the information is actually there although the revenue collection department does not make use of it. The information on driving schools and minibus taxis is available from within ZIMRA - there is a department that has a list of minibus taxis and driving schools that are registered. One respondent said “We have a register of driving schools. One of our departments handles the registration of all omnibuses but we have not yet started using that database for tax purposes. The Ministry of Transport also has a list of all registered commuter omnibuses in

⁸¹ It is important to note that information on informal sector operators is difficult to obtain even in a non-crisis country. This is a sector with very high churn rates and where enterprises frequently change their location, making them hard to track. The absence of informal sector registers is therefore a problem even in non-crisis countries.

⁸² Most cross-border traders sell their wares at flea markets in Zimbabwe which is why the flea markets were chosen as one of the case studies in this thesis.

the country but we have not started using it” (Key Informant 11, ZIMRA, 6 September 2011). It was not clear why these lists (from the Ministry of Transport and the department within ZIMRA that has a similar list) were not being used for tax collection and monitoring purposes.

Information on flea market operators (who were all cross-border traders in this study) should be relatively easy to obtain – at the border or at the flea markets. For cross-border traders, there is a 10 per cent presumptive tax, the VDP, which is paid at the port of entry for all goods imported by all those who are not registered with ZIMRA for income tax purposes. However, while it should be relatively easy to collect information on goods being imported into the country (and thereafter determine the amount of presumptive tax due), the process is complicated by the prevalence of smuggling and corruption (usually with the involvement of drivers who ferry these goods). This corruption and evasion of taxes has forced ZIMRA officials to mount roadblocks on all major roads from South Africa, Botswana, Zambia and Mozambique so as to obtain information on goods imported by cross-border traders. Penalties are imposed on bus drivers who assist passengers in smuggling goods and as explained in the next chapter, ZIMRA has gone to the extent of seizing buses that were transporting smuggled goods (Key informant 15, ZIMRA, 29 September 2011).

ZIMRA also does try to obtain information on imported goods from flea markets (where most of them are sold by the cross-border traders). Information on the location of these flea markets is readily available. What is not readily available is information on who (among these flea market operators) has actually paid the requisite presumptive tax (i.e. VDP) and who has not. The raids on flea markets are mainly to ensure that all sellers of imported goods have paid the presumptive tax (VDP) at the border.

Apart from these highly visible minibus taxi and flea market operators, getting information on informal sector operators has proven to be a challenge for ZIMRA. And based on the interviews conducted, even where lists of transport vehicles are in existence, they are not used for tax monitoring purposes. ZIMRA relies on voluntary compliance coupled with raids of selected (visible) sectors such as transport operators, flea markets and, sometimes, hairdressing salons. It would appear that certain activity classes are not as closely monitored as others in spite of the availability of information on where their enterprises are located. This selective application of tax regulations is an issue that will be discussed in more detail in the

next chapter as it has implications for equity and efficiency. The cottage industry activity, for example, has largely escaped these presumptive taxes.

6.2.2 Manpower levels

When asked to name the three main constraints that ZIMRA faces in attempting to collect taxes from the informal sector, six of the seven ZIMRA respondents cited the shortage of manpower as the main constraint.⁸³ Corruption also featured prominently with four officials mentioning it (see Section 6.2.5 below). The other constraints mentioned were the lack of information on informal sector operators, the culture of impunity (on the part of informal sector operators) and the unwillingness of informal sector operators to pay.

Although ZIMRA has an office to deal with large taxpayers (who make up the bulk of tax payments), it does not have a dedicated office for the small taxpayers as is the case in some developing countries as was described earlier.⁸⁴ This means that large taxpayers (who generate much higher revenues) get priority in terms of tax compliance monitoring, education and support services. Due to these manpower shortages, ZIMRA has resorted to largely *ad hoc* methods in the collection of taxes from the informal sector.

The main method used by ZIMRA to induce payment of informal sector presumptive taxes is one of raiding known informal sector establishments such as flea markets and hairdressing salons. In the case of driving schools, taxis and minibuses, these raids take the form of roadblocks which are mounted in conjunction with the police. In all these raids, informal sector operators are asked to provide proof that they have indeed paid taxes for that quarter with penalties being levied on those failing to produce this evidence. There have been cases where flea market operators have had their goods seized when they failed to provide evidence of having paid VDP at the port of entry (for imported goods) (see NewsDay, 2010).

A feature of all collection efforts during these raids is the confrontational and coercive manner in which they are conducted. However, the numerous officers who are deployed to collect these taxes usually have very little to show for their efforts. According to a key

⁸³ The actual number of employees required to effectively implement informal sector taxes was not specified by the ZIMRA officials that were interviewed.

⁸⁴ See, for example, Mulenga (2011) on Zambia Revenue Authority's (ZRA) attempts to improve compliance through the establishment of a small taxpayer's office.

informant “We dispatched a team of officers to Mupedzanhamo [flea market] for the whole week but they collected little revenue. Informal sector taxation sucks.” (Key Informant 15, ZIMRA, 29 September 2011).

Due to the high levels of manpower required to carry out these raids (and the fact that these raids are seen as diverting scarce resources from the business of attending to large taxpayers), they are only conducted sporadically. The results of this study indicate that most informal sector operators (especially those operating cottage industries) have never experienced these raids in spite of having operated for more than two years. Judging from the accounts of the informal sector operators, other key informants and newspaper articles on the raiding of suspected tax evaders, the initial enthusiasm for enforcing presumptive tax regulations shown by ZIMRA in 2009 seems to have waned. According to a tax consultant, “ZIMRA has to be realistic - they do not have the resources to effectively tax the informal sector. They did try to tax this sector in the past but it is very rare to see ZIMRA officials raiding flea markets and hairdressing salons nowadays” (Key Informant 7, Ernst & Young, 25 November 2011).⁸⁵

One method that seems to have been used to improve the collection of taxes from the informal sector is that of relying on landlords to collect taxes. However, whether this has been a success is unclear. Landlords who rent out business premises to informal traders are supposed to collect a presumptive tax (10 per cent of the rental) which should then be remitted to ZIMRA (as explained in Chapter Five). In the interviews with ZIMRA officials, however, there were contradictory accounts between the research department and the revenue collection department as to whether these taxes were actually being collected by landlords and remitted to ZIMRA. These landlords are not incentivised in any official way. ZIMRA officials felt that the holding of these taxes for a month (before passing them on to ZIMRA) actually improves these organisations’ cash flows and therefore should act as an indirect incentive (Key Informant 15, ZIMRA, 29 September 2011). However, the additional administrative burden for these landlords may act as a larger disincentive counteracting any possible cash flow benefit.

⁸⁵ This seems to contradict the statements made by some ZIMRA officials that revenues had increased as a result of better monitoring. The general improvement in the economic conditions leading to increased cross-border trade (and increased VDP collections at the border) therefore seems to be a more plausible explanation for increased presumptive tax collections.

The proposal by treasury for ZIMRA to use local authorities as agents in the collection of all presumptive taxes (i.e. not only the 10 per cent presumptive tax on the rentals that these local authorities collect for the premises they rent out to informal traders) was never implemented. According to one respondent “We did not think that this was a viable proposal. There is just too much corruption in municipalities. Some of these municipalities are actually struggling to pay their own taxes” (Key Informant 15, ZIMRA, 29 September 2011).⁸⁶

6.2.3 Education and awareness

Many informal sector operators do not know about presumptive taxes. While informal sector operators seem to know about taxes in general, this study found that even well-educated informal sector operators (i.e. those with a tertiary education) who were not in the highly targeted sectors, transport and flea-markets, did not know about these taxes that are specifically targeted at them. This is consistent with what was found by Utaumire et al. (2013). As explained in more detail in the next chapter on equity and efficiency, a quarter of those running hairdressing salons also did not know about presumptive taxes, and none of the cottage industry operators who formed part of this study knew about presumptive taxes.

The representatives of informal sector associations who formed part of this study i.e. the Zimbabwe Chamber of Informal Economy Associations (ZCIEA), Zimbabwe National Commuter Omnibus Operators’ Organisation (ZINCOOO) and the Indigenous Commuter Operators Association of Zimbabwe (ICOAZ) indicated that they were not consulted about the introduction of taxes and the rates. One respondent said “Other business organisations are recognised and consulted but the informal sector is not recognised, they do not consult us” (Informal Sector Operator 42, Transport, 25 April 2014). This lack of consultation seems to be in stark contrast to the consultations that occur between treasury, ZIMRA and formal sector business associations such as the Confederation of Zimbabwean Industries (CZI) and the Zimbabwe National Chamber of Commerce (ZNCC) around taxation. However, a ZIMRA respondent said that the revenue authority does convene stakeholder meetings (where the informal sector associations are invited). According to this respondent “We have launched educational campaigns which have involved all stakeholders. There has also been an awareness campaign through our ‘Did you know’ column in the media” (Key Informant 10, ZIMRA, 6 September 2011). Another key informant said “There have been workshops to

⁸⁶ See also The Herald (2012).

educate informal traders, we have also placed adverts and written some newspaper articles on presumptive taxes” (Key Informant 13, ZIMRA, 12 September 2011).

An important aspect of any education and awareness programme in Zimbabwe should be the explication of the term ‘job’. There is a strong perception in Zimbabwe (which is largely a carry-over from the period before independence) that those in the informal sector (even the relatively prosperous ones) do not have ‘proper’ jobs. “People in the informal sector are difficult to tax. They feel that they are not part of the economy” (Key Informant 11, ZIMRA, 6 September 2011). In a country in which informal employment accounts for 84 per cent of those currently employed (ZIMSTAT, 2012: 113), there is a need to re-define what a ‘proper job’ is. Indeed, operators themselves may not regard themselves as having a ‘proper job’. According to one respondent, “We are struggling due to a lack of jobs and so we shouldn’t be taxed. We are involved in these activities as a last resort” (Informal Sector Operator 6, Cottage Industry, 7 September 2011). This view was shared by a number of informal sector operators and speaks to the issue of equity which will be discussed in Chapter Seven. ZIMRA has a role in changing this mind-set by educating informal operators and making them aware that those who are gainfully employed and are earning an income should be complying with tax regulations. The need to raise revenues for government expenditure is a legitimate function of governments and the public needs to be reminded of this. However, in Zimbabwe this is complicated by the fact that many do not see the government as legitimate or that it is spending revenues suitably for the benefit of all.

6.2.4 Corruption

The widespread ignorance of tax regulations and the shortage of manpower are not the only challenges facing the revenue authority. A major problem that many tax authorities face in the administration of taxes in developing countries is that of corruption. Not only is corruption rife within ZIMRA, it is also a major problem facing the nation’s police force (which, as pointed out earlier, assists ZIMRA in collecting taxes from the informal sector). Zimbabwe’s police force is very corrupt – a recent report ranked Zimbabwe’s traffic police as the most corrupt in the SADC region (Anti-Corruption Trust of Southern Africa, 2010). Corruption usually occurs in the form of bribes and extortion.

Bribes occur when ZIMRA officials and police officers accept either cash or ‘gifts’ in return for not enforcing tax regulations (voluntary bribes). While there is a loss to society from this

type of bribe, both the informal sector operator and the people (they usually operate in groups) receiving the bribe derive benefits. In the case of the urban transport operators, the bribes tend to be coercive. Coercive bribes tend to benefit only the persons receiving the bribe – informal sector operators do not benefit at all. These bribes are usually paid so that the informal operator is protected from harassment (even when they have paid their taxes and complied with road regulations) – this is really a form of extortion (see NewsDay, 2012a). As one respondent said “Even when your things are in order, the police officers will just ask for money and if you don’t pay they always find something wrong with your car and write out a \$20 ticket. We just bribe them so that they can leave us alone.” (Informal Sector Operator 25, Transport, 19 September 2011).

6.2.5 Selective tax administration

The tax authority seems to focus its revenue collection efforts on a number of informal sub-sectors that are easy to tax. When asked to name the informal sub-sectors that were easiest to tax, four ZIMRA officials cited cross-border trading (i.e. VDP), while the urban transport sector was cited by three officials. The prominence of these two informal sub-sectors is not surprising given that VDP is collected at the border while roadblocks can always be mounted to monitor compliance among those in the transport sector. According to one respondent “We are supposed to collect these taxes but it is a difficult process as people do not want to pay. We end up focusing on omnibuses” (Key Informant 11, ZIMRA, 6 September 2011).

However, there are a number of visible locations which have large numbers of informal traders that seem to be exempt from these tax raids – ZIMRA officials do not seem to venture there. As will be explained in more detail in the next chapter on equity (Chapter Seven), this means that the way that informal sector taxes are actually administered in Zimbabwe (i.e. leaving out large portions of informal sector operators) has an effect on the equity of these taxes. This study identified two such locations - a regional bus station where informal goods transporters provide services to cross-border traders (using mainly small and medium-size trucks), and a furniture-making cottage industry complex in a high density area. This regional bus station is located right in the centre of Harare’s central business district and about 500 metres from the ZIMRA regional offices. These two sites are run by ‘committees’ which are affiliated to the ruling party and informal sector operators at these locations feel that they are untouchable (due to the fees paid to the committee). This preferential treatment of certain segments of the informal sector, which speaks to the concept of equity, was cited as a major

disincentive by those informal sector operators that were paying their taxes (see Section 6.3.5 below).

According to the urban transport operators interviewed, paying these monthly ‘committee’ fees of between \$10 and \$20 in exchange for ‘protection’ also meant that they were sometimes called upon to provide free transport to supporters attending ZANU-PF rallies. One respondent said “To operate without problems we sometimes have to provide transport for ZANU-PF rallies once a month” (Informal Sector Operator 28, Transport, 3 September 2011). Those transport operators that were paying these committee fees saw this as a small price to pay for the protection they received (from police harassment and competition). In the case of the small-scale furniture manufacturing complex, the committee also provides security and protection from competition as only those paying the fees are allowed to operate within the complex (in spite of the fact that the complex belongs to the city council). None of the seven cottage industry operators interviewed from these two particular sites had ever had an encounter with ZIMRA officials and not one of them knew about informal sector presumptive taxes.

6.2.6 Commitment to enforce presumptive taxes by ZIMRA

The implementation of informal sector presumptive tax regulations has not proved popular with tax authority staff. From the interviews with ZIMRA officials, there is a palpable lack of commitment to informal sector taxation among some of them, especially in implementing the presumptive tax schedule in its current form. While presumptive taxes such as the VDP are easy to collect (at the border), taxes that require the commitment of scarce resources, such as staff, are implemented with less enthusiasm. The implementation of presumptive tax regulations also seems to have been negatively affected by what are considered to be unrealistic rates by some within ZIMRA. There were some officials who feel that informal sector taxes were low “These taxes are low. People in the informal sector are making a lot of money” (Key Informant 10, ZIMRA, 6 September 2011). However, other officials feel that these rates (for some activity classes) are too high. According to one official, “These have largely become nonsense taxes. We do not agree with \$1,500 per quarter for hairdressing salons. We need to start with low figures and move from there” (Key Informant 15, ZIMRA, 29 September 2011).

6.2.7 Monitoring and evaluation

Although the presumptive tax schedule outlines the various informal sector taxes, it is not possible to determine the amount of tax that is collected from each informal sector activity class – all presumptive taxes collected are put into a common account. When asked whether it is possible to determine the amount of tax that is collected from each informal sector activity class, one respondent said “No. All the monies received go into a pooled fund” (Key Informant 11, ZIMRA, 6 September 2011). This means that there is no way of telling how much a particular informal sub-sector contributed as a proportion of total revenue collected from the sector. Clearly, it is difficult to then have targeted efforts to increase coverage if there is no basis for comparison between the different informal sub-sectors.

The way the informal sector revenue collection system currently works also encourages evasion. According to the presumptive tax regulations:

Taxicab and omnibus operators are required to carry a Tax Clearance Certificate in their respective vehicles. Failure to carry or produce the Tax Clearance Certificate renders the person in charge of the vehicle liable to a fine of 100 per cent of the amount due or, if in default of payment, imprisonment for a period not exceeding six months. Failure to pay the Presumptive Taxes in time also renders the operators liable to interest charges ZIMRA (2014b).

However, although the presumptive tax schedule does stipulate penalties for those in arrears, the actual collection system does not punish recalcitrant informal tax payers – the focus (for those who are unregistered) is always on the current quarter. “The system does not encourage compliance. Those who are caught at roadblocks pay the penalty and the tax for that quarter. This means that someone who is caught at the end of the year only pays the penalty and the tax for that quarter” (Key Informant 16, ZIMRA, 11 November 2011). This form of tax administration clearly also has equity implications which will be discussed in the next chapter. Because presumptive taxes are not collected in a systematic and consistent manner, according to all the ZIMRA officials interviewed, the proportion of informal sector operators who do not comply with presumptive tax regulations can only grow under these circumstances. Their ranks will be swelled by those who realise that there are other free-riders due to lax enforcement.

There is also poor evaluation of the tax system within ZIMRA: as one respondent said “There is a need to be consistent when taxing the informal sector. At the moment we tend to go after these people when we have revenue targets to meet instead of looking at a long-term strategy of taxing this sector” (Key Informant 11, ZIMRA, 6 September 2011). The revenue targets referred to by this particular informant were the total revenue targets (and not informal sector presumptive tax revenue targets). The informant did not know whether there were revenue targets for informal sector presumptive taxes. Without proper revenue targets, data collection and analysis of patterns and trends, proper evaluation of the system cannot occur.

From the interviews conducted, even those tasked with collecting taxes from the informal sector within ZIMRA were not sure whether there had been an increase or decrease in revenues collected since 2009. This means that not only is there no system for determining informal sub-sector performance, but that the system of disseminating information on revenue collected from the informal sector as a whole seems to be lax. While the information on total informal sector tax revenues is available from the research department, some ZIMRA officials responsible for informal sector revenue collection did not even know whether this information existed or not.

6.2.8 Tax morale

Problems of informal sector tax collection go beyond mere administration. There is very little that ZIMRA can do about certain external factors that are outside its control. One such factor is the low tax morale due to the prevailing political situation in Zimbabwe where many people (including those in the informal sector) feel that the current government is not really legitimate. Informal sector operators, like all other citizens, will tend to resist paying taxes to a government they feel is not legitimate. There are concerns that taxes collected will not be used in the national interest but will instead be used for narrow sectarian ones. One respondent said “We also pay toll fees but the roads are in a poor state. Taxes have to be justified. Taxes should be used to develop the informal sector. There should be a subsidy for legally registered operators. This will increase fairness” (Informal operator 25, Transport, 19 September 2011).

Administrative shortcomings which result in the selective application of tax regulations (see Section 6.2.5), be it within the informal sector or between the informal sector and the formal sector, will have an impact on compliance behaviour. If there are people who are getting

away without paying taxes, those who continue paying will be demoralised. One respondent said “It is not good to pay when others evade these taxes, it is a disadvantage. Nothing is being done about those that are not paying, especially those who are not registered. These taxes are not fair and transparent” (Informal Sector Operator 31, Transport, 20 March 2013). This reference to ‘fairness’ or equity is an important one which will be analysed in more detail in the next chapter.

According to an urban transport operator, the informal sector can be effectively taxed if the operators in this sector are properly consulted before the setting of tax rates and if realistic rates are set. The respondent said “Government is losing a lot of money by not properly taxing the informal sector. If amounts are too high, people will run away. Smaller amounts, more frequently would be ideal. Proper research should be done and we should be consulted on the figures. The taxes we have just encourage corruption” (Informal Sector Operator 29, Transport, 9 November 2011).

6.3 Complying with tax regulations

Informal sector presumptive tax collection in Zimbabwe varies across informal sector activity classes. As outlined above, this variation occurs not only in the amounts paid by the different activity classes (see Chapter Five) but also in the way in which these taxes are implemented and monitored. In analysing administrative effectiveness, it is therefore useful to examine the extent of informal sector tax compliance and the challenges faced by informal entrepreneurs in complying with regulations. The four case studies representing the various informal sub-sectors that form part of the study had different experiences with ZIMRA in its administration of presumptive taxes. The following sections therefore discuss these sub-sectors’ experiences with ZIMRA and their tax compliance behaviour.

6.3.1 Transport operators

This activity class has featured prominently in ZIMRA’s efforts to tax the informal sector in Zimbabwe and the initial research on informal sector taxation in 2003, as explained in Chapter Five, focused only on this sector. In this study, this group of informal operators was made up of minibus taxis, taxi-cabs and goods vehicles. Of the 23 respondents in this activity class, 21 respondents said that they had paid presumptive tax at least once, 10 reported that they consistently paid their taxes, eight said that they sometimes paid, and three said that they had stopped paying these taxes.

According to the informal sector operators, registering with the Ministry of Transport and the municipality is a time-consuming, complicated and costly process.⁸⁷ However, their main complaint was there were far too many fees and ‘taxes’ that they were already paying. Apart from presumptive taxes, they were supposed to pay rank marshals’ loading fees (of at least \$0.5 per trip) and, in some cases, ‘committee’ fees (of up to \$1 per trip) (Informal Sector Operator 27, Transport, 24 November 2011).⁸⁸ According to one respondent “Everyone who operates from this rank has to pay the touts. If you don’t pay they will harass you. This is a forced permit. You have no choice” (Informal Sector Operator 45, Transport, 4 May 2014).

According to one respondent who was also a member of a transport operators’ association, a proposal was made to the Ministry of Finance in 2010 for a lower rate. According to this respondent “In March 2010, we had a meeting with the Ministry of Finance where ZINCOOO proposed an amount of \$50 per quarter as a fair presumptive tax. This was based on discussions with our members. The Ministry of Finance has done nothing about this issue” (Informal Sector Operator 27, Transport, 24 November 2011). Under these circumstances, according to this respondent, transport operators are always going to resist paying these taxes. “These taxes are too high. If rates are too high people will not pay. The Ministry of Finance needs to get information on those in the informal sector. Who is in the informal sector? What

⁸⁷ Before they can operate on Zimbabwe’s roads, all minibus taxis and taxi-cabs have to be registered with the Ministry of Transport and licensed by the municipal authority. Before this registration and licensing can take place, the vehicle has to be certified as roadworthy by the Ministry of Transport’s Vehicle Inspection Department (and this inspection costs \$200). After this, the operator applies to the Ministry of Transport for the route authority (\$75) and if successful is given a rank disc by the municipality which costs \$100 and is renewable every quarter (in 2011). They also have to pay vehicle insurance of around \$75 per quarter and passenger insurance of around (\$300) a year.

⁸⁸ There are various self-appointed ‘committees’ and groups of touts that operate in Zimbabwe’s urban transport sector and extort money from operators. A particularly ruthless ‘committee’ which terrorised urban transport and flea market operators and whose power reached its peak in 2012 was Chipangano. Informal sector operators in this study were afraid of openly mentioning this organisation by name. In a clear case of state-sponsored thuggery, this mafia-style outfit was extorting ‘fees’ of \$1 - \$5 per trip from minibus taxi operators (and in some cases a fixed fee from flea market operators). This organisation, which started out as a ZANU-PF youth league controlled militia, was finally disbanded by ZANU-PF after the fragmented minibus taxi operator associations finally took a united stand at the end of 2012 (see NewsDay, 2012b; The Zimbabwean, 2012). The problem of touts and rank marshals still continues to be a problem in Zimbabwe although the situation does not seem to be as bad as it was between 2011 and 2012.

are they doing? How much money are they making? Only about 20 per cent of our members are paying taxes voluntarily” (Informal sector operator 27, Transport, 24 November 2011).⁸⁹

6.3.2 Flea market operators

Flea market operators in Zimbabwe are mainly cross-border traders (and, in some cases, people who purchase their goods from cross-border traders) (Mupedziswa and Gumbo, 1998; Jamela, 2013). The flea markets in high density areas have been caught up in the political feuds between the country’s two main political parties (ZANU-PF and MDC). In the high density areas, violent contestations around the allocation of stalls along party lines usually occur and these have an adverse impact on business activity.⁹⁰ These contestations usually result in a party aligned ‘committee’ being set up which then goes on to extract its own ‘committee fees’ from all those operating from the flea market. These ‘committee fees’ are usually in addition to a daily stall rental fee that is paid to the owner of the flea market (in some cases, the city council). Clearly, these flea market operators are being ‘taxed’ (by the committees) although these ‘taxes’ are not being received by ZIMRA.

Of the nine cross-border traders interviewed, two of them said that they always paid VDP every time they imported goods into Zimbabwe for resale. Three of the flea market operators said that they sometimes paid and sometimes “negotiated” with officials at the border. The other four flea market operators did not respond to questions on tax payments.

The main challenges in complying with the tax regulations, according to the respondents, were the high tax rate, and the rampant corruption by ZIMRA officials and police which allowed many traders to evade paying taxes. According to one respondent “Many people are smuggling goods into the country and can sell their goods cheaply. I always pay and those who pay taxes are competing with those who are not paying. This is not fair” (Informal Sector Operator 19, Flea market, 24 November 2011).

6.3.3 Hairdressing salons

Hairdressing salons are expected to pay presumptive tax amounting to \$1,500 per quarter. The way that most hairdressing salons operate has changed over the past few years. It is not

⁸⁹ This finding is consistent with the public finance literature which shows that a high tax rate does lead to low compliance (Alm, 1996).

⁹⁰See NewsDay (2012c).

common to find a salon that is ‘owned’ by an individual. In most cases, the owner claims that all she/he is doing is renting out chairs to individual informal operators (the ‘rent-a-chair’ system).⁹¹ However, according to ZIMRA, it is the registered salon operator (and not these individuals who are renting chairs) who is liable for the presumptive tax.

Two of the eight respondents operating a hairdressing salon did not know about anything about presumptive taxes. Of the six respondents that reported that they knew about informal sector taxes targeted at hairdressing salons, four respondents knew about the \$1,500 presumptive tax that is supposed to be paid per quarter, but none of them was paying it. Instead, these four operators reported that they were paying the 10 per cent presumptive tax on rentals to the landlord.

Although there was a feeling by two ZIMRA respondents that these are profitable businesses, the other five respondents from ZIMRA felt that hairdressing salons were being treated unfairly given the very high presumptive tax amounts for this sector (an equity issue that will be analysed in Chapter Seven). According to the hairdressing salon operators, they were struggling to survive due to the stiff competition in the sector. According to one respondent who owned a salon, “There are too many salons in this area and there are few customers. We are all fighting for the same customers. On some days I have very few customers. How can I pay \$1,500?” (Informal Sector Operator 10, Hairdressing Salon, 25 April 2014).

6.3.4 Cottage industries

ZIMRA is supposed to collect \$300 per quarter from this activity class. However, none of the seven respondents knew about these presumptive taxes.⁹² ZIMRA is also supposed to collect 10 per cent of the rent paid by these operators from the landlord (in most cases the city

⁹¹ Those renting chairs in such a salon are not licensed to run a salon. They are effectively operating their own informal enterprise and do not report to the owner – all they do is pay the rent. These informal enterprise owners are usually responsible for their own beauty salon products (Informal Sector Operator 8, hairdressing salon, 17 April 2013). See also Zinyemba and Mutana (2013).

⁹² Three of the seven cottage industry operators in the study reported that they sell their goods to both informal and formal sector businesses. Those furniture manufacturers supplying goods to the formal sector were probably paying withholding tax for those without the ITF 263 although it was not mentioned.

council) according to the presumptive tax schedule.⁹³ While they were paying their rentals, none of them said anything about the presumptive tax on rent.

6.3.5 Advantages and disadvantages of paying taxes

Informal sector operators were asked questions on whether there were any advantages and/or disadvantages of paying presumptive taxes in Zimbabwe. Tax administration involves the encouragement of quasi-voluntary compliance so as to lower administration costs. Therefore, if there are clear benefits to paying taxes, compliance should increase. Some of the benefits from paying taxes could be good infrastructure (e.g. good roads, schools and clinics) or better government services or support to businesses. One respondent said “There is a need to support the informal sector so that it can grow. We are ready to pay if the rates are reasonable and we have been consulted. We need support after paying taxes. Support can be in the form of good roads, omnibus purchase schemes and reasonable fares. There is also a need to control corruption” (Informal Sector Operator 27, Transport, 24 November 2011). Of the 32 informal sector operators who said that they had paid these taxes in the past, not one of them cited a single advantage/benefit to paying. The respondents however mentioned a number of disincentives/disadvantages to paying informal sector presumptive taxes in Zimbabwe.

Most of the informal sector operators (who reported that they were paying presumptive taxes) were concerned about the generally low level of compliance in this sector. When asked what the major disadvantage of paying these taxes was, 14 of the transport operators cited unfair competition from tax evaders as the main disadvantage (also cited as “too many people not paying”). One minibus taxi operator actually reported that he had stopped paying when he realised that the vast majority of other operators were not paying (Informal Sector Operator 38, Transport, 14 April 2013). Other disadvantages cited were: low profits/inability to pass these taxes on to customers; touts and rank marshals who were collecting their own ‘taxes’; the inability to negotiate with ZIMRA when the vehicle is off the road (or when profits are low in that quarter); and the lack of any form of consultation in the setting of tax rates. These are issues that lead to low tax morale and therefore compliance. They also have implications for equity that will be discussed in more detail in the next chapter.

⁹³ As mentioned earlier, it is not clear whether the city council is collecting these taxes and if they are being remitted to ZIMRA.

6.4 Concluding remarks

This chapter analysed the attempt to collect taxes from the informal sector in Zimbabwe with reference to administration and compliance. A notable success in the collection of these taxes has been the increase in the amounts collected between 2009 and 2011. However, without clear revenue targets or information on the potential tax revenue from this sector, it is not clear what the remaining tax gap is. Furthermore, an evaluation of the way taxes are administered needs to go beyond the amount of revenue collected. This examination needs to look at issues such as the coverage of these taxes, the amount collected as a proportion of total revenues, the costs incurred in collecting (and complying with) these taxes, and the administration's ability to encourage quasi-voluntary compliance.

Any analysis of tax administration within the context of a failing state, such as Zimbabwe, cannot ignore the political reality in which revenue collection occurs. There are a number of factors (called external factors in this study) that are beyond ZIMRA's control such as perceptions around government legitimacy, accountability and transparency. In a country where the government is failing to maintain the basic infrastructure, for example, it is very difficult to convince people to pay their taxes. These factors have an impact on tax compliance behaviour. Taxpayers in this study viewed such things as the way tax revenues are used by the state (with no benefits for those paying them), the existence of 'committees' (aligned to ZANU-PF) that collected their own fees, the coercive nature of tax collection, the lack of consultation on the setting of tax rates, and government corruption as major disincentives. These factors have a negative impact on tax morale.

These external factors were not the only ones that ZIMRA had to contend with. Although ZIMRA is largely a functioning institution, the crisis notwithstanding, the study found that there were a number of internal factors that affected the effective administration of informal sector taxes in Zimbabwe. These include such things as limited manpower, poor monitoring and evaluation, and high levels of corruption. This study indicates that the levels of evasion due to poor monitoring (confirmed by the informal sector respondents themselves) and corruption (within ZIMRA and the police) are high. These weaknesses on the part of ZIMRA, the lack of awareness of these taxes on the part of informal sector operators, together with what were considered to be high tax rates, operate as an impediment to informal sector tax compliance.

Also, not much seems to have been done in educating informal sector operators and making them aware of informal sector taxes in Zimbabwe. While there was some knowledge of formal sector taxes among informal operators who formed part of the study, not much was known about the taxes that affected their own sector. According to those informal sector operators who knew about these taxes, presumptive tax rates are too high in Zimbabwe, especially when one includes the other ‘fees’ that informal sector operators have to pay. This makes compliance difficult and in some cases (such as the hairdressing salons) impossible. This was an issue on which there was agreement between taxpayers (the informal sector operators) and many within ZIMRA (particularly with respect to the tax rate for hairdressing salons). These high tax rates and the selective administration of, and compliance with, tax regulations are issues that speak to the concept of equity, the subject of the next chapter.

Chapter Seven – Equity and efficiency of presumptive taxes

7.1 Introduction

The previous chapter looked at administrative effectiveness, one of the three criteria of a good tax system as defined in the public finance literature. This chapter analyses the other two criteria of a good tax system - equity and economic efficiency. As outlined in Chapter Two, a good tax should be fair. Equals should be treated in the same way (horizontal equity) and those at different income levels should be treated differently (vertical equity). The assessment of economic efficiency involves analysing the tax-induced changes in behaviour that result from the implementation of presumptive taxes.

This chapter begins by assessing the equity of informal sector presumptive taxes in Zimbabwe vis-à-vis formal personal and corporate income taxes using a method similar to the one used by Grown and Valodia (2010) as explained below. The analysis is based on the interviews with informal sector operators and key informants as well as information from the tax code. The chapter assesses the tax-induced behavioural changes (i.e. economic efficiency) that result from the implementation of informal sector presumptive taxes. As noted in Chapter Four, the assessment of economic efficiency is not done using conventional public finance analysis. Instead, this assessment is based on interviews with informal sector operators and key informants – a more feasible approach given the limited statistical data available from ZIMSTAT.

This chapter is organised as follows. Section 7.2 explains the methodology used to assess equity in more detail. Section 7.3 provides an analysis of the equity impact of presumptive taxes for each of these sub-sectors vis-à-vis both personal (PIT) and corporate (CIT) income taxes. Each sub-section begins by analysing these enterprises' characteristics, their mode of operation and reported profits. This section also looks in more detail at a major source of inequity resulting from the poor tax administration first outlined in Chapter Six – the selective application of tax regulations. Section 7.4 presents the evidence on the behavioural changes that were observed and reported by the informal sector operators and key informants. This section also looks at the possible behavioural changes that could occur if these taxes were effectively implemented according to the presumptive tax schedule (Appendix 6). Section 7.5 concludes.

7.2 Informal sector taxation and equity: Describing the methodology

Informal sector taxes have to be raised not only in an administratively effective manner (as outlined in Chapter Six) but also in a way that ensures fairness. Equity issues are (or should be) a central consideration of tax policy (Bird and Gendron, 2006). This is especially true when one looks at informal sector taxation, where it is difficult to ascertain the incomes of those in this sector and incomes may be low or variable. Presumptive taxes have the potential of adversely impacting informal sector operators vis-à-vis those paying formal sector taxes (through horizontal and vertical inequity) if they are poorly designed. There may also be inequitable outcomes if individuals within the informal sector are treated differently depending on their sub-sector.

In analysing both horizontal and vertical equity, this study uses a method similar to the one used by Grown and Valodia (2010). However, unlike Grown and Valodia who based their analysis on gender, the analysis in this study is based on whether taxpayers are in the formal or informal sector. For the comparative analysis of informal sector presumptive taxes vis-à-vis the formal sector income taxes, hypothetical examples based on two types of taxpayers are used, i.e. one from the formal and one from the informal sector.

The analysis of equity involves a comparison of the taxes that would be paid by individuals in the formal and informal sector at a hypothetical minimum level of earnings, twice this minimum and three times the hypothetical minimum. Information from the personal income tax (PIT) schedule and informal sector presumptive tax code is used to calculate the tax burden. The aim, with vertical equity, is to ascertain whether there are differences in the tax burden between taxpayers with different levels of earnings. In terms of horizontal equity, the comparison is used to determine whether individuals with similar incomes have similar tax burdens. A similar analysis is conducted using the corporate income tax (CIT) rate. The hypothetical tax burden of an informal enterprise is compared with that of a formal enterprise, at the corporate income tax rate of 25 per cent, to determine whether the tax burden is similar at the same level of income.

The analysis of equity also compares the presumptive taxes paid by the different informal sector activity classes (i.e. the different cases). This was done to ascertain whether these taxes are fair within the informal sector itself. In other words, are some informal sector activities being treated more harshly than others? The views on the equity of these taxes were also

sought from the informal sector operators and the key informants. What follows is an outline of the method used in the assessment of these presumptive taxes vis-à-vis the formal sector taxes in Zimbabwe. Although the informal sector does pay a number of other taxes apart from presumptive taxes (e.g. VAT on their inputs and the 10 per cent withholding tax on all sales of \$250 or more for those failing to produce the ITF 263 tax clearance certificate), the analysis of equity in this section focused primarily on presumptive taxes.⁹⁴

Table 28 (which is the same as Table 12 in Chapter Five and is shown here for convenience) shows the personal income tax schedule for formal sector workers in Zimbabwe as from 1 January 2012, which is used for comparative purposes. The personal income tax (PIT) in Zimbabwe is progressive. This means that the proportion of income paid as tax increases as income increases as shown in Table 28. The first \$3,000 of taxable income per annum is tax free (i.e. those earning an income of \$250 or less per month have a tax rate of zero). The marginal tax rates imposed on income are progressive with the maximum rate of 45 per cent for those whose taxable income exceeds \$10,000 per month. The other payroll tax paid by individuals in Zimbabwe is the AIDS levy (paid by the employee and employer, each paying three per cent of the income tax payable).⁹⁵ The income tax in Zimbabwe does not have a system of allowances for children and dependents. Tax deductions are therefore carried out according to the schedule in Table 28 (with an additional compulsory three per cent AIDS levy on tax payable).⁹⁶

⁹⁴ It is important to note that according to ZIMRA “The payment of Presumptive Taxes does not exempt the presumptive taxpayer from the obligation to render Income Tax returns” (ZIMRA, 2014b).

⁹⁵ There is also the National State Security Agency (NSSA) contribution of seven per cent of insurable earnings (employers and employees pay 3.5 per cent each). The monthly insurable earnings limit is \$700 in Zimbabwe. The pension contribution made by the employee to NSSA and other pension funds is tax free as long as all these contributions do not exceed \$5,400 per year. Contributions to private pension funds and the compulsory government NSSA contributions will not be included in the analysis (these are a form of investment not normally enjoyed by those in the informal sector).

⁹⁶ The AIDS levy, which was introduced in 1999, provides a source of funding for Zimbabwe’s fight against the AIDS epidemic, especially the purchase of Anti-retrovirals (ARV). According to the National Aids Council which manages this levy, US\$20.5 million was raised in 2010 which contributed almost a quarter of the funds used for the purchase of ARVs in Zimbabwe (Report of the Comptroller and Auditor General, 2011).

Table 28: Personal income tax applicable by income bracket, Zimbabwe

| Monthly table | | | | | | | |
|----------------------|-----------|-----------|--------|-------------|------------|--------|-------|
| Taxable income bands | | | | Rates | Deductions | | |
| from | - | to | 250 | multiply by | 0% | | |
| from | 250.01 | to | 1 000 | multiply by | 20% | Deduct | 50 |
| from | 1 000.01 | to | 2 000 | multiply by | 25% | Deduct | 100 |
| from | 2 000.01 | to | 5 000 | multiply by | 30% | Deduct | 200 |
| from | 5 000.01 | to | 7 500 | multiply by | 35% | Deduct | 450 |
| from | 7 500.01 | to | 10 000 | multiply by | 40% | Deduct | 825 |
| from | 10 000.01 | and above | | multiply by | 45% | Deduct | 1 325 |

Source: ZIMRA website: www.zimra.co.zw (Accessed: 4 June 2012)

The comparison with formal sector businesses in this study uses the corporate tax rate of 25 per cent. After the addition of the three per cent AIDS levy on income tax payable, the effective rate is 25.75 per cent. To obtain this effective CIT tax rate of 25.75 per cent, the corporate tax rate of 25 per cent was multiplied by the three per cent AIDS levy (since it is levied on tax payable and not taxable income) resulting in a figure of 0.75 for the AIDS levy. Unlike the PIT with its tax-free threshold of \$250, the CIT does not have any tax-free thresholds.

However, many companies (both domestic and foreign owned) do pay a much lower rate due to various incentives. These incentives do not apply to presumptive tax and therefore any comparison between the informal taxes and company taxes is likely to overstate the taxes paid by formal firms. One example of an incentive that is available to formal sector companies in Zimbabwe is the special initial allowance. This is a capital allowance that applies to an enterprise's expenditure on such things as the construction of buildings and the purchase of materials and utensils that are used in the enterprises' operations. There are also capital allowances for the purchase of motor vehicles up to a limit of \$10,000 (ZIMRA, 2014b).

This analysis compares formal and informal earners at a hypothetical minimum level of earnings, twice this minimum and three times the hypothetical minimum. These hypothetical income levels are used because not all the respondents in this study provided information on tax payments and profits. These missing data make the calculation of the actual tax burden for each respondent difficult. The hypothetical figures in Table 29 are therefore based on the informal sector operators' reported profit figures (for those who answered the question on profits). For the 39 respondents who responded to the question on enterprise profits, the

reported monthly profit figures ranged from \$250 to \$2,000 (with a median of 600 and mean of 598.5). Eighty-five per cent of the respondents reported a profit figure of between \$250 and \$750 and these are the figures that were used to inform the selection of the hypothetical income levels used in the calculation of equity.⁹⁷ The comparison used the CIT rate because the presumptive tax operates inside the CIT system in Zimbabwe (see Chapter Five). The reported profit in this study (and the one conducted by ZIMRA described in Chapter Five), was the enterprise's profits before the operator's salary had been deducted. Profits in the informal sector are hard to determine (hence ZIMRA's focus on tax/turnover ratios) and it is probably safe to assume this profit is the entrepreneur's salary. Therefore, this study compared this profit (i.e. salary) with both the PIT rate and the CIT rate.

Table 29: Income at three hypothetical levels

| Employment Sector | Number of income earners | Income level | Monthly income before tax (US\$) |
|-------------------|--------------------------|---------------------|----------------------------------|
| Formal/informal | One | Minimum | 250 |
| Formal/informal | One | Twice the minimum | 500 |
| Formal/informal | One | Three times minimum | 750 |

Source: Based on Grown and Valodia (2010)

For formal sector workers, Table 30 shows the monthly PIT payable by a formal sector worker at the three hypothetical income levels based on the rates in Table 28. As shown in Table 30, the AIDS levy is applied to the income tax payable (i.e. the effective rate multiplied by three per cent). For example, the effective tax rate including the AIDS levy for those at three times the minimum level is 13.73 per cent (i.e. the effective rate of 13.33 per cent multiplied by the 3.0 per cent AIDS levy). The table also shows that the personal income tax is progressive, with the proportion of income paid as tax rising as income rises. Those earning US\$250 a month pay no tax (0 per cent), those earning US\$500 a month pay US\$51.50 (10.3 per cent) and those earning US\$750 a month pay US\$102.98 (13.73 per cent).

⁹⁷ For the transport operators, the reported profits per vehicle were used as the presumptive tax is also levied per vehicle.

Table 30: Income tax paid by formal sector taxpayer (PIT) including AIDS levy

| Income level | Type of taxpayer | Monthly income | Monthly tax | Effective rate | Effective rate (incl. AIDS levy) | Tax amount |
|---------------------|------------------|----------------|-------------|----------------|----------------------------------|------------|
| Minimum | Formal | 250 | 0 | 0% | 0% | 0 |
| Twice minimum | Formal | 500 | 50 | 10.00% | 10.30% | 51.50 |
| Three times minimum | Formal | 750 | 100 | 13.33% | 13.73% | 102.98 |

Source: Own calculations based on ZIMRA tax schedule. Absolute values in US\$.

Table 31 shows the tax rates and amounts that a company in the formal sector would pay at the three hypothetical income levels if they declared profits and paid the CIT. The CIT is a proportional tax. Tax is paid at a constant rate of 25.75 per cent (including the AIDS levy) regardless of profit. Those enterprises declaring a profit of US\$250 pay US\$64.38, those with a profit of US\$500 pay US\$128.75, and those declaring a profit of US\$750 pay US\$193.13.

Table 31: Income tax paid by formal sector taxpayer (CIT) including AIDS levy

| Income Level | Type of taxpayer | Monthly income | Monthly tax | Effective rate | Tax rate | Tax amount |
|---------------------|------------------|----------------|-------------|----------------|----------|------------|
| Minimum | Formal | 250 | 62.50 | 25.00% | 25.75% | 64.38 |
| Twice minimum | Formal | 500 | 125.00 | 25.00% | 25.75% | 128.75 |
| Three times minimum | Formal | 750 | 187.50 | 25.00% | 25.75% | 193.13 |

Source: Own calculations

Since presumptive taxes in Zimbabwe vary according to informal sector activity, a comparison will be made between a formal sector taxpayer and an informal entrepreneur in each of the four activity classes that form part of this study (i.e. transport, flea markets, hairdressing salons and cottage industries) (the tax rates described in Chapter Five have been summarised in Appendix 6 for convenience). Before assessing the equity of presumptive taxes, each of the four sections below begins by summarizing some of the main findings from the structured questionnaire that was administered to informal entrepreneurs in each of the informal sub-sectors. A summary of the informal sector operators' demographic characteristics and a detailed description of their enterprises is provided. This information, particularly the findings on the reported profit, also allows us to relate the hypothetical examples above to the earnings reported by the informal operators.

7.3 Informal sector taxes and equity: Comparison across sectors

7.3.1 Transport operators

Within the transport operators' activity class, there are four distinct types of operations – minibus taxis (often referred to as commuter omnibuses or “kombis” in Zimbabwe), taxi-cabs, goods vehicles and driving schools. Of the 23 transport operators interviewed in this study, 16 (70 per cent) were minibus taxi operators and five (22 per cent) were taxi operators. Two goods vehicle operators (or nine per cent of the transport operators) whose trucks were below 10 tonnes (without a trailer, and therefore not subject to presumptive tax) also formed part of this study. Although goods vehicle transporters (under 10 tonnes and without a trailer) are excluded from the presumptive tax schedule, they were included in this study so as to assess the possible equity and efficiency impacts of not taxing these operators.

Twenty-two of the respondents reported that they knew about presumptive taxes and 21 of them said that they had paid these taxes at least once since starting their enterprises while two respondents (the two goods vehicle transporters) reported that they had never paid these taxes.⁹⁸ Of the 21 respondents that had paid at least once, 10 reported that they consistently paid their taxes, eight of the respondents said that they sometimes paid, and three said that they had stopped paying these taxes.

The ages of the transport operators ranged from 26 to 52 with a median of 38 and a mean of 36. Three (13 per cent) of the transport operators had completed secondary school. Six (26 per cent) had a post-secondary certificate or diploma, seven (36 per cent) had an undergraduate degree and another seven (36 per cent) had a postgraduate degree. Before starting their enterprises, 14 (61 per cent) of the transport operators had been employed in the formal sector and two (nine per cent) had been employed in the informal sector. Of the 16 respondents who had been employed before, seven had resigned, five had been retrenched, three had opted for voluntary retrenchment and one had been fired. The voluntary retrenchment option is usually accompanied by a generous package (by Zimbabwean standards) for most professional employees. The eight respondents (i.e. 50 per cent of those

⁹⁸ One of the goods transporters actually reported that he had paid presumptive taxes before as a taxi-cab operator although he had never paid these taxes as a goods vehicle operator. He is therefore excluded from the number of respondents that had paid their taxes at least once before (as he had never paid them as a goods vehicle operator).

formerly employed) who had resigned or opted for voluntary retrenchment clearly indicates ‘exit’ - they voluntarily decided to opt out of the formal sector (see Chapter Two).

Table 32 lists the respondents’ former occupations. The former occupations listed in the table clearly indicate the heterogeneous nature of Zimbabwe’s informal sector. These are not the typical occupations of informal entrepreneurs that are normally found in the literature. The economic crisis has resulted in an influx into informal employment of highly educated people who either choose not to be in the formal sector (‘exit’) or have failed to secure employment (or maintain their jobs) in the shrinking formal sector (pointing to the concept of ‘exclusion’ that was first outlined in Chapter Two).

Table 32: Former occupations of transport operators

| | |
|--------------------------|----------------------|
| Branch manager | M&E officer |
| Child protection officer | Manager |
| Credit controller | Merchandiser |
| Cross-border trader | Sales manager |
| Lecturer | Driver |
| Tax collector | IT manager |
| Data administrator | Sales representative |
| Telecoms engineer | School teacher |

Source: Own survey

None of the vehicles in these enterprises were owner-operated. All the respondents (some of whom had more than one vehicle) had at least one paid employee. The number of paid employees ranged from one to six. Only three respondents (13 per cent) had more than three paid employees, and 18 respondents (78 per cent) had between one and two employees. Twenty-one respondents reported that they paid their workers a commission based on how much they made, one reported paying a salary, and one reported paying both a salary and commission.

Starting and operating a transport enterprise requires a significant injection of capital. The amounts needed to start the business ranged from \$5,000 to \$18,000 (largely dependent on the number and type of vehicles initially purchased) with a median of \$9,000 and a mean of \$9,200. Twenty of the respondents (87 per cent) used their own (or household) capital to start their enterprises while three respondents (13 per cent) reported that they had obtained a personal loan from the bank which they used as start-up capital.

Many of the respondents in the study were established entrepreneurs (based on the number of years that they had spent running their enterprises). Eleven (48 per cent) of the 23 respondents reported that they had been operating their businesses for more than three years. Six (26 per cent) of the transport operators reported having been in business for eight years or more (with three of these having operated their enterprises for more than 10 years).

Fourteen (61 per cent) of the respondents said that they were members of an association.⁹⁹ In response to the question on the advantages of belonging to an association, the respondents cited issues such as the ability to lobby local authorities (on parking and licensing issues), negotiating with police (especially concerning bribery and touts), and the accessing of cheap vehicle spare parts. There seem to be a number of different taxi associations operating in Harare. The 10 minibus taxi operators who reported that they were members of an association mentioned five different associations while the four taxi-cab operators who were members of an association mentioned two different associations. The two goods vehicle operators reported that they did not belong to any association but both said that they paid monthly fees to self-appointed committees. This fragmentation of transport associations seems to have compromised their effectiveness as local authorities and government have complained that they have to deal with many different bodies, each with its own set of requests (see *The Herald*, 2013).

In terms of the recording of business transactions, only five (22 per cent) respondents said that they did not keep any written records of their business transactions. Fourteen (61 per cent) reported that they kept basic records of income and expenditure while four (17 per cent) said that they maintained simplified accounts. Only one transport operator in the study reported that he kept a separate bank account for the enterprise (i.e. separate from his personal bank account).

The reported (pre-tax profit) figures are shown in Table 33. An important point made in the literature on informality is the difficulty of reliably capturing information on profit as many in the informal sector do not distinguish between turnover, gross earnings, and net earnings

⁹⁹ There is a distinction between an association and a committee in Harare's informal sector. Associations are voluntary organisations whereas committees are groups of usually self-appointed individuals that in some cases organise and run the affairs of the informal sector operators at a particular site. However, in some cases these are just party-aligned individuals who extort money from those in the informal sector.

(see Mkhize et al., 2013). The profit figures mentioned by informal sector operators in this study should therefore be interpreted with caution although the distinction between turnover and profit was clearly explained to the respondents.

Table 33: Transport operators' gross profit per month (per vehicle)

| | Minibus taxi | Taxis | Goods transporters |
|---------|-----------------|-------|-----------------------|
| Median | 600 | 300 | 850 |
| Mean | 596 | 318 | 850 |
| Minimum | 400 | 250 | 700 |
| Maximum | 750 | 400 | 1000 |
| N | 14 | 5 | 2 |

Source: Own survey

Minibus taxi operators in the study reported that it is very difficult to make a profit of more than \$800 per month, per minibus taxi.¹⁰⁰ This is due to three main reasons: firstly, the fares (which are regulated by government); secondly, the frequent police roadblocks and checkpoints (where bribes have to be paid); and thirdly, the days their vehicles spend off the road due to breakdowns - attributed to the poor state of the roads (a clear sign of a failing state).¹⁰¹

One public passenger transport operator reported that calculating his monthly profit is not too difficult. Each of his 18-seater minibus taxis makes between eight to 12 trips a day. This gives a daily turnover figure of \$90 for 10 trips, but could be higher if the driver has more than 18 passengers per trip (each passenger pays \$0.5 per trip). The transport operator sets the driver a daily turnover target of between \$60 and \$80 depending on the route. In other words, the driver has to give the operator \$60 to \$80 at the end of each day. The three main expenses borne by the driver which cannot be deducted from the \$60-\$80 target are the purchase of

¹⁰⁰ Although the participants in this study were not randomly selected, the mean profit figures reported by minibus taxi operators and taxi-cabs of \$596 and \$318 respectively are similar to those from ZIMRA's own studies on the profitability of this sub-sector. The study conducted by ZIMRA a few years earlier reported slightly lower average profit figures for the minibus taxis and taxi-cabs of \$556 and \$278 respectively (using the IMF's equilibrium nominal exchange rate for June 2005, see Chapter Five).

¹⁰¹ Roads in Harare are in a very bad state as the government is failing to maintain them. According to the state failure theorist Robert Rotberg (2003: 7) "Failed states are typified by deteriorating or destroyed infrastructures. Metaphorically, the more potholes (or main roads turned to rutted tracks), the more a state will exemplify failure".

fuel, the payment of daily bribes of between \$10 and \$30 to the police and at least \$0.5 per trip (or \$5 a day) to touts. The taxi is on the road for, on average, 20 days a month. This particular operator reported paying a weekly wage of \$60 to the driver and \$30 to the conductor. The minimum daily (turnover) target of \$60 means that the operator makes \$1200 in 20 days before deducting wages of \$360 and maintenance costs of around \$100 a month. The monthly profit, based on these calculations is \$740 (Informal Sector Operator 27, Transport, 24 November 2011 and 8 October 2014).¹⁰²

According to the presumptive tax schedule (as described in Chapter Five), all taxi-cabs are supposed to pay a presumptive tax of \$100 per quarter. According to the 2011 presumptive tax schedule, the amounts paid by minibus taxis range from a minimum of \$150 to \$450 per quarter depending on carrying capacity. This analysis of equity focuses on minibus taxis with a carrying capacity of 18 (i.e. paying \$175 per quarter) which was the most common type of minibus taxi among the respondents. Table 34 outlines the monthly presumptive tax that should be paid by public passenger transport operators (i.e. taxis and minibus taxis) at the three hypothetical levels of income. The calculations used for the assessment of equity use monthly profit figures whereas the presumptive tax schedule specifies amounts to be paid quarterly. To obtain the monthly tax amount in Table 34, the quarterly presumptive tax figures (\$100 and \$175 for taxi-cabs and minibus taxis with a capacity of 18 passengers respectively) are divided by three. The effective tax rate is then obtained by dividing the monthly tax amount by the monthly income (i.e. 33.33 divided by 250 for taxi-cabs at the hypothetical minimum income level).

¹⁰² Although not mentioned by any of the respondents, clearly allowances would have to be made for depreciation before arriving at a profit figure.

Table 34: Taxi-cab and minibus taxi monthly taxes compared to PIT

| Income level | Type of earner | Monthly income | Presumptive tax | | Personal income tax | |
|---------------------|----------------|----------------|-----------------|----------------|---------------------|----------------|
| | | | Monthly tax | Effective rate | Monthly tax | Effective rate |
| Minimum | Taxi-cab | 250 | 33.33 | 13.32% | 0 | 0 |
| | Omnibus | 250 | 58.33 | 23.33% | 0 | 0 |
| Twice minimum | Taxi-cab | 500 | 33.33 | 6.67% | 51.5 | 10.30% |
| | Omnibus | 500 | 58.33 | 11.67% | 51.5 | 10.30% |
| Three times minimum | Taxi-cab | 750 | 33.33 | 4.44% | 102.98 | 13.73% |
| | Omnibus | 750 | 58.33 | 7.78% | 102.98 | 13.73% |

Source: Own calculations

As mentioned earlier, the presumptive tax is a specific or unit tax. It is not based on the level of income or profit but rather the same absolute value is paid by all operators regardless of the income or profit. As Table 34 shows, these taxes are highly regressive given that a minibus taxi operator making a profit of \$250 a month pays \$58.33 (23.33 per cent), while one making a profit of \$500 a month also pays \$58.33 (or 11.67 per cent of income), which is the same amount paid by the one earning \$750 (who also pays \$58.33 or 7.78 per cent of income). This is in contrast to the personal income tax rates also shown in Table 34: a worker earning \$250 pays nothing (0 per cent) while the one earning an income of \$500 would be expected to pay \$51.50 (or 10.3 per cent of their income) and the one earning \$750 would be expected to pay more, \$102.98 (i.e. 13.73 per cent) in the form of PIT. In other words, both the absolute and relative burdens increase as the income increases. The transport operators' presumptive tax is therefore vertically inequitable as it results in those earning more paying less in relative terms. This is, as outlined in Chapter Two, a feature of specific/unit presumptive taxes.

Next, horizontal equity is considered. Compared to personal income taxes which have a tax-free threshold of \$250, presumptive taxes for the two informal sector activities in Table 34 are horizontally inequitable at the hypothetical minimum level of income. While those earning \$250 as an employee in the formal sector have a zero per cent tax rate, taxi-cab operators pay 13.32 per cent of their income and minibus taxis pay 23.33 per cent. At twice the hypothetical minimum level, the results are mixed. The minibus taxi operators pay 11.67 per cent which is more than that paid by a formal sector worker (who pays 10.30 per cent) while taxi-cab operators (at 6.67 per cent) pay less than those in the formal sector at this level. The rates for both types of passenger public transport operators are lower when compared with formal sector taxes at three times the minimum income level (where a formal

sector worker pays a rate of 13.73 per cent while taxi-cab operators and minibus taxi operators pay 4.44 per cent and 7.78 per cent respectively – see Table 34). This means that at three times the hypothetical minimum income level, the PIT is horizontally inequitable vis-à-vis the presumptive tax, but with the disadvantage to the formal workers.

Table 35 shows the comparison between the presumptive taxes paid by transport operators and formal sector enterprises that pay a corporate income tax (CIT) of 25.75 per cent. The table shows that the public passenger transport tax rates are lower at the three hypothetical income levels when the presumptive taxes are applied. This indicates that there is horizontal inequity with the disadvantage to the formal businesses. However, it must be noted that an analysis of the way these enterprises operate shows that being in the informal sector has its hazards (particularly in the form of payments made to the police and touts) coupled with such things as uncertain income streams and days when the vehicles are off the road.¹⁰³

Table 35: Taxi-cab and minibus taxi monthly taxes compared to CIT

| Income level | Type of earner | Monthly income | Presumptive tax | | Corporate income tax | |
|---------------------|----------------|----------------|-----------------|----------------|----------------------|----------------|
| | | | Monthly tax | Effective rate | Monthly tax | Effective rate |
| Minimum | Taxi-cab | 250 | 33.33 | 13.32% | 64.38 | 25.75% |
| | Omnibus | 250 | 58.33 | 23.33% | 64.38 | 25.75% |
| Twice minimum | Taxi-cab | 500 | 33.33 | 6.67% | 128.75 | 25.75% |
| | Omnibus | 500 | 58.33 | 11.67% | 128.75 | 25.75% |
| Three times minimum | Taxi-cab | 750 | 33.33 | 4.44% | 193.13 | 25.75% |
| | Omnibus | 750 | 58.33 | 7.78% | 193.13 | 25.75% |

Source: Own calculations

There are various ‘taxes’ that public passenger operators have to pay, particularly the payments made to touts and the police.¹⁰⁴ According to one operator “They [taxes] are Ok but there are too many payments that we have to make - to the police and to touts” (Informal Sector Operator 47, Transport, 6 May 2014). As outlined in Chapter Six, the issue of touts has a bearing on the equity of presumptive taxes. Transport operators, particularly those operating minibus taxis, are at the mercy of (usually party-aligned) touts who exact a fee for

¹⁰³ Also, those registered for CIT can claim certain deductions which may result in the effective rate being less than 25.75 per cent.

¹⁰⁴ Although these ‘taxes’ in the form of bribes and fees to touts are factored into the profit calculations and are essentially a cost of doing business, minibus operators, as shown below, regard them as an unavoidable ‘tax’. Also, these are business costs that do not normally apply to formal sector organisations.

every trip that the minibus taxi makes – called a “forced permit” by one of the respondents (Informal Sector Operator 45, Transport, 4 May 2014). For example, an 18-seater minibus taxi making 10 trips a day and paying the minimum of \$0.50 per trip actually pays these touts \$5 a day. This means that if this minibus taxi operates for 20 days in a month, the operator loses \$100 per month to touts. Clearly, unless a transport operator finds a way of avoiding these touts (almost impossible in Harare), these fees increase the ‘tax rate’ over and above the one specified in the presumptive tax schedule.

Paying bribes to corrupt police officers for the smallest infringements also exacts a heavy toll on the transport operators’ earnings. According to a transport operator “The police mount roadblocks and checkpoints just to make money from kombis. We just pay them so that they don't harass us and waste our time” (Informal Sector Operator 26, Transport, 19 September 2011). If these payments in the form of bribes and fees paid to touts are added to the informal tax payments, presumptive taxes (particularly in the case of minibus taxis) become horizontally inequitable vis-à-vis formal sector personal income taxes at all the hypothetical levels of income.¹⁰⁵ Minibus taxi fares, unlike those of taxi-cabs which are negotiated, are regulated by government. This means that minibus taxi operators cannot shift the tax burden to passengers.

The payments that transport operators make to (often violent and unruly) touts and the police (in the form of bribes) are a manifestation of the crisis in Zimbabwe.¹⁰⁶ In the case of touts, whose behaviour is condoned and sometimes encouraged by ZANU-PF, this has meant that money which should be flowing into government coffers (or remaining in the operators’ pockets), instead flows into a section of society that supports ZANU-PF.

According to the Twenty-Sixth Schedule of the Income Tax Act (23:06) of 2010 “A police officer may demand that any operator or person in charge of an omnibus or taxicab produce a tax clearance certificate as proof that he or she has paid the presumptive tax payable in respect of the omnibus or taxicab”. Many of the respondents felt that the police conveniently use this act to extort bribes from them. One respondent who reported paying around \$10 every day to police said “I have to pay the police to avoid intimidation and time wasting”

¹⁰⁵ However, the CIT would still be horizontally inequitable vis-à-vis the public passenger transport presumptive taxes even if the payments to touts were treated as a tax and not a cost of doing business.

¹⁰⁶ See also (NewsDay, 2012d).

(Informal Sector Operator 36, Transport, 10 April 2013). According to transport operators, paying presumptive taxes does not exempt them from police harassment – bribes still have to be paid. Police bribes therefore operate as a disincentive when it comes to paying presumptive taxes. Two of the three transport operators who reported that they no longer paid taxes cited the bribes paid to police as the main reason why they had stopped paying (with the other one citing the high levels of tax evasion, an issue that is analysed below). According to one respondent “The police at roadblocks are very corrupt. You have to pay a bribe even when you have paid taxes, even when your vehicle is in a good state. Otherwise they will waste your time until you pay. Now I just pay the police” (Informal Sector Operator 44, Transport, 29 April 2014).

Not surprisingly, 16 transport operators said that the presumptive tax rates were too high. According to one respondent “These taxes are too high. I had to pay presumptive tax even when one of my taxis had been involved in an accident” (Informal Sector Operator 33, Transport, 3 April 2013). This relates to the point made earlier on the regressive nature of these taxes where those who make no profit (as is the case here) are still liable. However, five respondents did say that the actual rates were reasonable although they complained about the fairness of these taxes given the fact that many other informal entrepreneurs were not paying.

Many respondents believed that a large number of those in the transport sector were not paying taxes. One of the respondents said “Taxes are fair in terms of the amount but not fair in the sense that there are many people evading and those evading the taxes are getting away with it - they are not punished” (Informal Sector Operator 36, Transport, 10 April 2013). The selective application of tax regulations was a major concern for transport operators in this study and was cited as a disadvantage by 11 respondents. One respondent said “ZIMRA is not efficient in this regard. They should tax everyone, not only those who are willing to pay” (Informal Sector Operator 38, 14 April 2013). Those that were paying presumptive taxes felt that those who were not paying had an unfair advantage over them. This was also cited as a disincentive by two of the three transporters who reported that they no longer paid presumptive taxes. According to one operator “I started paying taxes just after I started operating. Then I stopped paying when I realised that most people were not paying” (Informal Sector Operator 38, Transport, 14 April 2013).

The ranks of the registered minibus taxis that are not paying presumptive taxes have also recently been swelled by a proliferation of unregistered minibus taxis (and taxi-cabs) that have been operating in Zimbabwe since 2009.¹⁰⁷ The main challenge facing taxi-cab operators seems to be one of intense competition due to the importation of cheap second-hand Japanese cars. According to one respondent who was commenting on the stiff competition in Harare's taxi-cab sector "There are too many people who are bringing in cars and turning them into taxis. Everyone in Harare has a taxi now and making money in this business is tough. We are just trying to survive" (Informal Sector Operator 42, 25 April 2014). There are vehicles, whose owners are not only evading tax, but have also not been certified as roadworthy by the Ministry of Transport – a manifestation of the Zimbabwean crisis where the government is failing to effectively regulate this sector.¹⁰⁸ One respondent said "We have to pay the municipality and the Ministry of Transport in order to operate, we have to pay insurance and then we have to pay ZIMRA. There are many pirate taxis here and they pay nothing, this is unfair" (Informal Sector Operators 44, Transport, 29 April 2014).

Another source of inequity that was mentioned by respondents, which is a combination of corruption and the selective application of regulations, was that of unfair competition from police officers who own minibus taxis in Harare.¹⁰⁹ According to one respondent, there was clearly a "conflict of interest" as they were now competing with the same people who were supposed to enforce the law. According to this respondent "There is a conflict of interest. We are now competing with police officers who have kombis. The kombis belonging to police officers are not treated in the same way. Our kombis are targeted at roadblocks" (Informal Sector Operator 27, Transport, 24 November 2011).¹¹⁰

¹⁰⁷ As outlined in Chapter Six, all minibus taxis and taxi-cabs have to be registered with the Ministry of Transport and licensed by the municipal authority before they can operate on Zimbabwe's roads.

¹⁰⁸ According to a recent Harare Municipality report, of the more than 14,000 commuter omnibuses that are operating in the city, only 7,220 are registered (see *The Sunday Mail*, 2014).

¹⁰⁹ This is an example of informal sector participation by those in formal employment. Although the focus of this study was on those who only operate in the informal sector, this phenomenon of people operating in both sectors appears to be a peculiarity of informal economies in a failing state. Unlike the participation of formal firms in the informal sector, very little empirical research has been conducted on this issue.

¹¹⁰ Although it was an issue that was cited by only three respondents, according to one newspaper report, up to 50 per cent of minibus taxis in Harare are owned by police officers (*NewsDay*, 2014).

According to the presumptive tax schedule, there are four distinct types of operations – minibus taxis, taxi-cabs, driving schools and goods vehicles (more than 10 tonnes). However, goods vehicles (less than 10 tonnes) appear to have been left out of the presumptive tax schedule although it is an activity whose operators (two of whom participated in this study) reported earning more, on average (i.e. \$850 compared with \$596 and \$318 for minibus taxis and taxi-cabs respectively), than the public passenger transport operators in this study. The two goods vehicle operators reported making profits of \$700 and \$1,000 each (see Table 33). The omission of this particular activity class not only speaks to the issue of equity but also that of economic efficiency as well, which will be analysed in more detail in Section 7.4.

Presumptive tax rates are lower than the PIT for taxi-cab operators at twice and at three times the hypothetical minimum level of income and for minibus operators at three times the minimum. Presumptive taxes are lower than CIT at all three hypothetical income levels for both taxi-cabs and minibus taxis. Of course, for those in the formal sector, this is unfair. However, it is difficult for taxi-cab operators to make a profit of more than \$400 a month (see Table 33 and ZIMRA’s own profit calculations for this sector in Chapter Five). For minibus taxi operators, there are also numerous hazards of operating in the informal sector such as bribery, corruption and the harassment by touts. And importantly, for those earning the minimum cited for this sector (\$250), they carry a much higher tax burden than formal sector employees who do not pay any PIT.

7.3.2 Flea market operators

The nine flea market operators in this study were all cross-border traders who imported goods mainly from South Africa, Botswana, Dubai and China for resale in Zimbabwe. Six of the respondents were males and three were females. Five of the respondents operated from a privately owned flea market in a low-density area while four operated from a council-owned flea market in a high-density suburb of Harare.

The ages of the flea market operators ranged from 24 to 49 with a median of 35 and a mean of 37 (a median of 31 for males and 44 for females). Three respondents had completed secondary school (two males and one female) and six had a post-secondary certificate or diploma (four males and two females). Four of the respondents (males) reported that they were the sole breadwinner in their household and the household sizes ranged from one to five with a median and a mean of three (a median of two for males and five for females).

Before starting their enterprises, seven of the respondents had been employed (six in the formal sector and one in the informal sector). Of them, three had resigned, two had been retrenched and two had opted for voluntary retrenchment. Three of the males had been employed in the formal sector while one had been employed in the informal sector. The three females had all been employed in the formal sector. The list of the respondents' former occupations is shown in Table 36.

Table 36: Former occupations of flea market operators

| | |
|----------------|---------------------|
| Accountant | Caterer |
| Accounts clerk | Clerk |
| Administrator | Computer programmer |
| Barber | |

Source: Own survey

Two of these enterprises were actually registered companies (but not registered for income tax) and seven enterprises were neither registered nor licensed. The number of paid employees in the enterprises ranged from zero to five (three respondents had no paid employees) and the mean and median number of paid employees was one. Of the six respondents who reported having paid employees, three paid a commission, two paid both a salary and commission and one paid a salary. Seven of the respondents reported that they only operated from one site but two respondents reported that they operated from more than one site (i.e. different flea markets). The number of years in operation ranged from one to 10 years with a median and a mean of three. Two respondents reported that they did not keep any records of their business transactions. Two reported that they kept simple records of orders, sales and purchases and five reported that they kept simplified accounts.

In terms of their inputs, flea market operators cited two sources (multiple responses were allowed): imports (from their own cross-border trading operations, cited by nine); and goods sourced from other informal traders (cited by three). The respondents' main customers (multiple responses were allowed) were as follows: 1) the general public (cited by nine respondents); 2) other informal traders (cited by four respondents); and 3) formal sector enterprises (cited by four respondents).

Two respondents reported that they maintained bank accounts for their enterprises that were separate from their private accounts while seven of the respondents did not have a separate

bank account for their enterprises. For the seven respondents who answered this question, the amount of start-up capital needed to establish these enterprises ranged from \$300 to \$2,000 with a median of \$1,000 and a mean of \$1,157. The reported profits for the four flea market operators who responded to this question ranged from \$600 to \$2,000 per month with a median of \$750 and a mean of \$1,025. In terms of their working capital needs (multiple responses were allowed), profits generated from the enterprises were cited as a source by nine respondents and trade credit from other informal sector enterprises was cited as a source by two respondents.

As cross-border traders, flea market operators are charged a 10 per cent tax on the value for duty purposes (VDP) of the item imported into Zimbabwe. Those operating from the flea market in the low-density area also pay a daily flea market stall rental to the landlord of \$10 a day (Informal Sector Operator 18, Flea Market, 25 October 2011) of which 10 per cent should be remitted to ZIMRA by the landlord (according to the presumptive tax schedule), while those in the high-density area pay monthly rentals of \$40 to the municipality (Informal Sector Operator 16, Flea Market, 31 August 2011).¹¹¹

Of the nine flea market operators interviewed, two of them said that they paid VDP every time they imported goods into Zimbabwe for resale, although none of them mentioned the 10 per cent presumptive tax on stall rentals. Three of the flea market operators said that they sometimes paid and sometimes negotiated with officials at the border. According to one respondent “There are too many taxes at the border. If you pay the taxes you will not make a profit. It is better to talk to the driver who negotiates with ZIMRA officials. The drivers know the ZIMRA officials better and they know what to do” (Informal Sector Operator 18, Flea Market, 25 October 2011). Another respondent said “I have been operating for a long time and I know the ZIMRA officials. They also know me. I can always negotiate” (Informal Sector Operator 16, Flea Market, 31 August 2011). The other four respondents did not respond to questions on tax payments although they said that they knew about the VDP.

Assuming that an operator imports goods worth \$500, \$1,000 and \$1,500 (thus attracting the 10 per cent VDP) per trip, to which the trader adds a mark-up of 100 per cent, Table 37

¹¹¹ As outlined earlier in this chapter, the presumptive tax schedule specifies that an additional amount equal to 10 per cent of the rental should be withheld (by all landlords including local authorities) and remitted to ZIMRA.

shows the tax that would apply.¹¹² As shown in the table, both VDP and the CIT are proportional taxes. In terms of vertical equity, this means that the VDP is neither progressive nor regressive. The PIT, as shown in Table 41, is a progressive tax.

Table 37: Flea market operators' taxes per trip

| Income level | Imports | Retail value | Costs | Profit | VDP | Effective rate | PIT rate | CIT rate |
|---------------------|---------|--------------|-------|--------|-----|----------------|----------|----------|
| Minimum | 250 | 500 | 250 | 250 | 25 | 10.00% | 0.00% | 25.75% |
| Twice minimum | 500 | 1 000 | 500 | 500 | 50 | 10.00% | 10.30% | 25.75% |
| Three times minimum | 750 | 1 500 | 750 | 750 | 75 | 10.00% | 13.73% | 25.75% |

Source: Own calculations

Flea market presumptive taxes are high when compared to PIT rates at the minimum hypothetical income level. At the minimum level of income, a flea market operator pays tax at a rate of 10 per cent while a formal sector worker pays nothing. At twice and at three times the hypothetical minimum level of income, the formal sector worker pays 10.3 per cent and 13.73 per cent respectively while the flea market operator pays 10 per cent. This means that at these higher income levels, there is horizontal inequity with a disadvantage to those paying the PIT. The presumptive tax rate of 10 per cent is lower than the corporate tax rate of 25.75 per cent. This means that at there is horizontal inequity with a disadvantage to those paying CIT.

Flea market operators are evading taxes at the border. The issue of smuggling was mentioned by three flea market operators who felt that many cross-border traders were bribing ZIMRA officials and the police so as to evade paying taxes. According to one respondent "Many people are smuggling goods into the country and can sell their goods cheaply. I always pay and those who pay taxes are competing with those who are not paying. This is not fair" (Informal Sector Operator 19, Flea Market, 24 November 2011). ZIMRA officials interviewed in this study were aware of the rampant smuggling and corruption at the country's border posts. They were also aware of the fact that many drivers were working with corrupt ZIMRA officials in helping cross-border traders smuggle goods and thus evade taxes

¹¹² Although the respondents were not asked questions related to profit targets, cross-border traders in Zimbabwe usually sell goods at least twice the price charged in the country of origin (see Jamela, 2013; see also The Mail and Guardian, 2013).

and duties. This is one of the reasons, according to one respondent, why they had decided to mount roadblocks that also focused on buses carrying cross-border traders. According to the official “They [bus drivers] have tried to change the drop-off points for traders after smuggling goods into the country. We have therefore intensified roadblocks with the police” (Key Informant 15, ZIMRA, 29 September 2011).

7.3.3 Hairdressing salons

This study found two distinct categories of hairdressing salon operators in Harare. The first category was made up of two entrepreneurs (both males) who were licensed owners of the businesses but operated the ‘rent-a-chair’ system. These two enterprises were located in Harare’s central business district. The second category was made up of six respondents (females) who ran their own salons either from home (two women) or from a rented room (or a flat) close to Harare’s central business district (four women), an area called the Avenues. The two respondents operating from their homes had neither registered nor licensed their salons with the city council, while the four respondents in the Avenues reported that their enterprises were licensed.

While there are a number of hairdressing salons in the high-end shopping complexes with a steady (and high paying) clientele, and which employ permanent employees, the majority of registered hairdressing salons in Harare’s central business district use the ‘rent-a-chair’ system (Informal Sector Operator 11, Hairdressing Salon, 25 April 2014). This is where the registered owner of the salon rents out chairs to independent hairdressers and barbers, none of whom are personally registered or pay taxes. According to one respondent “I have 15 to 20 hairdressers and barbers in this salon. This number changes all the time. Barbers pay rent of \$196 and hairdressers pay \$250 per month” (Informal Sector Operator 9, Hairdressing Salon, 17 April 2014).

The two male respondents’ ages were 33 and 38. The six female respondents’ ages ranged from 25 to 56 with a median of 33 and a mean of 36. Both male respondents had completed secondary school. Half of the female respondents had completed secondary school while the other half had a post-secondary certificate or diploma. Of the six female respondents, only two reported that they were the sole breadwinner in their households. One male respondent reported that he was the sole breadwinner.

Of the eight hairdressing salon operators in the study, three (one male and two females) reported that they had been employed before (in the formal sector). The male respondent had been a laundry presser. One of the female respondents had worked as a secretary while the other respondent had been a sales representative. One of the female respondents had resigned while the other two respondents had opted for voluntary retrenchment.

All the respondents reported that they had used their own capital to start their enterprises. The one male respondent who answered the question on start-up capital said that he had used \$1,000 to start the business. The amounts used by the female respondents to start their businesses ranged from \$100 to \$4,000 with a median of \$300 and a mean of \$1,200 (with the two female respondents operating from their homes reporting the lowest amounts of \$100 and \$200). Each of the male respondents reported that they had one paid employee in their enterprise. The number of paid employees for the female respondents ranged from zero to two (with the two respondents operating from home having no paid employees).

Many of the respondents reported that they had been in business for a long time: nine and 14 years for the male respondents; and between two and six years for the six female respondents (with a median of five and a mean of seven years). Of the five hairdressing salon operators who responded to the question on the recording of business transactions, three reported that they did not keep any records while two said that they kept simplified accounts.

In terms of their inputs, the most common sources cited (multiple responses were allowed) were formal traders (cited by six respondents), other informal traders (cited by six) and the importation of inputs by the hairdressing salon operators themselves (cited by three). All the respondents reported that the profits generated from the business were the main source of their working capital requirements.

The two male hairdressing salon owners (who rent out chairs to ‘entrepreneurs’) reported making profits of \$500 and \$800 per month each. The six female hairdressing salon operators reported making profits of between \$300 and \$1,000 (with a median of \$500 and a mean of \$542) a month. For the female respondents in this study, there was a relationship between enterprise location and reported profits. The two respondents operating from their homes in the high-density suburbs reported making profits of \$300 and \$350 each while those operating in the Avenues area of Harare reported making profits of between \$400 and \$1000.

One respondent said “Starting this business is not difficult. You can even work from your home. That is why there are many salons that are not licensed with the council and are not inspected. It is now difficult for licensed salons to make money” (Informal Sector Operator 14, Hairdressing Salon, 29 April 2014). When not attending to clients, many hairdressers and barbers can be seen on the street, just outside these establishments, touting for business.

According to the presumptive tax schedule, hairdressing salons are supposed to pay \$1,500 per quarter (i.e. \$500 per month). Presumptive taxes are fixed and there are no exemptions for those below a certain level of income as is the case with the personal income tax. Table 38 shows the application of hairdressing salon presumptive taxes to the three hypothetical levels of income compared with the PIT. As the table shows, the hairdressing salon presumptive tax is not vertically equitable. It is a highly regressive tax (i.e. not treating taxpayers at different income levels differently). A hairdressing salon owner making a profit of \$250 is expected to pay a tax of \$500 (or 200 per cent of the profit), while those making a profit of \$500 and \$750 are expected to pay a tax rate of 100 per cent and 66.7 per cent respectively. Unlike the presumptive tax, the PIT is progressive – those earning more also pay a greater share of their income as tax.

Table 38: Hairdressing salon presumptive taxes compared to PIT

| Income level | Type of earner | Monthly income | Presumptive tax | | Personal income tax | |
|---------------------|----------------|----------------|-----------------|----------------|---------------------|----------------|
| | | | Monthly tax | Effective rate | Monthly tax | Effective rate |
| Minimum | Salon owner | 250 | 500 | 200.00% | 0 | 0 |
| Twice minimum | Salon owner | 500 | 500 | 100.00% | 51.5 | 10.30% |
| Three times minimum | Salon owner | 750 | 500 | 66.67% | 102.98 | 13.73% |

Source: Own calculations

However, what is particularly striking about Table 38 is the proportion of income that an informal sector hairdressing salon operator would be expected to pay if these taxes were implemented according to the presumptive tax schedule. Operators at the minimum level of income would be expected to pay twice what they earn and those at twice the hypothetical minimum income level would be expected to hand over all their earnings to ZIMRA. Clearly, these taxes are out of line with the ability of informal sector operators to pay, given the profit levels in this industry described above. A formal sector worker with a comparable monthly income would pay nothing at the hypothetical minimum income level and only \$51.50 (i.e. an

effective rate of only 10.3 per cent) at twice the hypothetical minimum income level. At three times the hypothetical minimum level of income, the hairdressing salon owner would be expected to pay 66.67 per cent of income to ZIMRA compared to the 13.73 per cent paid by a worker with a similar income in the formal sector.

While the participants in this study were not randomly selected, as explained in the methodology chapter (Chapter Four), it is difficult for hairdressing salon operators to make huge profits given the *modus operandi* of these enterprises outlined above. The ‘rent-a-chair’ system (with its many independent entrepreneurs) limits the hairdressing salon operator to collecting rentals at the end of the month. The two hairdressing salon operators working from home (in the high-density areas) were making very low profits and did not even have any paid employees. Although the four hairdressing salon operators who were running their enterprises from premises in the Avenues were better off, none of them was making more than \$1,000. Clearly, the results show that that hairdressing salon operators’ presumptive taxes are not horizontally equitable compared to the formal sector personal income tax at the three hypothetical income levels used in this study.

The CIT is a proportional tax and applies the same tax rate at the three hypothetical levels of income. The corporate income tax rate of 25.75 per cent is much lower than the presumptive taxes proposed for informal sector hairdressing salon operators at all the three income levels. As shown in Table 39, while a hairdressing operator is expected to pay a presumptive tax of \$500 (or 200 per cent of income) at the minimum income level, an enterprise in the formal sector making a profit \$250 is only expected to pay a CIT of \$64.38 (i.e. 25.75 per cent of profit). At twice the minimum income level, the hairdressing salon operator is expected to pay 100 per cent of income as tax while a formal sector enterprise at this level is only expected to pay 25.75 per cent. At three times the minimum level of income, the hairdressing operator is expected to pay 66.67 per cent of income while the formal sector enterprise again pays the constant CIT rate of 25.75 per cent. Hairdressing salon operators’ presumptive taxes are not horizontally equitable compared to the formal sector corporate income tax at the three hypothetical income levels.

Table 39: Hairdressing salon presumptive taxes

| Income level | Type of earner | Monthly income | Presumptive tax | | Corporate income tax | |
|---------------------|----------------|----------------|-----------------|----------------|----------------------|----------------|
| | | | Monthly tax | Effective rate | Monthly tax | Effective rate |
| Minimum | Salon owner | 250 | 500 | 200.00% | 64.38 | 25.75% |
| Twice minimum | Salon owner | 500 | 500 | 100.00% | 128.75 | 25.75% |
| Three times minimum | Salon owner | 750 | 500 | 66.67% | 193.13 | 25.75% |

Source: Own calculations

Even those within ZIMRA felt that the presumptive tax rate for those in this activity class was too high and unfair. According to one ZIMRA official (when asked whether presumptive taxes were promoting equity) “They are not fair, especially when you look at hairdressing salons and compare them with other sectors and also when you compare the same activity in different suburbs” (Key Informant 10, ZIMRA, 6 September 2011). Another ZIMRA official said “More research on informal sector taxes needs to be done if informal sector operators are expected to comply with them instead of relying on assumptions. They are unfair to some sectors such as hairdressing salons” (Key Informant 12, ZIMRA, 7 September 2011). According to ZIMRA, no data were collected on the operations and the profitability of hairdressing salons (see Chapter Five), the rates were merely prescribed by the Ministry of Finance. An economic consultant who is a former adviser to the Ministry of Finance reported that after dollarization, the presumptive tax rates that were set were essentially “a thumbsuck” as no research was carried out (Key Informant 3, ZIMCONSULT, 26 October 2011). According to a key informant “These taxes are too high and merely encourage corruption. It is an irony of our independence that we have informalised our economy. We must face up to this” (Key Informant 1, ZCTU/LEDRIZ, 14 October 2011).

Compared to formal sector personal income taxes and CIT rates, it is clear that hairdressing salon presumptive taxes are not horizontally equitable. Not only are the presumptive tax figures much higher than the formal sector tax rates at all the three income levels used in this study, informal sector tax compliance is impossible – no one could possibly be expected to pay 200 or 100 per cent of their income to the tax authorities.

According to the presumptive tax schedule, informal operators who are not tax compliant should pay a 10 per cent presumptive tax on the rent. When asked whether they knew about the taxes that specifically targeted hairdressing salon operators, the two respondents operating

from their homes did not know anything about presumptive taxes. Of the six respondents that reported that they knew about informal sector taxes targeted at hairdressing salons, four respondents knew about the \$1,500 presumptive tax that is supposed to be paid per quarter and none of them was paying it. However, all the six respondents knew about the 10 per cent presumptive tax that is supposed to be paid as part of the rent (to the landlord).

According to the presumptive tax schedule (ZIMRA, 2014b):

All persons in receipt of rental income from an informal trader in respect of residential accommodation, premises or a place on which trade is carried on are required to withhold an additional amount of Presumptive Tax equal to 10 per cent of the rental and remit to ZIMRA. This includes local authorities.

Tax compliance, in the case of the respondents in this study, meant paying the 10 per cent presumptive tax on rentals. One respondent said “Taxes are the landlord’s responsibility. I have an idea about presumptive taxes but I am not sure about the actual figures. What I know is that the person who receives the rent also charges presumptive tax on the rent” (Informal Sector Operator 11, Hairdressing Salon, 25 April 2014). Another respondent said “I pay rent that includes water and electricity charges. What I know is that the rent I pay also caters for ZIMRA. The owner of the building pays tax from my rent to ZIMRA. I do not know about presumptive taxes” (Informal Sector Operator 8, Hairdressing Salon, 17 April 2014). Only one respondent reported ever having been raided by ZIMRA (in 2009) although the respondent said that ZIMRA officials had “visited” the salon after this raid. According to this respondent “When ZIMRA officials ask for my tax clearance, I tell them that I pay my rent to my landlord and tax is from the rent I pay. I cannot afford to pay presumptive taxes. I make \$500 in a month so where do I find \$1,500 to pay ZIMRA? I just negotiate with ZIMRA officials when they ask why I pay tax on rent and not presumptive tax” (Informal Sector Operator 9, Hairdressing Salon, 17 April 2013).

There is also an important gender dimension to the hairdressing salon presumptive taxes. The majority of people who work in hairdressing salons (and many of those who own them) are women. It is therefore a weakness in the presumptive tax system if it unfairly targets a sector that is dominated by a particular sex – this clearly introduces an element of gender bias in the system. This sub-sector is supposed to pay the highest amounts (in the form of presumptive

taxes) of all the informal sub-sectors in this study. This means that it is the women in this sector who have to devise ways and means of dealing with the various agents that try to implement the tax and municipal regulations (i.e. ZIMRA, the police and local authorities).

In sum, the hairdressing salon presumptive tax is simply not viable. Given the nature of hairdressing salon operations in Harare, it is difficult to understand how the final figure was arrived at by the Ministry of Finance. Not only are there glaring horizontal inequities between the presumptive tax and formal sector income taxes (both personal and corporate), it is virtually impossible for the vast majority of hairdressing salons to be tax compliant.¹¹³

7.3.4 Cottage industries

Cottage industry operators (sometimes called “home industries” in Zimbabwe) are those in the informal small-scale manufacturing sector who are involved in such activities as furniture-making, welding and the manufacture of farm implements. Although there are a few women who operate in this activity class, this is a sub-sector that is dominated by men. The seven respondents in this study were all males who were drawn from a council-owned site in one of Harare’s high density areas. Six of the respondents manufactured furniture and one manufactured wooden cabins.

The ages of the cottage industry operators ranged from 20 to 52 with a median of 31 and a mean of 32. One respondent had completed primary school, four had completed secondary school and two had a post-secondary certificate or diploma. Five of the respondents reported that they were the sole breadwinner in their household and the household sizes ranged from one to seven with a median and a mean of four.

Before starting their enterprises, five of the respondents had been employed (four in the formal sector and one in the informal sector). Of the five respondents who had been employed before, two had resigned, two had been retrenched and one reported that he left when the contract came to an end. The list of the respondents’ former occupations is shown in Table 40.

¹¹³ See also The Patriot (2014).

Table 40: Former occupations of cottage industry operators

| | |
|----------------------------|---------|
| School teacher (Carpentry) | Moulder |
| Upholsterer | Packer |
| Builder | |

Source: Own survey

Three of these enterprises were actually registered companies (but not registered with ZIMRA) and four of them were neither registered nor licensed. The seven respondents in the cottage industry activity class operated their stalls with the help of family members and employees and all of them had at least one paid employee. The number of paid employees in these enterprises ranged from one to five. Two of these entrepreneurs paid a salary, two paid a commission and three paid both a salary and a commission to their employees. Three of the seven respondents reported that they operated from more than one site. The second site, for these respondents, focused on sales (i.e. the selling of furniture manufactured at the cottage industry site). The number of years in operation ranged from three to 11 years with a median of five and a mean of six. Two respondents reported that they did not keep any records of their business transactions. Four reported that they kept simple records of orders, sales and purchases and one reported that he kept simplified accounts.

Informal sector cottage operators buy their inputs from both formal and informal enterprises (multiple responses were allowed). Six respondents said that they bought their inputs from both formal and informal enterprises while only one respondent reported buying his inputs only from the informal sector. The respondents' main customers (multiple responses were allowed) were as follows: 1) the general public (cited by five respondents); 2) other informal traders (cited by three); and 3) formal sector enterprises (cited by three).

Three respondents (those that operated registered companies) reported that they maintained bank accounts for their enterprises that were separate from their private account while four of the respondents did not have a separate bank account for their enterprises. The amount of start-up capital needed to establish these enterprises ranged from \$400 to \$1,500 with a median of \$500 and a mean of \$700. The reported profits for the six cottage industry operators who responded to this question ranged from \$300 to \$900 per month with a median of \$450 and a mean of \$508. In terms of their working capital needs (multiple responses were allowed), profits generated from the enterprises (cited by six respondents) and trade credit

from both informal and formal sector enterprises (cited by two respondents) were mentioned as the main sources.

While the cottage industry operators knew about taxes in general (i.e. that enterprises and individuals should pay taxes), none of them knew about the presumptive taxes specifically targeted at their sector (i.e. neither the \$300 quarterly presumptive tax nor the 10 per cent on stall rentals). Apart from the rentals paid to the city council, all the cottage industry operators in this study also paid a monthly committee fee.¹¹⁴ According to one respondent “I pay rent of \$40 every month. We also pay a fee of \$4 for every person who works in this workshop. The committee makes sure that this place is clean and secure. You cannot operate here if you do not pay the committee” (Informal Sector Operator 7, Cottage Industry, 7 October 2011). According to another respondent “As I explained earlier, here we do not pay taxes, we pay rent and committee fees. If you want to talk about taxes you should talk to the committee” (Informal Sector Operator 6, Cottage Industry, 7 September 2011).

Cottage industry operators are supposed to pay a quarterly presumptive tax of \$300 (i.e. \$100 per month) regardless of profit. Table 41 shows the monthly taxes that a cottage industry operator is supposed to pay according to the presumptive tax schedule, compared with formal sector taxes. The last two columns of the table show the PIT and CIT that would be paid at the three hypothetical income levels. Presumptive taxes are regressive while the PIT is progressive. The CIT is a proportional tax. As shown in Table 41, at the minimum income level, a cottage industry operator is supposed to pay 40 per cent of income compared to the 20 per cent and the 13.33 per cent paid at twice and three times the minimum income level respectively. These rates indicate that the presumptive tax is not vertically equitable.

Compared with those in the formal sector earning a similar income at the hypothetical minimum level, cottage industry presumptive taxes are not horizontally equitable. As shown in Table 41, cottage industry operators making a profit of \$250 a month are expected to pay a presumptive tax of \$100 (i.e. 40 per cent of their profit). At this level of income, a worker in the formal sector does not pay the personal income tax. At twice the minimum income level,

¹¹⁴ The committee running this cottage industry site was clearly aligned to ZANU-PF and was hostile. As pointed out in Chapter Four, the methodology chapter, this researcher was detained for more than an hour in spite of having a letter from the Ministry of Small and Medium Enterprises Development. The questionnaire was also carefully scrutinised. The committee tried to prescribe the questions that could or could not be asked by the researcher. The intervention of the Ministry of Small and Medium Enterprises Development ensured that the research carried on normally although some of the cottage industry operators seemed unnerved by this incident.

cottage industry operators are still expected to pay more than formal sector workers i.e. 20 per cent of income compared to the 10.3 per cent formal sector workers would pay. It is only at three times the hypothetical minimum income level that some form of parity is achieved between cottage industry operators and formal sector workers. At this income level, the PIT and presumptive taxes are almost horizontally equitable as formal sector workers pay a slightly higher rate of 13.73 per cent compared to 13.33 per cent that is paid by cottage industry operators.

Comparing these cottage industry operations with formal businesses making similar profits shows that presumptive taxes are still horizontally inequitable at the minimum income level (i.e. where a formal business is expected to pay a rate of 25.75 per cent, cottage industry operators have to pay 40 per cent). It is only at twice and three times the hypothetical minimum income level that cottage industry operators actually pay lower rates than those in the formal sector paying CIT.

Table 41: Cottage industry presumptive taxes

| Income level | Monthly income | Monthly tax | Effective rate | PIT rate | CIT rate |
|---------------------|----------------|-------------|----------------|----------|----------|
| Minimum | 250 | 100 | 40.00% | 0.00% | 25.75% |
| Twice minimum | 500 | 100 | 20.00% | 10.30% | 25.75% |
| Three times minimum | 750 | 100 | 13.33% | 13.73% | 25.75% |

Source: Own calculations

Although not as dramatic as the horizontal inequities that exist between the hairdressing activity class and the formal sector taxpayers at similar levels of income, cottage industry presumptive taxes are horizontally inequitable vis-à-vis the personal income tax at both the hypothetical minimum and twice the minimum income level. Being an informal sector cottage industry operator at these income levels translates into a much heavier tax burden than being in the formal sector. Although those in this informal sector activity class pay more than formal sector companies at the hypothetical minimum level of income, the presumptive tax rates are lower at twice and at three times this hypothetical minimum income level. This means that at these higher income levels, there is horizontal inequity with a disadvantage to those paying CIT.

7.3.5 Income, poverty and taxation in Zimbabwe

Given the common perception of informal workers being predominantly poor and marginalised, it is useful to explore how the incomes of the self-employed interviewed in this study compare to the official poverty line in Zimbabwe and to workers' wages more generally in the national economy. In order to assess whether the very poor are being taxed through presumptive taxes, in this sub-section, I use Zimbabwe's official poverty datum line and the incomes of those who are employed, based on the most recent labour force survey, for comparative purposes. According to the 2011 LFCLS (ZIMSTAT 2012: 54):

The poverty datum lines (PDLs) represent the cost of a given standard of living that must be attained if a person is deemed not to be poor. There are two measures of standard of living, the food poverty lines (FPL) and the total consumption poverty lines (TCPL). The FPL represents the minimum consumption expenditure necessary to ensure that each individual can (if all expenditures were devoted to food) consume a minimum food basket representing 2,100 kilo calories. Another measure of the standard of living is the total consumption poverty line (TCPL), derived by computing the non-food consumption expenditure of poor households whose consumption expenditure is just equal to the FPL. This amount is added to the FPL. An individual whose total consumption expenditure does not exceed the TCPL is deemed to be poor. An individual whose total consumption expenditure does not exceed the food poverty line is deemed to be very poor.

According to the 2011 LFCLS, the FPL and the estimated TCPL for one person in May 2011 was US\$30.48 and US\$100 respectively. However, the average household in Zimbabwe was estimated at five persons in 2011. According to the 2011 LFCLS "The FPL and TCPL for five persons were US\$152.38 and US\$497.84, respectively" (ZIMSTAT, 2012: 54). None of the 39 respondents who provided information on profits in this study were earning less than \$100, the estimated TCPL for one person in 2011. This is shown in Table 42 which summarises the profit information of the informal sector operators. The mean and median (in all but the cottage industry sector) were higher than the TCPL of \$497.84 for a family of five. However, the mean can mask substantial variation in profits; a third of the respondents reported profits below the TCPL of \$497.84 for a family of five.

Table 42: Informal sector operators' profits

| | Transport operator | Flea market | Hairdressing salon | Cottage industry |
|---------|--------------------|-------------|--------------------|------------------|
| Mean | 554 | 1025 | 569 | 508 |
| Median | 600 | 750 | 550 | 450 |
| Minimum | 250 | 600 | 300 | 300 |
| Maximum | 1000 | 2000 | 1000 | 900 |
| N | 21 | 4 | 8 | 6 |

Source: Own survey

Table 43 tries to provide a better understanding of the poverty status of the informal sector operators in this study by taking into account household size and whether the operator was a sole breadwinner or not. The table shows the profits, the number of people in the household, and the earnings per capita for the 39 respondents who provided information on profits. Of the 39 respondents, 12 were living in households where the earnings per head were less than the TCPL for one person of \$100. However, as the table shows, in only two of these cases the informal sector operator reported being the sole breadwinner; in the other 10 cases there was at least one other earner in the household. It is therefore highly likely that the majority of respondents in this study were not poor (assuming that the 10 who were not the sole breadwinner were living in households where their earnings were being augmented by those of other earners).

Table 43: Profit, household size and earnings per capita of informal sector operators

| Profit | No. in Household | Sole Breadwinner | Earnings per Head |
|--------|------------------|------------------|-------------------|
| 300 | 9 | No | 33 |
| 267 | 6 | No | 44 |
| 300 | 6 | No | 50 |
| 350 | 7 | No | 50 |
| 450 | 9 | No | 50 |
| 550 | 9 | No | 61 |
| 250 | 4 | Yes | 63 |
| 400 | 6 | No | 67 |
| 300 | 4 | Yes | 75 |
| 400 | 5 | No | 80 |
| 600 | 7 | No | 86 |
| 375 | 4 | No | 94 |
| 600 | 6 | No | 100 |
| 600 | 6 | No | 100 |
| 400 | 4 | Yes | 100 |
| 500 | 5 | Yes | 100 |
| 500 | 5 | Yes | 100 |
| 675 | 6 | No | 113 |
| 350 | 3 | No | 117 |
| 700 | 5 | No | 140 |
| 600 | 4 | No | 150 |
| 600 | 4 | No | 150 |
| 600 | 4 | Yes | 150 |
| 600 | 4 | Yes | 150 |
| 900 | 6 | Yes | 150 |
| 800 | 5 | No | 160 |
| 650 | 4 | Yes | 163 |
| 675 | 4 | Yes | 169 |
| 750 | 4 | Yes | 188 |
| 600 | 3 | No | 200 |
| 800 | 4 | No | 200 |
| 600 | 3 | Yes | 200 |
| 1000 | 4 | Yes | 250 |
| 400 | 1 | Yes | 400 |
| 500 | 1 | Yes | 500 |
| 700 | 1 | Yes | 700 |
| 700 | 1 | Yes | 700 |
| 1000 | 1 | Yes | 1000 |
| 2000 | 1 | Yes | 2000 |

Source: Own survey

It is possible that my purposive sample of the self-employed in the informal sector is a very select sample of higher earners. Therefore, it is also useful to compare their profits with the incomes of the employed in the national economy to gain some sense of where these workers fall within the national income distribution. Unfortunately, the 2011 LFCLS did not collect income on the self-employed (own-account workers or employers) in either the formal or informal sector. However, data were collected on the earnings of employees, i.e. those employed by others in either the formal or informal sector.¹¹⁵ Table 44 describes the distribution of paid employee earnings in the two sectors. The figures suggest that 94.7 per cent of employees in the formal sector received incomes that were above the TCPL of US\$100, compared to only 47.5 per cent of those in informal employment. However, only 2.4 per cent (i.e. 17,108) of those in informal employment were not poor in terms of the TCPL for a family of five of \$497.84, compared to 10.3 per cent (55,476 workers) of those in formal employment. The income figures in the table clearly indicate many of Zimbabwe's workers, both formal and informal, assuming they are the sole breadwinners for families of five, are poor (i.e. have an income of less than \$497.84). Many of these workers are being taxed given that the tax-free PIT threshold is \$250.¹¹⁶

Comparing these figures to the profit values from the informal sector operators interviewed in this study, shows that the minimum profit of US\$250 received in this group (Table 42) was higher than the earnings of at least 80.3 per cent of informal sector employees and 28.0 percent of formal sector employees.¹¹⁷ In terms of the legitimacy of the state to tax informal sector businesses, it is important to note that the informal sector operators in this study (which belong to sectors that are generally the focus of the tax administration) were earning higher incomes than a large portion of the (formal) paid employees in the economy, and would be unlikely to be classified as poor using official poverty lines.

¹¹⁵ Informal sector employees are defined as those paid employees not entitled to any of the following: contribution to a pension fund by employer, paid annual leave, paid sick leave and written contract with employer. Formal sector employees are paid employees entitled to all of the following: contribution to a pension fund by employer, paid annual leave, paid sick leave and written contract with employer (ZIMSTAT (2011: 113).

¹¹⁶ The issue of taxing the very poor in Zimbabwe is an issue that has been articulated on several occasions by Zimbabwe's trade unions who have based their arguments on these poverty statistics from ZIMSTAT (see The Standard, 2013).

¹¹⁷ These values would be higher if we were able to perfectly match the US\$250 minimum profit value to the bracket ranges in the table.

Table 44: Earnings distribution of paid employees aged 15 years and older, Zimbabwe 2011 LFCLS

| Cash received in US\$ | Informal employment | | | Formal employment | | |
|-----------------------|---------------------|---------|---------|-------------------|---------|---------|
| | Male | Female | Total | Male | Female | Total |
| 100 and below | 46.3 | 64.0 | 52.5 | 4.9 | 6.3 | 5.3 |
| 101 - 200 | 31.9 | 20.1 | 27.8 | 25.2 | 19.7 | 23.6 |
| 201 - 300 | 14.5 | 10.5 | 13.1 | 43.6 | 50.1 | 45.5 |
| 301 - 400 | 2.9 | 2.7 | 2.8 | 11.6 | 7.9 | 10.5 |
| 401 - 500 | 1.6 | 0.8 | 1.3 | 5.0 | 4.1 | 4.8 |
| 501 - 1000 | 1.5 | 1.0 | 1.3 | 5.6 | 8.9 | 6.6 |
| 1001 - 3000 | 0.7 | 0.5 | 0.6 | 2.8 | 2.3 | 2.6 |
| 3001 and above | 0.3 | 0.2 | 0.2 | 0.9 | 0.2 | 0.7 |
| Not stated | 0.4 | 0.2 | 0.3 | 0.4 | 0.6 | 0.4 |
| Total percentage | 100 | 100.0 | 100 | 100 | 100 | 100 |
| Total number | 465 640 | 247 174 | 712 814 | 380 483 | 158 128 | 538 611 |

Source: 2011 LFCLS (ZIMSTAT, 2012: 125)

Note: Sample consists of those aged 15 years and older paid cash only or both cash and in kind, based on earnings in the month preceding the survey.

7.3.6 Comparison between different informal sector activity classes and the formal sector

The results presented in the discussion above show that many of the informal sector operators interviewed in this study are not poor by Zimbabwean standards and are in fact earning incomes that are higher than many paid employees in the economy, based on national data. As shown in Table 42, the mean and median incomes reported by the study participants in all four activity classes were higher than the TCPL for a family of five of US\$497.84 (in 2011), except for cottage industry activity class, which had a median income that was slightly lower than the TCPL. Although this was not a random sample of those in the informal sector in Zimbabwe, these results (and those of the 2011 LFCLS) do show that the informal sector in Zimbabwe is highly heterogeneous. With this in mind, this section summarises the results on vertical and horizontal equity within the informal sector, across activity classes, and between the informal and formal sectors.

The presumptive tax rates for the four activity classes range from 4.4 per cent (for taxi-cab operators at three times the minimum income level) to 200 per cent (for hairdressing salon operators at the minimum income level). In terms of vertical equity, Table 45 shows that presumptive taxes, which are specific or unit taxes, are highly regressive (apart from the VDP which is an *ad valorem* tax). For three of the informal sub-sectors, the higher the informal sector operator's income, the lower the share of income paid as tax. Personal income taxes,

however, are progressive (i.e. the higher the income, the greater the share of income paid as tax). The VDP, like the CIT, is a proportional tax – the rate is constant. This means that the proportion of income paid in tax is constant as income increases. Within the informal sector there is also horizontal inequity as Table 45 further shows that certain sectors, hairdressing salons especially, have higher rates than others.

Table 45: Comparison of informal sector presumptive taxes

| Income level | Monthly income | Minibus taxi | Taxi-cab | Flea market | Hairdressing salon | Cottage industry |
|---------------------|----------------|--------------|----------|-------------|--------------------|------------------|
| Minimum | 250 | 23.33% | 13.32% | 10.00% | 200.00% | 40.00% |
| Twice minimum | 500 | 11.67% | 6.67% | 10.00% | 100.00% | 20.00% |
| Three times minimum | 750 | 7.76% | 4.44% | 10.00% | 66.70% | 13.33% |

Source: Own calculations

Informal sector taxes are generally horizontally inequitable when compared with formal sector taxes as shown in Table 46, however, the advantage is not always in favour of informal sector operators, especially as profits increase. Presumptive tax rates range from 13.32 per cent (for taxi-cabs) at the minimum income level to 200 per cent (for hairdressing salons). Formal sector tax rates range from zero (for the PIT) to 25.75 (for the CIT) at this level.

At twice the minimum income level, informal sector taxes are still horizontally inequitable ranging from 6.67 per cent (for taxi-cabs, the only informal sub-sector that has a lower tax rate than formal sector taxes at this income level) to 100 per cent for hairdressing salons. Formal sector taxes range from 10.3 per cent for the PIT to 25.75 per cent for the CIT at twice the hypothetical minimum income level.

It is only at three times the hypothetical minimum income level that operators in three informal sub-sector activity classes, i.e. public passenger transport, flea market and cottage industry, are expected to pay a lower tax rate (ranging from 4.44 per cent to 13.33 per cent respectively) than the PIT (13.73 per cent). However, as Table 46 shows, the tax rates for the hairdressing salons (at 66.67 per cent) are not horizontally equitable compared to the PIT at this level of income. At three times the hypothetical minimum income level, the CIT rates are higher for three of the four informal sector activity classes in this study (i.e. public passenger transport, flea market and hairdressing salon). The hairdressing salon presumptive tax, even at this level, is still higher vis-à-vis the CIT.

Table 46: Comparison of informal sub-sector presumptive taxes and formal sector taxes

| Income level | Type of earner | Monthly income | Monthly tax | Effective rate | PIT rate | CIT rate |
|---------------------|--------------------|----------------|-------------|----------------|----------|----------|
| Minimum | Hairdressing salon | 250 | 500.00 | 200.00% | 0.00% | 25.75% |
| | Cottage industry | 250 | 100.00 | 40.00% | 0.00% | 25.75% |
| | Omnibus | 250 | 50.00 | 23.33% | 0.00% | 25.75% |
| | Flea market | 250 | 50.00 | 10.00% | 0.00% | 25.75% |
| | Taxi-cab | 250 | 33.33 | 13.32% | 0.00% | 25.75% |
| Twice minimum | Hairdressing salon | 500 | 500.00 | 100.00% | 10.30% | 25.75% |
| | Flea market | 500 | 100.00 | 10.00% | 10.30% | 25.75% |
| | Cottage industry | 500 | 100.00 | 20.00% | 10.30% | 25.75% |
| | Omnibus | 500 | 50.00 | 11.67% | 10.30% | 25.75% |
| | Taxi-cab | 500 | 33.33 | 6.67% | 10.30% | 25.75% |
| Three times minimum | Hairdressing salon | 750 | 500.00 | 66.67% | 13.73% | 25.75% |
| | Flea market | 750 | 150.00 | 10.00% | 13.73% | 25.75% |
| | Cottage industry | 750 | 100.00 | 13.33% | 13.73% | 25.75% |
| | Omnibus | 750 | 50.00 | 7.76% | 13.73% | 25.75% |
| | Taxi-cab | 750 | 33.33 | 4.44% | 13.73% | 25.75% |

Source: Own calculations

Two factors that have not been taken into account above are the VAT paid by informal sector operators that cannot be claimed back as input tax and the formal sector tax incentives. VAT and the incentives for formal businesses are factors that would increase the gap between formal and informal businesses with informal sector operators bearing the greater burden. This was evident also in the responses of interviewees.

When asked whether informal sector presumptive taxes were promoting equity vis-à-vis formal sector taxes, a key informant said:

In principle yes they are. But compared with the formal sector, the informal sector is paying VAT as an input tax already, so no. One could say yes, particularly for those offering services. For those selling goods, there isn't much to increase on due to VAT, they are the largest contributor (Key Informant 15, ZIMRA, 29 September 2011).

According to another key informant, presumptive taxes are not fair; this informant said:

All those who are able should pay taxes. It is important to facilitate growth and development before taxing the informal sector. Incentivise them by providing factory shells, access to funding and then tax them - not the other way round. The lack of a

developmental approach makes these taxes unjustifiable. While there are numerous concessions for big businesses there are none for the informal sector with no benefits for paying. Presumptive taxes should be scrapped. They do not promote equity among informal sector operators and vis-à-vis the formal sector (Key Informant 1, ZCTU/LEDRIZ, 14 October 2011).

A key informant said “Informal sector is not made up of only poor people. There is a need to formalise this sector. However, consultations are critical in order to get an appreciation of how these people operate. There is a need for research. Presumptive tax figures are arbitrary and do not promote equity” (Key Informant 5, ZNCC, 20 October 2011).

However, even if the rates themselves were amended to ensure horizontal equity with the formal sector and across the informal sub-sectors, a major source of inequity is the selective enforcement of tax regulations which offers different opportunities for evasion within the informal sector. There are a number of informal sector locations which seem to be exempt from ZIMRA raids - ZIMRA officials do not seem to venture there and this study identified two - a furniture manufacturing cottage industry complex in a high density suburb and a regional bus station where informal transport operators provide services mainly to cross-border traders. The issue of coverage is probably the biggest source of inequity within the informal sector. The majority of informal sector operators are escaping (or are allowed to escape) the tax net while others find it difficult to do so.

In the key informant interviews, the respondents from ZIMRA felt that the presumptive taxes were not promoting equity within the informal sector. The ZIMRA officials acknowledged the fact that this inequity arose from the selective application of tax regulations and the differences in the tax rates. According to one respondent “This collection is unfair as it focuses only on a few informal activities” (Key Informant 11, ZIMRA, 6 September 2011). The explanation given for the selective application of regulations was that there was insufficient manpower within ZIMRA (see Chapter Six). In terms of the rates, the explanation was that these are determined by the Ministry of Finance (see Chapter Five).

The four key findings from the assessment of equity presented in this section are as follows. First, the informal sector in Zimbabwe is highly heterogeneous as a result of the economic crisis and the respondents in this study were, in the main, not poor based on their stated

profits and compared to the official poverty line. The results show that of the 27 respondents who had previously been formally employed, 17 (59 per cent) had either resigned or had opted for voluntary retrenchment (indicating an 'exit' from the formal sector). The education levels of the informal sector operators ranged from those with only a secondary school education (15 respondents or 34 per cent) to those who had a degree (14 respondents or 30 per cent). Of the 39 informal sector operators who responded to the question on profits, two thirds of them were making profits above the TCPL of \$497.84 for a family of five while all of them were making profits above the TCPL of \$100 for one person.

Second, informal sector presumptive taxes (apart from the VDP) are vertically inequitable. Because they are specific or unit taxes, they are highly regressive. This means that the proportion of income paid in tax decreases as income increases. This is in contrast to the personal income tax which is progressive and the CIT which is a proportional tax. The results also show that presumptive taxes are generally horizontally inequitable vis-à-vis personal income taxes. Presumptive taxes are horizontally inequitable at the hypothetical minimum income level where the formal sector worker is exempt from personal income tax. At twice the hypothetical minimum income level, informal sector operators (except for flea market operators and those operating taxi-cabs) are expected to pay more than formally employed workers who only pay a PIT rate of 10.3 per cent. Only at three times the hypothetical minimum level are some in the informal sector expected to pay a lower rate than that paid by formal sector workers. However, hairdressing salon owners still pay more than a formal sector worker at three times this hypothetical minimum income level. Presumptive taxes are much fairer when compared to corporate income taxes for all the informal sector activity classes that formed part of this study (with the notable exception of hairdressing salon operators). Apart from the hairdressing salon operators (whose rates are higher at all the hypothetical income levels) only the cottage industry operators pay a higher rate than the CIT, and this only at the hypothetical minimum level of income. All the other informal sector activity classes pay a lower rate than the CIT rate at all the hypothetical levels of income, indicating that formal businesses paying the CIT are likely to be at a disadvantage.

Third, the selective implementation of regulations is a major source of inequity. Most informal sector operators are evading these taxes and this operates as a disincentive for those who are tax-compliant. A manifestation of the crisis has been the failure by the government to effectively regulate the transport sector where, according to local authorities, almost half of

the minibus taxis are unregistered while, according to one taxi association's estimates, only 20 per cent of the registered ones are paying tax.

Fourth, corruption is a major issue. Informal sector operators in the transport sector are often paying more to touts and the police than they are remitting to ZIMRA. Corruption within the police force has created a situation where some operators would rather pay bribes than pay both these bribes and presumptive taxes. Corruption at the border was also reported as a major concern by both flea market operators and ZIMRA officials. Cross-border traders are smuggling goods into the country with the connivance of ZIMRA officials at the border.

7.4 Informal sector taxes and economic efficiency

This final section analyses the third criterion of a good tax system – economic efficiency, i.e. the extent to which taxes induce changes in behaviour. When faced with taxes, individuals and businesses tend to change their behaviour - they make different decisions from those they would have made in the absence of these taxes. They also spend time (and resources) devising ways of avoiding these taxes. This tax-induced distortion in economic behaviour results in reduced output and growth – it represents a net efficiency loss to the economy as a whole (Barnett and Grown, 2004). Taxes therefore create a loss of welfare over and above the revenues collected, referred to as the deadweight loss or excess burden of taxation (Rosen, 1995; Tanzi and Zee, 1996). As outlined in Chapter Two, only lump-sum taxes are efficient as tax liability does not depend on behaviour. Lump-sum taxes (e.g. a head tax paid by everyone in the country) are taxes whose liability cannot be avoided and are therefore considered to be efficient, even though they are highly inequitable.

The assessment of economic efficiency here is based on both the actual (i.e. reported and observed) and possible tax-induced behavioural changes in Zimbabwe's informal sector resulting from the implementation of presumptive taxes. The section also outlines the inefficiencies deriving from the rent-seeking behaviour of the police and ZIMRA officials. The section begins by presenting the evidence that emerged from the interviews with informal sector operators and ZIMRA officials on the effect of these taxes on public passenger transport, flea market and hairdressing salon operators. As noted earlier, none of the cottage industry operators knew about presumptive taxes and so, unlike the other three sub-sectors, questions on the behavioural responses to the implementation of these taxes were not asked. The section then goes on to present the possible behavioural changes that can

occur as a result of the implementation of these taxes for the four sub-sectors. For those in the cottage industry sub-sector, the focus of this analysis is on the possible (rather than reported and observed) responses to tax implementation. The section then outlines the inefficiencies that result from the rent-seeking and corrupt conduct of those responsible for the collection of presumptive taxes.

Commuter omnibus operators and cross-border traders/flea market operators have been the main targets of ZIMRA's tax collection efforts. This has led them to seek various ways and means of avoiding these taxes. In the case of minibus taxis and taxi-cabs, these methods have involved such things as the use of circuitous routes to avoid police road-blocks, lengthy 'negotiations' when minibus taxi drivers are detained at these road-blocks and, as a last resort, parking their vehicles at home during the common police blitzes that occur in Harare. One respondent said "We are currently charging just five cents per passenger per kilometre - these fares are uneconomical. There has been a lack of homework [research] on the part of ZIMRA. Most of our members will just play hide-and-seek with the police or park instead of paying taxes" (Informal Sector Operator 27, Transport, 24 November 2011). Another transport operator said that he usually parks his cars to avoid roadblocks: "If there are too many roadblocks, I park my vehicles. Sometimes there are too many roadblocks and it is difficult to avoid them because the police will be looking for money" (Informal Sector Operator 43, Passenger Transport, 26 April 2014). A number of key informants also reported that they had observed some behavioural changes resulting from the implementation of presumptive taxes. One key informant said "When we have these revenue projects focusing on omnibuses, they end up just parking their vehicles" (Key Informant 10, ZIMRA, 6 September 2011). According to another key informant "They [kombis] waste time trying to find ways of avoiding these taxes and therefore make less money as a result. They also park or drop off people far from town to avoid roadblocks" (Key Informant 9, Ministry of Small & Medium Enterprises, 12 September 2011).

These activities have a distortionary effect on the economy as minibus taxi drivers, instead of concentrating on their core activity of transporting commuters, end up wasting their time (and that of their passengers), trying to find ways of avoiding tax authorities. Instead of transporting passengers to their respective places of work, many man-hours are lost, output is reduced and society experiences a welfare loss. There are many man-hours that are lost every month in Zimbabwe during these frequent police/ZIMRA operations targeting the public passenger transport sector. The withdrawal of these minibus taxis from Harare's roads (a

method used by minibus taxi operators to avoid paying taxes) has a negative effect on production as many workers are left stranded.¹¹⁸

In the case of cross-border traders, many spend a lot of time devising ways of smuggling goods into the country so as to avoid paying taxes. ZIMRA and the police have resorted to mounting roadblocks on all the major highways that link Zimbabwe to neighbouring countries. A number of buses carrying these traders' goods have been impounded after successfully 'negotiating' their way past ZIMRA officials at the country's border posts. According to one key informant, "We have fired a number of officers and we continue to recruit [new ones] in order to improve the manpower situation. There are times when we have seized buses which were carrying traders who had smuggled goods into the country" (Key Informant 15, ZIMRA, 29 September 2011). However, one respondent said "Taxes are too high. That is why people smuggle goods at the border and pay bribes to ZIMRA officials. Even when the buses are stopped at roadblocks, the police ask for bribes from these people with smuggled goods" (Informal Sector Operator 17, Flea Market, 25 October 2010). There is an efficiency cost resulting from these activities as informal traders then cannot get their goods to market, resulting in a welfare cost to society. Those who would have bought these goods are either forced to buy higher priced goods or forego consumption (given limited supply).

There have also been raids on flea market operators to ensure that they have receipts proving that presumptive taxes were paid at the border for goods imported into the country.¹¹⁹ Although not reported by any of the respondents as a factor that adversely affected their operations, such raids on flea markets can have the effect of pushing some traders out on the street where not only are they at the mercy of the elements but may also suffer from lower sales. This shift in operation from the flea market to the street can create inefficiencies. For example, not being at a fixed location may mean that your customers will not be able to find you (one is constantly dodging the municipal police as street vending without a license is not allowed in Harare), and customers may end up consuming less of your product or move to substitutes.

¹¹⁸ See The Mirror (2014).

¹¹⁹ See Mail and Guardian (2014).

Trying to implement the hairdressing salon presumptive taxes can result in changes in the way that entrepreneurs in this sector operate. As pointed out earlier, none of the hairdressing salon operators was paying the quarterly tax of \$1,500 according to the presumptive tax schedule, although six reported that they were paying the presumptive tax on rent. When these operators were asked questions about their tax-induced behavioural changes, none of them attributed any behavioural changes to the implementation of presumptive taxes. One explanation for this could be the fact that this was not a random sample, as pointed out earlier in the methodology chapter. Another possible explanation could be that due to the many factors that are affecting their operations in Zimbabwe (e.g. stiff competition from new entrants, high rentals and the cost of chemicals), they could have failed to directly attribute their behavioural changes to presumptive taxes.

However, one ZIMRA official reported that there had been some observed behavioural changes due to the implementation of the presumptive tax. According to the ZIMRA official, there has been a shift in activities from the central business district to residential areas which are more difficult to monitor. Residential areas (i.e. running enterprises from one's home) allow informal operators to run their enterprises anonymously. According to this respondent, "There are many hairdressing salon operators who are working from home and people who are selling their goods from home instead of the flea market" (Key Informant 12, ZIMRA, 7 September 2011). Although hairdressing salon operators who run their operations from their homes may not be visible to tax authorities, this shift to operating from home can have an impact on production if they are also less visible to customers. If this move to the residential areas results in fewer clients that can now have their hair done (due to, for example, not being able to travel to the new hairdressing salon's location), this represents a loss to society as clients can no longer benefit from these services.

The informal sector operators from the cottage industry class who formed part of this study are escaping the presumptive tax net.¹²⁰ As outlined above, none of them even knew about these taxes. This means that these informal entrepreneurs are not affected by the distortionary effects that these taxes induce. However, by being outside the tax net and only operating, as

¹²⁰ Although they are not paying presumptive taxes, they are not completely escaping the tax net. All of them are paying taxes in the form of VAT (five of them said that they sourced at least some of their goods from the formal sector) and/or the ITF 263 withholding on sales as three of them said that they do also sell to formal sector companies. There is also the 10 per cent tax which is paid as part of the rent.

most of them do, within the confines of the cottage industry site allocated to them by the city council (where they felt protected by their 'committee'), they cannot grow. This means that they might find it difficult to expand their business operations and advertise their products as this may make them more 'visible' and attract the attention of the tax authorities.

The differences in the presumptive tax rates (or ZIMRA's monitoring behaviour) between the informal sector activities (e.g. the differences between minibus taxis and taxi-cabs or the differences between minibus taxis and cottage industries) can distort the behaviour of informal entrepreneurs. If there is a feeling that one particular informal sub-sector is lightly taxed, an informal entrepreneur may decide to switch from operating minibus taxis (an activity he/she may be very good at) to the cottage industry activity. This tax-induced behaviour change, where one chooses a particular activity due to the differential treatment of these activities by tax authorities, creates inefficiencies as resources are not allocated where they can be best used.

Apart from the economic inefficiencies arising from the behaviour of informal sector operators, presumptive taxes have created rent-seeking opportunities for government officials responsible for tax collection. Rent-seeking and corruption are activities that do not add value and benefit only the rent-seeker with the government losing potential revenues. By seeking bribes from informal sector operators, corrupt government officials are expending their efforts in order to capture the informal sector operators' surplus. By mounting numerous road-blocks and constantly devising ways and means of extracting this surplus from the informal sector, there is a misallocation of ZIMRA and police resources which could be more productively employed elsewhere.

This section presented the evidence on the observed and reported behavioural changes that resulted from the implementation of informal sector presumptive taxes. The section also looked at the possible behavioural changes that occur if these taxes were effectively implemented. The behavioural changes that were reported by the public passenger transport operators were the use of circuitous routes and the withdrawal of their vehicles in order to avoid paying presumptive taxes. An observed behavioural change reported by ZIMRA was the shift from the central business district to home-based activities, particularly by hairdressing salon and flea market operators, in an attempt to operate under the radar, away from the reach of tax authorities. This assessment of economic efficiency also notes that

although those entrepreneurs that are not paying presumptive taxes may be escaping the distortionary effect of taxes, not paying these taxes may have a limiting effect on their growth as they cannot expand their operations for fear of attracting the attention of tax authorities.

7.5 Concluding remarks

This chapter began by assessing the equity of informal sector presumptive taxes in Zimbabwe vis-à-vis formal personal and corporate income taxes. The analysis of horizontal and vertical equity in this study used a method similar to the one used by Grown and Valodia (2010). While following essentially the same methodology as Grown and Valodia, who based their analysis on gender, taxpayers in this study were analysed based on whether they were in the formal or informal sector. For the comparative analysis of informal sector presumptive taxes vis-à-vis the formal sector income taxes (both personal and corporate income taxes), hypothetical examples based on two types of taxpayers (drawn from both the formal and informal sector) were used. The assessment was based on a comparison between these two types of taxpayers at three hypothetical income levels - a minimum income level of \$250, at twice this minimum level (i.e. \$500) and at three times this minimum level (i.e. \$750). This assessment of equity was also based on the informal sectors' responses on the perceived equity of these taxes.

Overall, this chapter has shown that presumptive taxes (apart from the VDP) are highly regressive. Due to the fact that these informal taxes are specific or unit taxes, the amount paid is the same regardless of the level of income. This means that those informal sector operators earning a higher income actually pay a lower share of that income as tax. The chapter has also demonstrated that informal sector taxes are not horizontally equitable when compared with personal income taxes. At the hypothetical minimum income of \$250, formal sector workers do not pay any taxes whereas informal sector operators in this study are expected to pay between 13.33 per cent (for taxi-cab operators) and 200 per cent for hairdressing salon operators per month. Presumptive taxes are generally lower than the corporate income tax rates at all the hypothetical income levels. The exception is hairdressing salon presumptive taxes which are much higher than CIT at all hypothetical income levels. The results of the study also show that although the public passenger transport operators are paying lower rates than the CIT rates, these operators pay various 'fees' and 'taxes' which are paid to the police, touts and Ministry of Transport officials. These 'taxes', as shown in the study, far exceed the amounts that are supposed to be paid to ZIMRA.

The chapter also showed that apart from the horizontal inequities between informal sector presumptive taxes and formal sector taxes, a major source of inequity is the selective application of tax regulations, an issue initially introduced in the previous chapter on tax administration. There are very few informal sector operators who are paying presumptive taxes, even in the highly targeted public passenger transport sector. The state is failing to effectively regulate this sector which has grown rapidly as a result of the economic crisis. The political crisis has also played itself out in the informal sector. The ruling party has increasingly used militias to intimidate informal sector operators. These militias are also levying their own 'taxes' which, in some cases, have resulted in informal sector operators feeling that they are protected and exempt from paying taxes to ZIMRA. In exchange for this protection, these informal sector operators are expected to be loyal and provide services to ZANU-PF. This selective application of tax regulations was cited as a major disincentive and form of inequity by those who were paying presumptive taxes. A number of informal sector operators who had stopped paying, or only paid these presumptive taxes sporadically, cited the number of evaders as the main reason for their non-compliance.

This chapter then assessed the third criterion of a good tax system - economic efficiency. The reported and actual behavioural changes that resulted from the implementation of presumptive taxes were presented. Public passenger operators reported using long circuitous routes and parking their vehicles to avoid the police checkpoints. These behaviours have the effect of wasting a lot of man-hours (when workers are not transported to their workplaces on time) which results in lower output – society as whole experiences losses. In the case of cross-border traders, the observed behavioural change was that these operators find ways of evading taxes by smuggling their goods into the country. An observation made by ZIMRA concerning hairdressing salon operators was that some of them were moving from areas of high visibility, such as the central business district, to residential areas. If this shift means that clients can no longer get to their new site or this site is not highly visible, this represents a loss to society as fewer people will be able to make use of their services and output is reduced.

Economic inefficiencies can also result from the differences in the tax rates or the selective application of tax regulations. If tax rates are much lower in some informal sub-sectors or if some sectors are getting away without paying presumptive taxes, entrepreneurs may end up

shifting their operations to these sectors (in which they may not be as productive). This type of shift represents an inefficient allocation of resources and society may lose out from consuming those services that are the subject of high tax rates as entrepreneurs move away from these sectors.

Chapter Eight – Conclusion

The crisis in Zimbabwe and the consequent economic decline have had an adverse impact on state revenue collection. The shrinking formal sector, particularly during the ‘lost decade’ period between 1998 and 2008, has helped to create a large informal sector in Zimbabwe. Informal employment, now accounting for 84 per cent of all those currently employed, has proven to be the only viable alternative for a highly heterogeneous group made up of not only semi-literate unskilled workers but also highly skilled professionals with postgraduate degrees. This large informal sector, as this thesis has shown, has not only attracted those who have failed to find formal employment (i.e. those who have been ‘excluded’) but also those who have decided to opt out of the formal sector (i.e. those who have decided to ‘exit’).

The falling tax revenue collection as a result of the crisis provided the Zimbabwean government with the impetus to introduce informal sector taxation (through presumptive taxes) in 2005. Zimbabwe is a country that has been and continues to be in crisis. Economic mismanagement and political instability have transformed the country, which used to be one of the strongest and most diversified sub-Saharan economies, into a failing state. Not only were there widespread shortages of food, electricity and foreign currency during the crisis, the government was unable to collect any meaningful revenues. As outlined in Chapter Three, the tax ratio, which has traditionally been high in Zimbabwe, fell to a record low of just four per cent in 2008 at the height of the crisis. Inflation soared to record levels, rendering the Zimbabwean dollar useless. One of the main impacts of the Zimbabwean crisis was the shift of economic activity from the formal to the informal economy.

The findings presented in Chapter Seven show that many of the informal sector operators in this study were not poor by Zimbabwean standards. The mean profit reported by the study participants in each of the four activity classes was higher than the TCPL of \$497.84 (in 2011). Also, none of the respondents in this thesis reported a monthly profit below \$250, the tax-free PIT threshold in Zimbabwe. Although this was not a random sample of informal sector operators in Zimbabwe, these results indicate that the informal sector in Zimbabwe is highly heterogeneous and that it is not made up of only the poor.

Based on the typology of informal enterprises in Chapter Two, the findings presented in Chapter Six clearly indicate that very few enterprises in this study could be classified as subsistence enterprises. Most of them, according to this typology, could be classified as small

enterprises based on the type of activity, high barriers to entry (e.g. transport operators), high finance needs, and basic record-keeping. For example, of the 44 respondents who answered the question on the recording of business transactions, 33 (or 75 per cent) maintained either simplified accounts or basic records of orders and sales.

The rationale for collecting taxes from the informal sector in Zimbabwe was that, given its size and composition (i.e. many firms that are generating profits that are worth taxing), it represents a potential source of tax revenue (Government of Zimbabwe, 2005; Utaumire et al., 2013). The other motivations for taxing the informal sector discussed in Chapter Two (i.e. equity, efficiency and governance) were not obvious in the Zimbabwean case, with the focus being predominantly on revenues. However, as one key informant pointed out (included in Chapter Five), presumptive taxes could have been introduced to try and force informal sector operators back into the formal tax system (i.e. using the 'stick'). As the state failure literature (which was reviewed in Chapter Three) shows, a crisis may lead to either total state collapse (as was the case with Barre's Somalia and Mobutu's Zaire) or the implementation of various innovative tax collection methods as was the case in Ghana under Rawlings (Joshi and Ayee, 2002). The state failure literature shows that states, even failing ones, are multi-dimensional and some can continue to leverage functional institutions. Zimbabwe has maintained a functioning revenue authority which continued to collect revenues even at the height of the crisis. It is this revenue authority that was mandated to collect revenue from the informal sector in 2005.

Although Zimbabwe has been collecting presumptive taxes since 2005, when this research was initiated in 2010, I could find no work that collated and described the tax code itself or evaluated its effectiveness. More recently, two studies on presumptive taxation in Zimbabwe have been published. The first study by Utaumire et al. (2013) on the effectiveness of the presumptive tax in ZIMRA's Region One found that most informal traders were not paying presumptive taxes due to the widespread lack of knowledge of these taxes. The second study by Zivanai et al. (2014) was on the impact of the presumptive tax on the viability of minibus taxi operators in Bindura. This study found that informal sector operators were not paying presumptive tax because other informal entrepreneurs were also not complying with these tax regulations. Both these studies, as is the case with most of the international literature, focused mainly on the tax revenue authority's effectiveness in administering informal sector taxes, leaving many gaps in knowledge.

This thesis attempted to begin filling these gaps. It evaluated informal sector presumptive taxes in Zimbabwe using the three criteria of a good tax system according to conventional public tax theory – administrative effectiveness, equity and economic efficiency. As far as I am aware, this has not been done before either for Zimbabwe or for other countries in which informal sector taxes have been introduced. It is therefore hoped that this work will begin to fill the gap, not only in the Zimbabwean context, but also contribute to the literature on informal sector taxes in developing countries more generally, where the focus has heretofore been on administrative issues. More specifically, this study had three main objectives. Firstly, to describe the informal sector tax code in Zimbabwe and to explain how it relates to the broader tax system in the country, as well as to analyse the rationale for its introduction. Secondly, to investigate the challenges and successes in implementing informal sector taxes in the context of the economic and political crisis. Thirdly, to assess the extent to which these informal sector taxes are addressing the issues of equity and efficiency.

In evaluating presumptive tax administration in Zimbabwe, information was collected using document analysis and the analysis of quantitative data, where available, but predominantly from qualitative interviews. In the interviews, a questionnaire was administered to 47 informal sector operators from four categories of informal sector activities (transport, flea markets, hairdressing salons and cottage industries). These informal sector operators were also interviewed using a more open-ended interview schedule. Further, qualitative interviews were conducted with 16 key informants from ZIMRA, the Ministry of Small and Medium Enterprises Development, academia and business organisations. Given the paucity of good quality data in Zimbabwe, the assessment of equity and economic efficiency was performed using information from the tax code and the qualitative interviews. Data required for a traditional public finance analysis of equity and efficiency are not available in Zimbabwe. Nonetheless, despite this somewhat unconventional approach, interesting findings were uncovered using the qualitative approach as outlined below, some of which would not have come to light in the analysis of purely quantitative data on income/expenditure or input-output tables. In addition, the use of qualitative interviews allowed the researcher to probe aspects of the tax administration and implementation that related to some of the political economy concerns in the tax literature. The state failure conceptual framework used in this study is important in understanding revenue collection from the informal sector in the context of the Zimbabwean crisis.

The findings presented in this thesis, although indicating that the informal sector is a potential source of tax revenue in Zimbabwe, clearly demonstrate that informal sector taxes have been poorly administered. Also, not only are presumptive taxes generally unfair when compared to formal sector taxes (both personal and corporate income tax), the findings show that these taxes have given rise to inequity within the informal sector itself. Furthermore, the implementation of presumptive taxes has induced changes in behaviour among those in the informal sector in their attempts to evade these taxes, resulting in economic inefficiency. I will proceed to describe some of the main findings further below.

Summary of main findings

In terms of administrative effectiveness, a notable success in the collection of informal sector presumptive taxes has been the increase in the amounts collected between 2009 and 2011. Presumptive tax collections increased from US\$1.4 million (0.14 per cent of total tax revenues) in 2009 to US\$13.1 million (0.45 per cent of total tax revenues) in 2011. This success is noteworthy, especially in a failing state like Zimbabwe. To put this into perspective, the US\$13.1 million collected through presumptive taxes in 2011 could have paid the annual salaries of more than 4,329 government employees (or 1.8 per cent of all civil servants at the minimum monthly salary of \$253 in 2011). However, administrative effectiveness has to do with much more than just the amount of revenues collected. Issues such as the coverage of these taxes, the amount collected as a proportion of total revenues, the costs incurred in collecting (and complying with) these taxes and the tax authority's ability to encourage quasi-voluntary compliance also need to be analysed.

This thesis showed that the crisis in Zimbabwe presented the revenue authority with a number of challenges, some of which were beyond its control. These challenges (called external factors in this study) were such things as the level of police corruption and perceptions around accountability and transparency. These factors have an impact on tax compliance behaviour. Taxpayers in this study viewed the following as major disincentives to compliance: the way tax revenues are used by the state with no benefits for those paying them (for example, the government's failure to maintain the nation's infrastructure such as roads); the existence of touts, rank marshals and 'committees' (aligned to ZANU-PF) that collected their own fees; the lack of consultation in the setting of tax rates; and government corruption. The thesis showed that these factors have a negative impact on tax morale.

This study has shown that ZIMRA also had its own internal challenges. The findings show that many of those in the informal sector were not paying presumptive taxes. Poor monitoring and evaluation, low manpower levels, a lack of commitment to enforce tax regulations, and high levels of corruption were the challenges that existed within ZIMRA. These weaknesses on the part of ZIMRA, together with what were considered to be high presumptive tax amounts, have resulted in low levels of compliance.

In addition, not much seems to have been done to educate informal sector operators about informal sector taxes. While there was some knowledge of formal sector taxes among informal operators who formed part of the study, not much was known about the taxes that affected their sector (apart from those in the highly targeted public passenger transport and flea market activity classes). In one particular activity class, cottage industries, none of the informal sector operators knew about presumptive taxes at all. These findings on the widespread lack of awareness are consistent with the findings in both the international literature and the literature on informal sector taxation in Zimbabwe. As outlined in Chapters Two and Three of this study, Carroll (2011), Demenet et al (2013) and Utaumire et al. (2013) in Ghana, Vietnam and Zimbabwe respectively also found that many informal traders did not know about the taxes that affected their sector. The findings in this thesis concerning the transport operators' knowledge of presumptive taxes are consistent with those of Zivanai et al. (2014), who found that only 10 per cent of the minibus taxi operators (a highly targeted group) were not paying presumptive taxes because they did not know about them.

According to those informal sector operators in this study who knew about these taxes, presumptive tax rates are too high, especially when one includes the other fees that informal sector operators have to pay. This finding is consistent with the public finance literature which shows that a high tax rate can lead to low compliance (Alm, 1996). These high presumptive amounts make compliance difficult and in some cases (such as the hairdressing salons) impossible. This was an issue on which there was agreement between taxpayers (the informal sector operators) and many within ZIMRA (particularly with respect to the presumptive tax amount for hairdressing salons).

The analysis of horizontal and vertical equity in Chapter Seven compared an informal sector taxpayer to one paying income taxes in the formal sector (either through CIT or PIT). The assessment of equity, was based on a comparison between these two types of taxpayers at

three hypothetical income levels - a minimum income level of \$250, twice this minimum level (i.e. \$500) and at three times this minimum level (i.e. \$750). These levels were informed by the profits stated by the informal sector operators in the qualitative interviews.

This thesis has shown that presumptive taxes (apart from the VDP which is an *ad valorem* tax) are highly regressive. Due to the fact that these informal taxes are specific or unit taxes, the amount paid is the same regardless of the level of income. This means that those informal sector operators earning a higher income actually pay a lower share of that income as tax. This was in contrast to the personal income tax in Zimbabwe which is progressive and the corporate income tax which is a proportional tax. The thesis also demonstrated that informal sector taxes are generally not horizontally equitable when compared with personal income taxes. At the hypothetical minimum level of income of \$250, formal sector income earners do not pay any taxes through the PIT, whereas informal sector operators in this study are expected to pay between 10 per cent (for cross-border traders) to 200 per cent for hairdressing salon operators per month. While presumptive taxes are generally lower than the corporate income tax rates at all the hypothetical income levels, those of hairdressing salon operators are much higher than CIT at all hypothetical income levels. The results of the study also show that although the public passenger transport operators are paying lower rates than the CIT rates, these operators pay various 'fees' and 'taxes' which are paid to the police, touts and Ministry of Transport officials. These 'taxes', as shown in the study, far exceed the amounts that are supposed to be paid to ZIMRA.

Further, the thesis showed that apart from the horizontal inequities between informal sector presumptive taxes and formal sector taxes due to the tax code, a major source of inequity was the selective application of tax regulations. None of the respondents in the cottage industry class were paying presumptive taxes. Also, none of those who were operating hairdressing salons were paying the presumptive tax specifically targeted at their activity class. The six hairdressing salon operators who reported that they were paying taxes reported that they were paying it as part of the 10 per cent presumptive tax on rent. Even many of those in the highly targeted public passenger transport sector were not paying their taxes. In this study, only 10 public passenger transport operators reported that they were paying these taxes consistently, out of the 21 public passenger transport operators who had ever paid these presumptive taxes before. As the findings show, ZIMRA is failing to effectively tax the informal sector which has grown rapidly as a result of the economic crisis. It is, however, important to note that the

nature of the informal sector makes it hard to tax. Some of the problems encountered by ZIMRA would apply anywhere in the developing world, and not just in Zimbabwe, and this was evident to a certain degree from the review of the informal sector tax systems in certain parts of Asia, Africa and Latin America (in Chapter Two).

The thesis has shown that there are a number of disincentives to tax compliance resulting from the political crisis in Zimbabwe. The ruling party has increasingly used militias to intimidate informal sector operators. These militias are also levying their own 'taxes' which, in some cases, have resulted in informal sector operators feeling that they are protected from competition and exempt from paying taxes to ZIMRA. In exchange for this protection these informal sector operators are expected to be loyal and provide services to ZANU-PF. The selective application of tax regulations was cited as a major disincentive by those who were paying presumptive taxes.

The findings show that there are two major disincentives that are linked to the police – corruption and unfair competition from police officers who themselves operate in the informal sector. Zimbabwe's tax legislation, which empowers the police to enforce presumptive tax compliance, has encouraged corruption in a police force already viewed as the most corrupt in the SADC region, as noted in Chapter Six. The findings suggest that the police see those in the public passenger transport sector as a good source of bribes. The results of this study show that bribes are extorted even from transport operators who have complied with tax regulations. This operates as a major disincentive to compliance for the transport operators as some of them have made the decision to stop paying presumptive taxes and just pay bribes instead. The findings also show that many police officers are themselves minibus operators with one report saying that 50 per cent of all taxis in Harare are owned by police officers (NewsDay, 2014). These police officers who own minibus taxis, according to the respondents in this study, see the public passenger transport operators as competitors and employ various tactics to harass them and waste their time. Clearly, there is a conflict of interest if those who are supposed to enforce tax regulations are also competing with those tax payers.

The findings presented in Chapter Five suggest that research on informal sector operations and profitability is important in order to set presumptive taxes that are horizontally and vertically equitable. The public passenger transport operators (i.e. minibus taxis and taxi-

cabs) generally have lower presumptive tax rates than the other informal sector activity classes in this study. Minibus taxi operators in this study have lower presumptive tax rates at three times the minimum hypothetical income level than those in the flea market, cottage industry and hairdressing salon activity classes. Taxi-cab operators have the second lowest presumptive tax rates at the hypothetical minimum income level (and the lowest tax rates at twice and three times this minimum level income) of the informal sector activity classes that formed part of this study. As outlined in Chapter Five, informal sector taxes were initially targeted at the transport sub-sector, hence the research that was carried out by ZIMRA between 2003 and 2005 to determine this sub-sector's profitability. Nonetheless, the Ministry of Finance went on to prescribe much higher presumptive tax amounts. However, the low presumptive tax amounts for the public passenger transport sub-sector compared to the other sectors, suggest that ZIMRA's research must have played some role in the determination of the final presumptive tax amounts that were announced by the Minister of Finance in 2005. These lower rates for the public passenger transport operators are in stark contrast to the rates specified for cottage industries and the hairdressing salons where data on operations and profitability were not collected by ZIMRA.

Based on the actual and reported behavioural changes as a result of the implementation of presumptive taxes, this thesis showed that these taxes may also introduce economic inefficiencies. Public passenger transport operators reported using long circuitous routes and parking their vehicles in order to avoid police roadblocks. These behaviours have the effect of wasting many man-hours (when workers are not transported to their workplaces on time) which results in lower output – society as a whole experiences losses. In the case of cross-border traders, the reported behavioural change was that of trying to find ways of evading taxes by smuggling their goods into the country. These findings are consistent with empirical findings in the conventional tax literature. This literature has found such behavioural responses as the increased use of tax practitioners and evasion after the introduction of a tax (Alm, 1996). An observation made by ZIMRA officials concerning hairdressing salon operators was that some of them were moving from areas of high visibility, such as the central business district, to residential areas. As pointed out in Chapter Seven, if this shift means that clients can no longer easily access the new site, fewer people will be able to make use of their services and output is reduced.

Corruption and the rent-seeking behaviour of militias and officials responsible for tax collection have also created inefficiencies in the economy. There is an inefficient allocation of resources when ZIMRA officials and police officers spend their time trying to find ways of extorting bribes from informal sector operators. The constant intimidation of informal sector operators and the efforts expended in order to capture these operators' surplus through various "committee fees" (in the case of militias) and the setting up of numerous roadblocks (by ZIMRA and the police) represent a misallocation of resources. These efforts do not result in any new wealth being created but focus instead on extracting what has been produced by others.

The thesis also showed that economic inefficiencies can result from the differences in the tax rates or the selective application of tax regulations. If tax rates are much lower in some informal sub-sectors or if some sectors are getting away without paying presumptive taxes (an issue that also speaks to equity), entrepreneurs may end up shifting their operations to these sectors in which they may not be as productive. This type of shift represents an inefficient allocation of resources and society may lose out from consuming those services that are the subject of high tax rates as entrepreneurs move away from these sectors.

Limitations and contributions of the work

Although the evaluation of presumptive taxes in this thesis has highlighted major weaknesses on all three criteria of a good tax system in the context of the crisis state, it is important to briefly review some of the limitations of the approach used to identify these weaknesses. As outlined in Chapter Four, the evaluation of the equity and efficiency of presumptive taxes used the information obtained from the qualitative interviews conducted with the informal sector operators and key informants. In other words, although the theoretical concept of presumptive tax evaluation was based on conventional tax theory, the actual method used to evaluate these taxes was not based on conventional public finance analysis, given the paucity of data in Zimbabwe. As mentioned in Chapter Four, there are serious gaps in economic data in Zimbabwe. The data needed for conventional public finance analysis of equity and efficiency are not available. For example, there are no input-output tables and the last social accounting matrix was produced in 1991. The Ministry of Finance (which controls ZIMSTATS) also does not implement international best practice in the dissemination of statistics and the accessing of existing data. This means that data from studies such as the income and consumption expenditure survey cannot be easily accessed by researchers. As

pointed out in Chapter Four, these problems in accessing data make it difficult to perform value added tax incidence analysis, for example, which depends on such data.

The second limitation was that respondents were not randomly chosen. Informal sector operators were purposively selected based predominantly on whether they had ever paid presumptive taxes before, since the study's aim was to evaluate the equity and efficiency of the presumptive taxes that were being paid. Therefore, those who were not paying taxes were largely excluded from the study. When it was realised that the level of non-compliance was very high (particularly in the cottage industry class), those who had never paid taxes were included as long as profit figures were available so as to get an indication of the profitability of these entrepreneurs, and their views on informal sector taxes more generally. Therefore, since a non-random sample of participants was chosen, the findings from this study will, strictly speaking, describe the conditions of the respondents.

The third limitation was that of missing data on profitability (for some of those who had paid presumptive taxes before) and as mentioned earlier, the fact that many respondents in the sample (particularly in the cottage industry class) were not paying taxes. This meant that even a basic calculation of equity based on the presumptive tax paid as a proportion of the profit could not be done (i.e. given the missing profit figures for some and the non-compliance of others). Hence, this study's reliance on the hypothetical income levels of respondents in the assessment of equity.

In spite of these limitations, the evaluation of presumptive taxes using the qualitative interviews with informal sector operators and key informants has been useful in several important ways. Firstly, the findings presented in this thesis contribute to a small but growing literature on informal sector taxation, a literature that has so far focused mainly on administrative effectiveness. This thesis has identified ZIMRA's successes and challenges in the administration of presumptive taxes. Secondly, using qualitative interviews and document analysis, the thesis has demonstrated, as outlined in the state failure literature (Di John, 2006; Everest-Phillips, 2010), that crude notions of chaos and disorder in failing states are rarely a true reflection of what goes on in these states. The thesis shows that ZIMRA has been collecting taxes (including presumptive taxes) in a failing state although, as Chapter Six clearly shows, there are numerous internal (and external) factors that have compromised ZIMRA's effectiveness. Thirdly, by using qualitative interviews and combining these with some quantitative analysis, this thesis makes a methodological contribution. This approach,

as far as I am aware, is being used for the first time in this dissertation in the evaluation of an informal sector tax system. The use of qualitative interviews in the evaluation of efficiency has been particularly useful in identifying some of the tax-induced behavioural changes outlined in the public finance literature among informal sector operators in Zimbabwe (see Slemrod, 1996). The qualitative interviews with key informants, the informal sector operators' reported profits and the hypothetical income levels (which were determined from these reported profits) have provided useful insights on the horizontal and vertical equity of presumptive taxes in Zimbabwe. In other words, while a conventional analysis of the tax burden (such as tax incidence analysis) may be superior in highlighting the equity of a tax, the qualitative approach used in this study has yielded some useful indications of the equity of presumptive taxes in the absence of good quality statistical data. And in many instances, information that shed light on various aspects of the functioning (or malfunctioning) of the tax administration emerged that would have not been possible using standard public finance theory and quantitative secondary data. This methodological approach can be used in other developing countries that have insufficient quantitative data. The approach can also be used to complement the findings resulting from a more conventional analysis of equity.

The use of political economy theory in the analysis of informal sector taxation is another contribution that this study makes. The thesis attempts to contribute to the understanding of informal sector taxation using, in part, conventional tax theory. However, it also draws on political economy theory which is not normally used in the analysis of informal sector taxation, in order to understand how this taxation occurs in a failing state. Political economy theory (and the state failure literature in particular) helps explain the rationale for taxing the informal sector and the multi-dimensionality of the state in which this tax evaluation occurs. Indeed, the analysis of informal taxes in a crisis/failing state is what makes the case of Zimbabwe particularly interesting, and requires that one goes beyond standard public finance theory to also consider the political economy of taxation and tax administration. The theoretical approach used in this thesis (i.e. the framing of the study using conventional tax theory within a political economy discourse) is one that can be used in future studies of informal sector taxation in crisis states.

Policy implications

Clearly, the amounts that informal sector operators should pay in the form of presumptive tax should result from a good understanding of the operations and profitability of these operators.

In order to derive realistic presumptive tax amounts, further research should be carried out on informal sector profitability, an issue that was mentioned by informal sector operators and key informants. This research should also factor in the hazards of operating in the informal sector such as irregular income streams, the bribes to the police and touts (factors that rarely affect formal businesses paying CIT and individuals paying PIT in Zimbabwe). The research that was carried out by ZIMRA between 2003 and 2005 (outlined in Chapter Five) was useful. However, it is important to note that even this research recommended relatively high presumptive tax rates of between four and nine per cent for public passenger transport operators (see Chapter Five). These rates were much higher than those of other countries in sub-Saharan Africa in 2011 which ranged from one per cent in Uganda to four per cent in Rwanda (see Chapter Two).

The findings from the research conducted on informal sector operators and profitability should be used by ZIMRA to more effectively lobby the Ministry of Finance for realistic, evidence-based presumptive tax amounts. Interestingly, one finding from this study was that many within ZIMRA reported that presumptive taxes (particularly those of the hairdressing salon operators) were not horizontally equitable vis-à-vis formal sector taxes. This shows that there is a need for more research by ZIMRA on what is feasible in terms of informal sector taxation and for ZIMRA to more effectively play its role of advising the Ministry of Finance on taxes in general and informal sector taxes in particular.

The informal sector in Zimbabwe has grown, and taxing this sector requires a more strategic approach. This might involve the setting up of a small taxpayers' office as this practice has brought success in some developing countries (see Mulenga, 2011). Monitoring and evaluation of informal sector tax collections, even if this is initially only in the form of an assessment of the revenues collected from each of the sub-sectors, is important. This monitoring of revenues collected should result in better targeted revenue collection efforts. Even those within ZIMRA who were responsible for collecting taxes did not know whether there had been any improvements in presumptive tax collections.

Another policy recommendation that can be made is that of involving informal sector associations in the determination of tax rates and carrying out education and awareness campaigns. Although some ZIMRA officials reported that they were involving stakeholders, the majority of respondents in this study (apart from those in the highly targeted sub-sectors)

were not aware of presumptive taxes, a finding that is consistent with that of Utaumire et al. (2013). This affects tax morale and therefore voluntary compliance.

The last recommendation has to do with access to data. In line with international practice, it is important to make the data collected by ZIMSTAT via national surveys publically available to *bona fide* researchers. Removing these restrictions on access to data can only improve the quality of research output which can be used to inform policy.

Final remarks

The raising of revenue to fund public expenditure, from those that have the ability to pay, is a crucial and legitimate function of the state. It is also legitimate for the state to try and tax informal sector businesses if, as the results from this study suggest, there is horizontal inequity, with formal sector workers/businesses sometimes paying more than informal sector businesses with similar profit levels. However, raising revenues from the informal sector, in an administratively effective manner that also addresses issues of equity and economic efficiency, is difficult.

This is partly because of the nature of the informal sector itself, which is characterised by the high physical mobility of operators (who are therefore difficult to locate), high churn rates, informal business structures (usually family based or sole proprietorships) and weak accounting systems. This means that taxing the informal sector is likely to be a complicated affair, whether these taxes are being implemented in Zimbabwe or in another developing country with a more functional state. The difficulty also arises because of the trade-offs across the three criteria, which are not unique to informal sector taxation, but are inherent in tax policy criteria more generally. Typically the trade-off is considered between equity and economic efficiency. To take one example from this study, roadblocks that are used to improve coverage and compliance with a view to reducing inequity within the transport sector are likely to result in inefficiency (i.e. minibus taxi operators parking their vehicles). In the cases where this tax enforcement leads to the payment of bribes, this could lead to further inequity. And finally, in Zimbabwe, the problems of taxing the informal sector are exacerbated by a lack of cohesion between the Ministry of Finance and ZIMRA. The results of this study uncovered a disjuncture between the Ministry of Finance's interest in and rationale for taxing this sector, and ZIMRA's ability to actually collect these taxes. This

resulted in low levels of commitment to collection on the part of ZIMRA officials and often corruption.

When presumptive taxes were introduced in 2005, the overarching aim appeared to be to raise revenue and not necessarily to develop these businesses into formal ones (see Government of Zimbabwe, 2005). However, as noted in Chapter Five, the rates were set at such punitive levels it is possible that these were, in part, levied to encourage those in this sector to move to the standard tax system (i.e. the 'stick' approach). Given the difficulty inherent in taxing the informal sector, one needs to ask the question of whether presumptive taxes in this sector are a viable way of raising revenue and/or encouraging firms to formalize. In trying to achieve these objectives, it might be better to make the environment more conducive to tax compliance, and increase incentives for businesses to operate within the formal sector (through, for example, the easing of access to finance and government tenders) - i.e. the 'carrot' approach. The ways in which this might be achieved are beyond the scope of this study, but are certainly worthy of further research.

In conclusion, although the informal sector in Zimbabwe does represent a potential source of revenue, government's efforts to tax this sector ought to be tempered by the realisation that this should be done in an efficient, equitable and administratively effective manner, and with a broader view of the ultimate objectives of informal sector taxation. ZIMRA, in trying to tax the informal sector, has achieved some successes, but more needs to be done if the potential revenues from this sector are to be realised. The levels of tax evasion are very high and the selective implementation of tax regulations is bound to have a negative effect on those already paying presumptive tax, thus reversing the progress that has been made so far in taxing this sector.

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ome_Tax_Report_draft_Jan11.pdf%26t%3D1456707906%26hash%3Dc021530ef7ab6fe76cd565e51240c88bc8cc74aa&ei=9xKGUuqbJsbP0QXro4CQCw&usg=AFQjCNE4-ZPdBiR5Ljhb-MWcnk67dn-b0Q&sig2=-d5ciflMLPVkWMYLe_DfRA&bvm=bv.56643336,d.d2k 4 November 2013.

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APPENDIX 1: Informed consent form

Informed Consent Form

(To be read out by researcher before the beginning of the interview. One copy of the form to be left with the respondent; one copy to be signed by the respondent and kept by the researcher.)

My name is Godwin Dube (student number 209522052). I am doing research on a project entitled 'A study of the financial concerns of the urban self-employed in Zimbabwe'. This project is supervised by Professor Imraan Valodia at the School of Development Studies, University of KwaZulu-Natal. I am managing the project and should you have any questions my contact details are:

School of Development Studies, University of KwaZulu-Natal, Durban.
Cell: 263 912217826 Tel: +263 772217826. Email: 209522052@stu.ukzn.ac.za.

Peofessor Imraan Valodia's details are:
School of Development Studies, University of KwaZulu-Natal, Durban.
Tel: +27 31260 1357 Email: valodia@ukzn.ac.za

Thank you for agreeing to take part in the project. Before we start I would like to emphasize that:

- your participation is entirely voluntary;
- you are free to refuse to answer any question;
- you are free to withdraw at any time.

The interview will be kept strictly confidential and will be available only to members of the research team. Excerpts from the interview may be made part of the final research report. Do you give your consent for: *(please tick one of the options below)*

| | |
|--|--|
| Your name, position and organisation, or | |
| Your position and organisation, or | |
| Your organisation or type of organisation <i>(please specify)</i> , or | |
| None of the above | |

to be used in the report?

Please sign this form to show that I have read the contents to you.

----- (signed) ----- (date)

----- (print name)

Write your address below if you wish to receive a copy of the research report:

APPENDIX 2: Interview guide - Key informants

A. Collection

- What was the main motivation for introducing informal sector presumptive taxes?
 - How were informal sector presumptive taxes determined?
 - When were these taxes introduced in Zimbabwe?
 - Do you feel that the informal sector represents a potential source of tax revenues?
 - Is the collection of presumptive taxes from the informal sector done in a systematic and consistent manner?
 - Are these presumptive taxes collected strictly according to the presumptive tax schedule?
 - Do you feel that informal sector tax collection is efficient in terms of the costs incurred in the collection process?
 - Does ZIMRA use agents (e.g. landlords, council) to collect these taxes?
 - If so, has the collection of taxes through agents increased the administrative efficiency of tax collection?
 - Are there any incentives for agents to collect these taxes on behalf of ZIMRA?
 - Do you have information on the number of informal sector operators paying presumptive taxes? Proportion?
 - How are informal sector operators identified?
 - In terms of information gathering - are there any links between ZIMRA and various licensing authorities?
-
- Have informal operators been cooperative in terms of paying these taxes?
 - If not, why have they not been cooperative?
 - What measures are in place to ensure that informal sector operators comply with these taxes?
 - Can taxpayers appeal if they feel that these taxes are too high?
 - How can they do this?
 - Have there been differences in collection levels from different activity classes?
 - If so, what has contributed to these differences?
 - Which informal sector activity classes are particularly difficult to tax?
 - Which informal sector activity classes are particularly easy to tax?
 - Is it possible to determine the amount of tax that was collected from each informal sector activity class?
 - How much revenue was collected through these presumptive taxes in 2010?
 - Compared to 2010, has there been an increase/decrease in number of informal sector operators covered by these taxes?
 - If so, what has caused this increase/decrease?
 - Has there been an increase/decrease in the amount of revenue collected from this sector compared to 2010?
 - What has caused this increase/decrease?
 - Do you feel that you have made significant inroads in taxing the informal sector?
-
- What are the three main challenges faced by ZIMRA in effectively taxing the informal sector in Zimbabwe?
 - What measures has ZIMRA taken to address these challenges you have just mentioned?
 - What is ZIMRA's capability in terms of data and information collection pertaining to the informal sector?
 - Which areas need strengthening in terms of revenue collection from the informal sector?
 - How does ZIMRA assess its effectiveness in collecting these taxes?

- Are there any programmes that have been implemented to make informal sector operators aware of these taxes?
- What are these programmes?

B. Efficiency and Equity

- Have there been noticeable changes in behaviour among informal sector operators as a result of these taxes?
- Are these taxes promoting equity within the informal sector? How?
- Are these taxes promoting equity vis-à-vis the formal sector (i.e. compared with formal sector income taxes)?
- Are there any informal sector operators that are deliberately excluded in terms of enforcement? Why?
- Any other comments

INTERVIEWS: Business Organizations, Academics

- Do you feel that the informal sector represents a potential source of tax revenues?
- Do you feel that presumptive taxes are a good way of taxing the informal sector?
- If not, what system could be implemented to ensure that the informal sector contributes to the fiscus?
- Do you feel that the informal sector in Zimbabwe is being taxed in a systematic and consistent manner?
- If not, why do you believe this is so?
- Do you feel that ZIMRA has the capacity to effectively tax the large informal sector in Zimbabwe?
- If not, what measures could be implemented to strengthen this capacity?
- Do you feel that ZIMRA has made significant inroads in taxing the informal sector?
- Do you feel that informal sector taxes have introduced a measure of equity vis-à-vis the formal sector?
- Has taxing the informal sector had an impact on your members' operations?
- What has been the nature of this impact?
- Other than contributing to the fiscus, do you feel that the informal sector has a role to play in the economy?
- If so, what role is this?

APPENDIX 3: Key informants list

Key Informants

| Key Informant | Organisation | Job Title | Gender | Date of Interview |
|------------------|--|--------------------------------|--------|---|
| Key Informant 1 | ZCTU/LEDRIZ | Chief Economist | Male | 14/10/2011 |
| Key Informant 2 | School of Social Work | Principal | Male | 22/11/2011 |
| Key Informant 3 | ZIMCONSULT | Director | Male | 26/10/2011 |
| Key Informant 4 | University of Zimbabwe | Lecturer (Public Finance) | Male | 04/11/2011 |
| Key Informant 5 | Zimbabwe National Chamber of Commerce | Economist | Male | 20/10/2011 |
| Key Informant 6 | Confederation of Zimbabwe Industries | Economist | Male | 26/09/2011 |
| Key Informant 7 | Ernst & Young | Tax Manager | Male | 25/11/2011 |
| Key Informant 8 | Ministry of Small & Medium Enterprises | Deputy Director Research | Male | 12/09/2011 |
| Key Informant 9 | Ministry of Small & Medium Enterprises | Research Officer | Female | 12/09/2011 |
| Key Informant 10 | ZIMRA | Acting Client Services Manager | Female | 06/09/2011 |
| Key Informant 11 | ZIMRA | Revenue Supervisor | Female | 06/09/2011 |
| Key Informant 12 | ZIMRA | Audit Head | Male | 07/09/2011 |
| Key Informant 13 | ZIMRA | Head Technical Services | Female | 12/09/2011 |
| Key Informant 14 | ZIMRA | Manager Technical Services | Male | 14/09/2011 |
| Key Informant 15 | ZIMRA | Manager Research & Development | Male | 29/09/2011 20/10/2014 (Re-interview) 22/10/2014 email |
| Key Informant 16 | ZIMRA | Sector Manager | Female | 11/11/2011 |

APPENDIX 4: Questionnaire and interview guide – Informal sector operators

QUESTIONNAIRE: Informal sector operators

| | |
|-------------------------------|---|
| Name of Interviewee: | Date of Interview: |
| Questionnaire Number: | |
| Activity Class: | 1. Hairdressing salon 2. Urban transport operator 3. Flea Market Operator 4. Bottle store owner |
| Location of Enterprise: | 1. Low Density suburb 2. High density suburb/Township 3. Central Business District |
| Is the enterprise registered? | 1. Not Registered 2. Companies Act 3. Licensed only 4. Companies Act, Income Tax, VAT & Licensed 5. VAT 6. Income Tax IF NOT CODE 1, 2 OR 3, TERMINATE INTERVIEW |

Note: A formal sector enterprise is one which is registered in terms of the companies act and registered for either income tax or VAT or both income tax and VAT.

1. ENTERPRISE OWNER DETAILS

I am going to ask you questions about yourself

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|-------------------------------------|--|--|--|--|---|--|--|--|
| Sex 1. Male 2. Female | How old were you on your last birthday? <i>Enter age in years</i> | What is highest level of education you have completed?? 0. None 1. Completed Primary 2. Completed Secondary 3. Diploma/certificate after secondary 4. Undergraduate degree 5. Postgraduate | What is your marital status 1. Never married 2. Married /Living together 3. Divorced /Separated 4. Widowed | <i>If code 2 in Q 4</i> What does your spouse/partner do? 1. House husband/wife 2. Retired 3. Unemployed 4. Formal Sector worker 5. Informal sector worker 6. Other, please specify 7. Student <i>For other, describe in 2 - 4 words e.g. "communal farmer"</i> | How many children do you have? <i>Write the number of children</i> | <i>If not 0 for Q 6</i> How many do of your children do you live with? <i>Write the number of children</i> | How many people are in your household? <i>Write the number of people in household</i> | Are you the sole breadwinner? 1. Yes 2. No |
| 1 2 | | | 1 2 3 4 | 1 2 3 4 5 6 7 | | | | 1 2 |

2. ENTERPRISE OWNER EMPLOYMENT BACKGROUND

I am now going to ask you questions about your employment background

| 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 |
|---|--|--|---|---|--|--|--|---|--|---|
| <p>Were you employed before starting this business?</p> <p>1. No</p> <p>2. Yes, in the formal sector</p> <p>3. Yes, in the informal sector</p> <p>4. Other, please specify</p> <p><i>Two word answer e.g. "communal farming"</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>How long ago was this?</p> <p><i>Write number of years</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>For how long were you employed in this job?</p> <p><i>Write the number of children</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>What was your occupation or job title?</p> <p><i>At least two word answer e.g. "School Teacher"</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>Which industrial sector were you employed in?</p> <p><i>At least one word answer e.g. "Manufacturing"</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>Why did you leave your job?</p> <p>1. Resigned</p> <p>2. Retrenched</p> <p>3. Voluntary retirement</p> <p>4. Retired</p> <p>5. Fired</p> <p><i>Other, Please specify</i></p> | <p><i>If code is not 1 for Q 10</i></p> <p>Before the last job, were you employed?</p> <p>1. No</p> <p>2. Yes, in the formal sector</p> <p>3. Yes, in the informal sector</p> <p>4. Other, please specify</p> <p><i>Two word answer e.g. "communal farming"</i></p> | <p><i>If code is not 1 for Q 16</i></p> <p>How long ago was this?</p> <p><i>Write number of years</i></p> | <p><i>If code is not 1 for Q 16</i></p> <p>For how long were you employed in this job?</p> <p><i>Write number of years</i></p> | <p><i>If code is not 1 for Q 16</i></p> <p>What was your occupation or job title?</p> | <p><i>If code is not 1 for Q 16</i></p> <p>Why did you leave?</p> <p>1. Resigned</p> <p>2. Retrenched</p> <p>3. Voluntary retirement</p> <p>4. Retired</p> <p>5. Fired</p> <p><i>Other, Please specify</i></p> |
| 1 2 3 4 | | | | | 1 2 3 4 5 6 | 1 2 3 4 | | | | 1 2 3 4 5 |

3. ENTERPRISE BACKGROUND & CHARACTERISTICS

I am now going to ask you questions about your business

| 21 | 22 | 23 | 24 | 25 | 26 | 27 | 28 | 29 |
|--|--|--|---|--|---|---|--|---|
| <p>When did you start this business?</p> <p><i>Write the Year</i></p> | <p>How did you get capital to start the business?</p> <p>0. Did not need any capital 1. Used own capital 2. Used household capital 3. Borrowed from friends/relatives 4. Personal loan from a private lender 5. Personal loan from a bank 6. Loan from a microfinance Institution 7. Other, please specify</p> <p><i>Read out options Multi-mention allowed</i></p> | <p>How much money did you need to start your business?</p> <p><i>Write the amount</i></p> | <p>Do you maintain a bank account for the business that is separate from your private/family account?</p> <p>1. Yes 2. No</p> | <p>What activities is your enterprise engaged in?</p> <p><i>Examples: Selling foodstuffs, cigarettes, clothing items. Repair services, manufacturing</i></p> | <p>How many paid employees do you have in your business?</p> <p><i>Not including owner</i></p> | <p>How many of your employees are family members?</p> <p><i>Write the number</i></p> | <p>How many employees are permanent?</p> <p><i>Write the number</i></p> | <p>Have you increased or decreased the number of permanent workers over the past six months?</p> <p>1. Increased 2. Decreased 3. Neither</p> |
| | 0 1 2 3 4 5 6 7 | | 1 2 | | | | | 1 2 3 |

| 30 | 31 | 32 | 33 | 34 | 35 | 36 | 37 | 38 |
|---|--|--|--|---|--|---|---|--|
| <p>Do you pay a salary or a piece-rate (commission)?</p> <p>1. Salary</p> <p>2. Commission</p> <p>3. Salary and Commission</p> | <p>How do you decide how much to pay your employees?</p> <p>1. I look at wages for similar work in other informal business</p> <p>2. I look at wages for similar work in formal businesses</p> <p>3. Based on what they sell</p> <p>4. Other, please specify.</p> <p><i>Multi-mention allowed</i></p> | <p>How do you acquire inputs for the services that you offer or the goods that you sell?</p> <p>1. Make them or grow them myself</p> <p>2. Buy them from other informal traders</p> <p>3. Buy them from formal traders</p> <p>4. Import them myself</p> <p>5. Other, please specify</p> <p><i>Read out options</i> <i>Multi-mention allowed</i></p> | <p>Where is the enterprise located?</p> <p>1. Flea market</p> <p>2. On a footpath, street, street corner, open space or field</p> <p>3. In the owner's home</p> <p>4. Site set aside by local authority</p> <p>5. No fixed location</p> <p><i>Other, please specify</i></p> | <p>Why do you choose to operate at this site? Is it because it is:</p> <p>1. Close to other informal traders that sell similar goods or offer similar services.</p> <p>2. Close to other informal traders that sell different goods or offer different services.</p> <p>3. Far from other informal traders that sell similar goods or offer similar services.</p> <p>4. Only site I could get</p> <p>5. Allocated by council</p> <p>Other, please specify.</p> | <p>Is this the only site where you operate your enterprise from?</p> <p>1. Yes</p> <p>2. No</p> | <p><i>If code is 2 for Q 35</i></p> <p>If you operate at different sites do you offer the same services or sell different goods at different sites?</p> <p>1. Yes</p> <p>2. No</p> | <p>How do you finance your business operations?</p> <p>1. From profits</p> <p>2. Trade credit from other informal traders</p> <p>3. Trade credit from formal traders</p> <p>4. Other, please specify</p> <p><i>Multi-mention allowed</i></p> | <p>Approximately how much profit do you make a month?</p> |
| 1 2 3 | 1 2 3 4 | 1 2 3 4 5 | 1 2 3 4 5 | 1 2 3 4 5 | | 1 2 | 1 2 3 4 | |

| 39 | 40 | 41 | 42 | 43 | 44 |
|--|---|---|--|--|---|
| <p>Does your enterprise allow you to support yourself and your family?</p> <p>1. Yes</p> <p>2. No</p> | <p>Who are your main customers?</p> <p>1. General public</p> <p>2. Other Informal traders</p> <p>3. Formal traders</p> <p><i>Multi-mention allowed</i></p> | <p>Do you belong to a business association?</p> <p>1. Yes</p> <p>2. No</p> | <p>If a member of association, which association is this?</p> <p><i>E.g. Hawkers' Association</i></p> | <p>What are the benefits of association membership?</p> | <p>What type of business-related records or accounts do you keep?</p> <p>1. Complete bookkeeping (balance sheet and operating statements)</p> <p>2. Simplified legal accounts</p> <p>3. Informal records of orders, sales, purchases</p> <p>4. No written records are kept</p> |
| <p>1 2</p> | <p>1 2 3</p> | <p>1 2</p> | | | |

INTERVIEW GUIDE: INFORMAL ECONOMY ENTERPRISE OWNERS

A. Site/user fees

- User fees to operate from site
- What user fees are paid?
- How much do they pay?
- Frequency of payment (e.g. daily, weekly, monthly or quarterly)?
- Who do they pay to?
- Any other fees e.g. loading fees, touts etc.

B. Impact of user fees

- Effect of user fees on business operations
- Effect of user fees on price of goods sold/services offered?
- Views on user fees (e.g. are they too high, too low)?
- Perceptions on whether services and benefits are commensurate with these user fees?

C. Knowledge of relevant taxes and payment

- Perceptions of informal sector as a potential source of tax revenues.
- Knowledge of specific taxes relating to sub-sector.
- Whether taxes have ever been paid
- If so, how did you pay these taxes (e.g. monthly, quarterly)?
- When operator started paying these taxes
- How taxes were collected
- Whether taxes were paid in full
- If not, whether there were any negotiations with tax officials or the police
- If taxes not paid, how they have managed not to pay
- Why they decided not to pay the taxes

D. Impact of taxes

- Effect of taxes on business operations (e.g. location, routes)
- Effect of taxes on price of goods and services (i.e. ability to pass on the increases to customers)?
- Perception of informal sector taxes (e.g. too high, too low)?
- If taxes are too high, how much they are prepared to pay, instead of this fixed amount set by government.
- Perceived benefits for business in paying these taxes.
- Any disadvantages for business in paying these taxes.
- Percentage of income paid in the form of presumptive tax

E. Collection

- Measures taken by ZIMRA to encourage the payment of taxes (e.g. awareness campaigns)
- Perceptions on fair and transparent tax collection
- Perceptions on penalties for non-payment

F. Governance

- Taxes put to good use by the government.

APPENDIX 5: List of Informal sector operators

| Informal Sector Operator | Activity Class | Gender | Interview Date |
|-----------------------------|--------------------|--------|--|
| Informal sector operator 1 | Cottage industry | Male | 25/10/2011 |
| Informal sector operator 2 | Cottage industry | Male | 05/09/2011 |
| Informal sector operator 3 | Cottage industry | Male | 07/09/2011 |
| Informal sector operator 4 | Cottage industry | Male | 14/09/2011 |
| Informal sector operator 5 | Cottage industry | Male | 07/09/2011 |
| Informal sector operator 6 | Cottage industry | Male | 07/09/2011 |
| Informal sector operator 7 | Cottage industry | Male | 07/10/2011 |
| Informal sector operator 8 | Hairdressing salon | Male | 17/04/2013 |
| Informal sector operator 9 | Hairdressing salon | Male | 17/04/2013 |
| Informal sector operator 10 | Hairdressing salon | Female | 25/04/2014 |
| Informal sector operator 11 | Hairdressing salon | Female | 25/04/2014 |
| Informal sector operator 12 | Hairdressing salon | Female | 27/04/2014 |
| Informal sector operator 13 | Hairdressing salon | Female | 28/04/2014 |
| Informal sector operator 14 | Hairdressing salon | Female | 29/04/2014 |
| Informal sector operator 15 | Hairdressing salon | Female | 29/04/2014 |
| Informal sector operator 16 | Flea market | Male | 31/08/2011 |
| Informal sector operator 20 | Flea market | Male | 07/09/2011 |
| Informal sector operator 21 | Flea market | Male | 14/11/2011 |
| Informal sector operator 17 | Flea market | Female | 25/10/2011 |
| Informal sector operator 18 | Flea market | Female | 25/10/2011 |
| Informal sector operator 19 | Flea market | Female | 24/11/2011 |
| Informal sector operator 22 | Flea market | Male | 15/11/2011 |
| Informal sector operator 23 | Flea market | Male | 24/11/2011 |
| Informal sector operator 24 | Flea market | Male | 07/11/2011 |
| Informal sector operator 25 | Urban Transport | Male | 19/09/2011 |
| Informal sector operator 26 | Urban Transport | Male | 19/09/2011 |
| Informal sector operator 27 | Urban Transport | Male | 24/11/2011 8/10/2014 (Re-interview) |
| Informal sector operator 28 | Urban Transport | Male | 03/09/2011 |
| Informal sector operator 29 | Urban Transport | Male | 09/11/2011 |
| Informal sector operator 30 | Urban Transport | Male | 20/03/2013 |
| Informal sector operator 31 | Urban Transport | Male | 20/03/2013 |
| Informal sector operator 32 | Urban Transport | Male | 26/03/2013 |
| Informal sector operator 33 | Urban Transport | Male | 03/04/2013 |
| Informal sector operator 34 | Urban Transport | Male | 06/04/2013 |
| Informal sector operator 35 | Urban Transport | Male | 08/04/2013 |
| Informal sector operator 36 | Urban Transport | Male | 10/04/2013 |
| Informal sector operator 37 | Urban Transport | Male | 10/04/2013 |
| Informal sector operator 38 | Urban Transport | Male | 14/04/2013 |
| Informal sector operator 39 | Urban Transport | Male | 17/04/2013 |
| Informal sector operator 40 | Urban Transport | Male | 25/04/2014 |
| Informal sector operator 41 | Urban Transport | Male | 25/04/2014 |
| Informal sector operator 42 | Urban Transport | Male | 25/04/2014 |
| Informal sector operator 43 | Urban Transport | Male | 26/04/2014 |
| Informal sector operator 44 | Urban Transport | Male | 29/04/2014 |
| Informal sector operator 45 | Urban Transport | Male | 04/05/2014 |
| Informal sector operator 46 | Urban Transport | Male | 06/05/2014 |
| Informal sector operator 47 | Urban Transport | Male | 06/05/2014 |

APPENDIX 6: ZIMRA Presumptive tax schedule

With effect from 1st January 2009 presumptive taxes are now payable in foreign currency. Details relating to the current rates and due dates of the various categories are shown below.

1. Transport Operators' Presumptive Tax

| Operators of: | Description | Presumptive Tax (USD per quarter for each vehicle) 2010 & 2011 |
|----------------------|--|---|
| Omnibuses | 8 to 14 passengers | 150 |
| | 15 to 24 passengers | 175 |
| | 25 to 36 passengers | 300 |
| | From 37 passengers and above | 450 |
| Taxi-Cabs | All | 100 |
| Driving Schools | Class 4 vehicles | 500 |
| | Class 1 and 2 vehicles | 600 |
| Goods Vehicles | More than 10 tonnes but less than 20 tonnes | 1 000 |
| | More than 20 tonnes | 2 500 |
| | 10 tonnes or less but with combination of truck and trailers of more than 15 but less than 20 tonnes | 2 500 |

Taxicab and omnibus operators are required to carry a tax clearance certificate in the respective vehicle. Failure to carry or produce the tax clearance certificate renders the person in charge of the vehicle liable to a fine of 100% of the amount due or, if in default of payment, imprisonment for a period not exceeding six months. Failure to pay the Presumptive Taxes in time also renders the operators liable to interest charges.

2. Hairdressing Salon Operators' Presumptive Tax:

Every operator of a hair dressing salon is required to pay Presumptive Tax amounting to **US\$1 500.00 per quarter**. Amounts not paid by the due date are subject to interest charges.

3. Informal Traders' Presumptive Tax:

All persons in receipt of rental income from an informal trader in respect of residential accommodation, premises or a place on which trade is carried on are required to withhold an additional amount of Presumptive Tax equal to **10% of the rental** and remit to ZIMRA. This includes local authorities.

The amount should be remitted within 30 days from the date the amount is recovered. Failure to recover or remit the Presumptive Tax renders the lessor personally liable for the payment of the Presumptive Tax and a penalty of 100% of the amount due. Failure or refusal on the part of the informal trader to pay the Presumptive Tax constitutes a breach of the lease and allows the lessor to terminate the lease without notice.

4. Cross-Border Traders' Presumptive Tax:

Cross border traders who import commercial goods into Zimbabwe are required to pay a Presumptive Tax equal to **10% of the value for duty purposes (VDP)** of the commercial goods. The only exception is cases where the trader is registered with ZIMRA for Income Tax purposes and is up to date with submission of tax returns and payment of all taxes due.

5. Operators of Restaurants or bottle-stores

Every operator of a restaurant or bottle store is required to pay presumptive tax amounting to US\$300 per quarter. The due dates are shown on the table above. Interest is chargeable on all amounts not paid by the due date.

6. Cottage Industry Operators

Every person who owns or is in charge of a cottage industry regardless of it being licensed or not is required to pay presumptive tax amounting to US\$300 per quarter.

The payment of Presumptive Taxes does not exempt the presumptive taxpayer from the obligation to render Income Tax returns. ZIMRA will be carrying out routine checks to ensure that all operators comply with these requirements.

Source: ZIMRA, www.zimra.com [Accessed 20 October 2014].