POLICY BRIEF

SETTING THE STAGE:

INNOVATIVE APPROACHES TO SUSTAIN ECONOMIES IN THE COVID 19 ERA -THE NEXT NORMAL

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COVID 19 IMPACT TO THE ECONOMY

The COVID19 shocks continue to affect Kenya in many ways including contraction of the economy, productivity losses, and welfare losses. Millions have been pushed into extreme poverty with the economic shocks — and disruptions to health, nutrition, and education systems – have multiplied the devastation of the pandemic well beyond the direct impact of illness from the virus. The spread of the Corona Virus as well as measures introduced to slow the spread of the disease have been a significant shock to the economy. An immediate impact has been the closing down of many establishments, resulting in widespread loss of jobs, hours and income. Moreover, it has directly affected international trade resulting in a decline in the performance of key sectors such as hospitality, aviation, capital markets and retail trade among others. The pandemic has generally caused:

- Plunge in key sectors of the economy such as manufacturing, tourism and hospitality, horticulture and diaspora remittances
- Commodity price falls, falls in remittances by migrants, capital flights and foreign investment decline.
- Closure of companies causing job losses, affect wage earners and Small and Micro Enterprises
- Worsened liquidity challenges which were already there before COVID19
- Low Production caused by idleness and ineffective use of the factors of production – Capital, labour, entrepreneurship and land
- Lower business investment caused by lower discretionary expenditures by consumers
- Eventually these would lead to loss of tax revenue and eventual slow-down in government expenditure and investments

Normally, crises are associated with unemployed labour and excess productive capacity, making it relatively easy to restart economies by boosting demand. But now, industries cannot easily be restarted until the medical crisis is over. Far from being just a disruption, the pandemic is an indication of the urgent need to re-set economic, industrial relations, health and other policy sectors.

In the near term, given considerable uncertainty, businesses and households are unlikely to behave as if the future was known with certainty, even if policymakers take action to lower the chances of a prolonged downturn. This makes spending choices more heavily dependent on current conditions rather than future expectations.

SUSTAINING REVENUE COLLECTION DURING COVID 19

Collecting taxes and fees is a fundamental way for countries to generate public revenues that make it possible to finance investments in human capital, infrastructure, and the provision of services for citizens and businesses.

According to the OECD (2020), estimates on tax buoyancy suggest that tax revenues could contract more strongly than economic output. Lower corporate profits, declining consumption and increases in unemployment will, respectively, cause declines in revenue from corporate income taxes, goods and services taxes and personal income taxes. A reduction in economic activity will reduce tax bases, and generally reduce tax-to-GDP ratios. Short-run tax buoyancy – how much tax revenues respond to a 1% change in GDP – tends to be greater than one in emerging markets and low-income countries during recession episodes.

Moreover, the OECD projects that public revenues will decline as governments reduce taxes in an effort to encourage an economic recovery, and as tax collections are suspended during the pandemic. This could induce both delays and reductions in taxes collected during 2020. The crisis will also affect non-tax revenues, especially rents from the exploitation of natural resources. The decline in international trade, travel and domestic consumption is further projected to suppress revenue from consumption taxes on which the majority of low- and middle-income countries rely.

How can the Tax Administrators then sustain revenue collection during and after the pandemic? The following are some of the considerations:

a) **Building more effective tax systems:** Those with the broadest shoulders will need to bear more of the burden, whether through administrative reforms to improve collection, or through changes in tax policy. The efficiency of the tax system can also be improved through the expansion of environmental taxation and cutting wasteful subsidies and tax expenditures

b) **Better priority-setting** can help focus spending on the most efficient and effective programmes. Reforms to expenditure management can ensure that frontline service providers have sufficient flexibility to respond to the new conditions and improve performance. There is need to put tighter systems to manage corruption– there are a number of corruption cases that are on the rise over CODIV-19 tenders across Africa.

c) **Narrow down the Trust Deficit:** For taxation to work, citizens must trust their governments. They need proof that their hard-earned resources are being used wisely, and that in the long run they will benefit from projects completed using taxpayer funds. In countries with a large trust deficit, governments can commit new resources for specific projects that have visible benefits for the average citizen. As trust in a country's ability to provide good public services grows, governments could then move away from relating new tax revenues to particular projects. Better public services would enhance people's trust in government, thus lowering tax evasion and increasing tax revenues further, which would sustain the level of government services, feeding a virtuous circle of trust and government services

d) **Predictable Tax Regime through an overarching tax policy:** for sustained revenue collection, there is need to prioritize the development of an overarching tax policy that will enable predictable environment for the taxpayers, international investors and businesses. This will catalyze investment and tax revenues in the process. For individuals and businesses alike, stability of the tax rate and measures is fundamental to effective planning and efficient compliance. This year (2020) alone, the business environment has been disrupted by the introduction of different tax measures through the business Laws Amendment Act, Tax Laws Amendment Act and the Finance Act.

e) **Buy Kenya Build Kenya:** Continuous promotion of local manufacturing and consumption of essential goods is a critical ingredient for continued revenue collection. Re-investing for enhancing productivity, expanding productive capacity of local sectors, or building precautionary reserves to ride out impact of the crisis will also be essential

f) **"Green" the Tax System:** Taxes have a key role to play in making growth sustainable and equitable, especially in the context of the COVID-19 crisis and increased impact of global warming and climate change. Through such efforts as "greening" tax systems, increased or more effective use of environmentally related taxes can drive growth-oriented reform by shifting the tax burden away from more distortive taxes, e.g. on corporate or personal income, and contribute to fiscal consolidation. The use of environmentally related taxation is widening in both OECD and non-OECD countries. Taxing carbon dioxide emissions and other greenhouse gases provide price signals that can trigger a market response across the entire economy. They encourage industries to shift to less greenhouse gas-intensive ways of production, either by improving their efficiency or by switching to low-carbon substitutes.

ECONOMIC RECOVERY MEASURES – BOUNCING BACK TOGETHER THROUGH TAX INCENTIVES

During the first phase of the Covid 19 pandemic, the Government rolled out a series of economic stimulus packages to cushion households and firms. However, during the twelfth Presidential Address on COVID-19 dated 28th September 2020, the president indicated the government intention to revert to the old tax regime as below:

1) Retaining VAT at 14% until 1st July 2021.
2) Retaining the Income Tax Rate (Pay-As-You-Earn) at 25 percent until 1st January 2021.
3) Retaining the Resident Income Tax (Corporation Tax) at 25% until 1st January 2021.
4) Maintaining the 100 percent tax relief for persons earning gross monthly income of up to Ksh. 24,000 beyond the Sunset date of 31st December 2020.
5) Maintaining the reduction of the current turnover tax rate from 3 percent to 1 percent for all Micro, Small and Medium-sized Enterprises (MSMEs).

The Institute would like to recommend that the president considers extending the tax interventions to a specific timeline of up-to two years (that is, December 2022) to facilitate business and economic recovery taking into account that most tax-payers had no income during the COVID period.

In the same breath, cognizant that the law permits the review of the specific excise duty to be in tandem with the cost of living or the average rate of inflation annually, there is need to cushion businesses reeling from the effects of Covid 19 to facilitate them to bounce back to normalcy of operation. The Government should reconsider the Gazette notice and inflationary adjustment to maintain the current rate and review the category of items under the excise regime that are not necessary “sin” but have significant impact to the general public like bottled water and fuel. Access to clean and safe water in adequate quantities is a basic right guaranteed under article 43 of the constitution. This will spur recovery and consequently, enable more collection in the future as opposed to killing the already struggling enterprises.

The Government through the recent tax reforms removed the exemption of payment of lumpsum to senior Citizens over the age of 65 year. As such, only pension withdrawals are tax free for Senior citizens. The provision is currently discriminatory given that most pensions are given in lumpsum. There is need to include lumpsum payments to encourage savings to later years, support fund values of the schemes and provide source of livelihood and medical care at a more senior age.

HOW BEST CAN KRA PREPARE TO SUPPORT FAST REVENUE RECOVERY POST COVID 19

a) The pandemic has caused an unprecedented shift in economic demand and supply to digital fronts. As such, revenue making and collection is shifting from the physical sphere to a virtual realm. Its hence natural for taxation to adopt and follow the trend. KRA should institute stronger measures to stem base erosion and profit shifting by multinational corporations

b) Consider increasing tax progressivity to address rising inequality

c) Build trust through continued taxpayer facilitation

d) **Make it easier to pay taxes**. Overly complicated tax systems are associated with high levels of tax evasion, large informal sectors, more corruption, and less investment. Enhance iTax system to optimize tax collections while minimizing the burden on taxpayers to comply with tax laws. This will further improve the Country's competitiveness

e) **There is a need to ensure that the tax system is fair and equitable.** There is need to balance increased revenue mobilization, sustainable growth, and reduced compliance costs goals with ensuring that the tax system is fair and equitable. Fairness considerations include the relative taxation of the poor and the rich; corporate and individual taxpayers; cities and rural areas; formal and informal sectors, labor and investment income; and the older and the younger generations.

f) **Adopt new forms of tax**: Property taxes, excise taxes, and carbon taxes are a potentially significant source of revenue in low-income countries—because they apply primarily to wealthier households. They can also deter unwanted behaviors, such as driving cars in already congested areas, smoking, or consuming unhealthy foods.

g) **Push for a Single Identifier and leverage on Big Data Analytics:** the rollout of big-data analytics can increase tax revenue, and at limited cost. Our current systems of data and identity are disconnected, incoherent and opaque

h) **Continuous Taxpayer engagement:** behavioural "nudging" through taxpayer communication, and the simplification of tax codes have proved to work. Limit the losses that result from illicit financial flows - that is, financial flows related to illegal gains, or flows intended to avoid taxation (such as hidden payments to entities based in tax havens). In fact, the taxation of international illicit financial flows related to corporations and individuals is thought to be so important that it has its own designated Sustainable Development Goal target: significantly reducing illicit financial and arms flows by 2030. The elevated focus on illicit financial flows is based on a growing awareness that they undermine both the credibility of institutions, and the fairness of tax systems.

ROLE OF BUSINESS COMMUNITY IN ECONOMIC RECOVERY POST COVID 19

It is clear that the global pandemic and resulting recession have created a tremendous challenge for small businesses, a rise in unemployment and strains on local communities. But, according to the IMF, the COVID-19 outbreak presents an opportunity to collectively reverse these trends by building back better with support of MSMEs and strengthen Africa's production capacity and diversify its export sector to create a more resilient and sustainable economy. The following recommendations are essential to help small businesses, private sector and professionals emerge from the pandemic in a position of strength, building their financial health and the tools they need to manage during the pandemic:

1. **Continued support to slow-down the virus:** Leverage on public-private sector partnerships to combat the virus and support access to health care for health personnel and COVID-19 patients. The path has been taken before in the manufacturing of PPEs, masks and other vital equipment to support the government in containing the spread of the virus in Kenya

2. **Foster collaboration between the public and private sectors** to speed the pace of recovery Collaboration needs to be driven between these sectors to help speed up recovery efforts for small businesses and individuals whose financial lives have been disrupted by the pandemic. It is part of the government’s role to support individuals and small businesses during a time of crisis. A rapid response is critical as small businesses need instant access to liquidity to be able to survive, meet payrolls, access needed inventory and hire back employees where possible. Quick and flexible payouts to those who need them are critical. Through public-private cooperation, we can help speed recovery efforts.

3. **Support uptake of technology and digitization:** It is clear that the global pandemic has sped up the shift towards online commerce. Yet, while consumers have increasingly been moving online, many businesses haven’t evolved their business models to serve these new consumer demands. With access to the right technologies, small businesses operating only in the physical world can establish an online presence, begin selling on various marketplaces and social media sites, enable experiences that blur the online and physical worlds – like buying online and picking up in-store or ordering ahead to skip the line – and access touch-free technologies like QR codes that can ensure in-store employees and customers can safely perform transactions as bricks-and-mortar businesses begin to reopen.

4. **Drive partnership across the private sector to build tools and services** that best serve evolving customer needs by combining our strengths, we can solve real customer challenges and reach new audiences. While great progress has been made with partnerships between networks, acquirers, banks and technology companies to enable

more secure and faster payment experiences, such as real-time payments and payouts for people and small businesses for example, much more work is still needed.

5. **Resource mobilization:** The Business community can be at the forefront in mobilizing financial and human resources to aid in recovery.
6. **Employment creation:** Through public private partnership businesses and private sector can support through investment in areas such as geothermal and solar energy, road infrastructure, water, ICT, PPE and housing. This could provide short-term employment and foreign exchange but could also boost productivity across all sectors of the economy and stimulate trade on the longer run.

7. **Awareness creation***:* Sensitization of members/ Business Member Organizations to support uptake and implementation of government programmes post-covid recovery

ROLE OF ACCOUNTANTS AND SMPS IN POST-COVID RECOVERY

Accountants can support Post-COVID Recovery through:

1. Development of Financial recovery Strategies Post-Covid19
2. Management Accountants and CFOs guide in new strategic development for companies and sectors in the economy
3. Development Business Continuity Plans and Disaster Recovery Strategies for all sectors of the economy
4. Support and help in strengthening internal controls, governance and risk management and mitigation during and Post-Covid19
5. Partner with the Supreme Audit Institutions (SAIs), for the case of Kenya, Auditor General's Office to conduct real time audits or provide pro-bono audit services to institutions managing COVID-19 funds
6. Provide insight on performance: Drive enhanced decision making by leveraging on technology and innovation; and
7. Empower and partner with citizens, civil society, and the media to improve social accountability in the management of COVID-19 funds