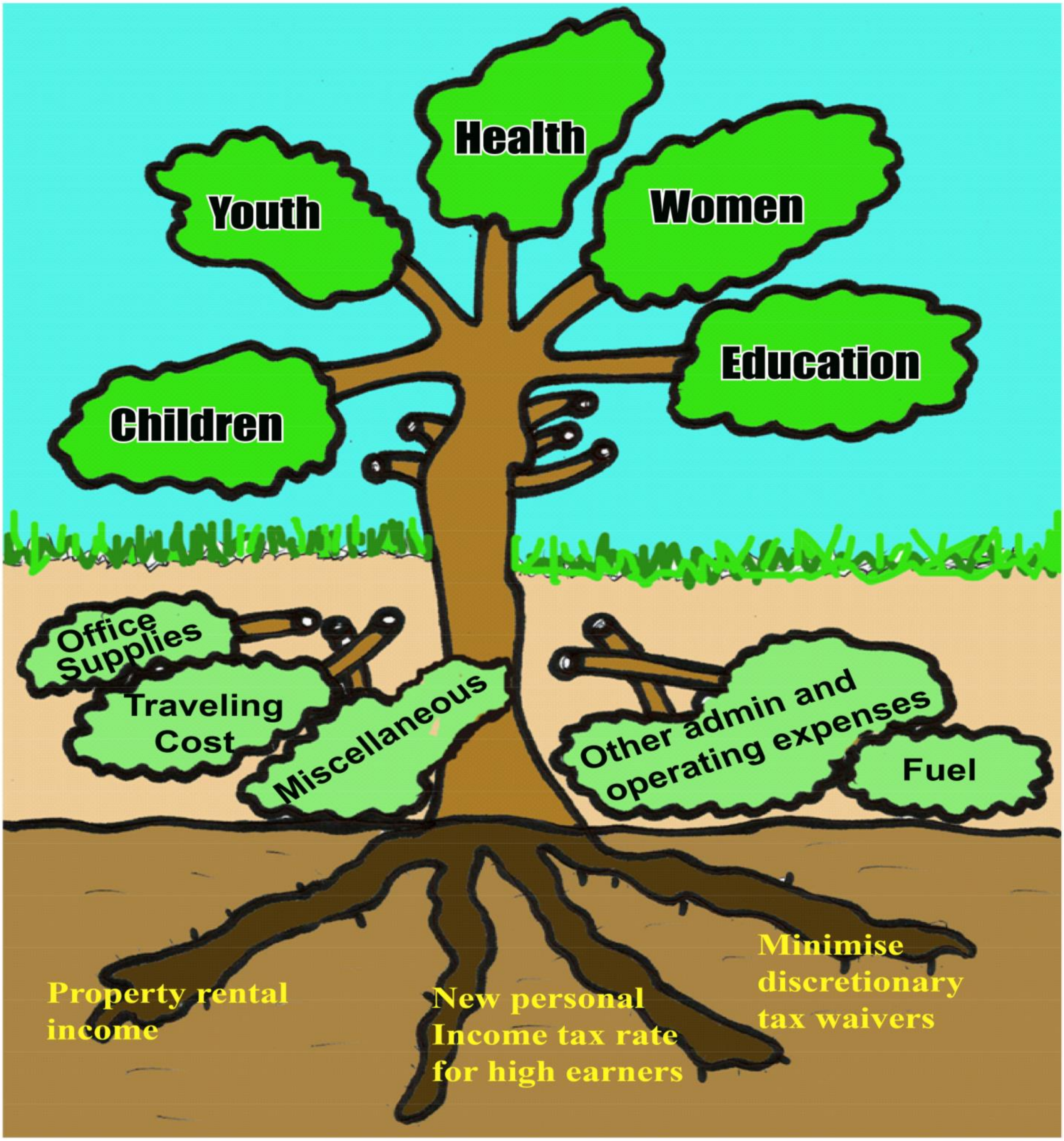
POLICY BRIEF

Fiscal Challenges in the Face of the Ebola Epidemic in Sierra Leone.

What Expenditure and Revenue Alternatives are Available to Government?



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BAN is fully responsible for the content of the report, including any omission or error.

About Budget Advocacy Network

The Budget Advocacy Network (BAN) is a Network of Civil Society Organisations in Sierra Leone committed to work on budgets and budget policies to enhance policy making and implementation for sustainable and equitable development. BAN was established in 2006. BAN consists of local and international organizations such as the Transparency International (TISL) Campaign for Good Governance (CGG) Network Movement for Justice and Development (NMJD), Western Area Budget Education Network (WABEAN), Actionaid International Sierra Leone (AASISL), Search for Common Ground (SFCG), and Christian Aid (CA).

1. Introduction

The Ebola epidemic has engendered tremendous pressure on the national budget stemming from revenue losses, estimated at US$45.7 million in the second half of last year, and additional spending of about US$36 million, bringing the Ebola-related budgetary needs to almost US$82 million. Whilst soliciting additional financial support from development partners is critical to the fight against this deadly disease, there is dire need for a review of the existing fiscal profile of government, identifying revenue and expenditure management options to help guide government's fiscal response to the unfolding emergency whilst ensuring that the livelihoods of the poor are not worsened beyond current levels. Thus, this study is an attempt to find ways of supporting the government of Sierra Leone with policy alternatives geared towards ensuring efficient management of public spending and generating potential revenue to sustain crucial social spending in response to the Ebola epidemic.

2.0 Revenue profile

Over the years, domestic revenue collections, mainly in the form of taxes, grew steadily in both nominal values and relative to nominal GDP. In nominal terms, it grew by Le337.74 billion (US$77.95 million) (or by 18.0%) from Le1.87 trillion (US$431.58 million) in 2012 to Le2.21 trillion (US$510.69 million) in 2013. Revenue collection in ten (10) months (January-October) in 2014 was Le1.82 trillion (US$372.53 million).The revenue-to-GDP ratio also increasedslightlyfrom 12.23% in 2012 to 12.46% in 2013; however, Sierra Leone's revenue-to-revenue GDP ratio of 12.46% is below the unweightedaverage revenue-to-GDP ratio of 15.0% for the Economic Community of West African States,17.2% for Sub-Saharan African countriesand that for the United Nations Millennium Development Goal benchmark of 20.0%.

With the outbreak of the Ebola Virus Disease in May 2014, the growth rate of the economyis projected to slow down to 4.0 percent in 2014 compared to the original projection of 11.3 percent. This substantial drop in economic activities translates into a projected Le390 billion (US$ 90 million) revenue shortfall by end 2014 (IMF, 2014).

The epidemic has affected domestic revenue collection through the following tax handles:

- ***Corporate incometax,***which constitutes over 25 percent of income tax revenue was revised downwards from its original annual target of Le283.43 billion (US$58.03 million) (by 3.17%) to Le274.44 billion (US$56.19 million) for 2014 on account of the fear factor associated with the EVD which has resulted to scaling down and in some cases closure of firms and industries in the country with its knock-on effect on corporate profit.
- ***Personal Income Tax***has continued to contribute the highest (over 68%)to income tax collection since 2012. Its target has, however, been revised downward from its original target of Le720.53 billion (US$147.53 million)to Le606.69 billion (US$124.22 million) (or by 15.8%) mainly due to laying off of workers resulting from the closure of sales outlets (bars, night clubs and entertainment centres) of major companies like Brewery; reduction in working hours by 1-3 hours (Budget, November, 2014) and non-extra working hours (overtime) for employees.
- ***Goods and Services Tax:*****T**he closure or downsizing of operations of major sales outlets have an immediate impact on sales of taxable goods and services including domestically

produced manufactured goods (beer, stout, maltina, cement). The reduction in sales has resulted to a projected shortfall of GST revenue by Le15.46 billion (US$3.17 million) from its original target of Le502.4 billion (US$102.87 million) in 2014.

- ***Excise dutyon domestically produced drinks and beverages***is levied on locally manufactured drinks and beverages. In just three months (August-October 2014) the total excise collection dropped to Le1.15 billion (US$0.24 million) or by 57 percent from Le2.68 billion (US$0.62 million) in the same months in 2013. This implies that it will be difficult to attain the target for this revenue handle for the year.

3.0 Expenditure Profile

There are fifty-eight (58) MDAs including Local Councils that compete for limited state resources on the recurrent front, budgeted at Le2.84 trillion for FY2015. Analysis in the study shows that spending on social services was largest during 2011-2013 (Le176.23 billion), which was driven mainly by recurrent spending on education sector (Le120.04 billion) followed by spending on the health and sanitation sector (Le38.97 billion). Spending on social welfare, gender, and children's affairs was very small at Le4.37 billion relative to education and health and sanitation, and other recurrent spending. The same trend is depicted for the planned spending for 2014 and 2015.Also of critical is the development (capital) spending, which is categorized by the eight Pillars of the Agenda for Prosperity (which is the National Poverty Reduction Strategy Paper). About 60.55 percent (Le2.70 trillion) of the total budget for 2015 (Le4.46 trillion) was devoted to implementing poverty reduction priorities. Of the amount devoted to poverty priorities, only 1.80 percent (Le48.60 billion) is allocated to Social Protection Pillar, even though social protection is priority spending area for government in 2015 as stated in the previous section. International Competitiveness (focusing on transport infrastructure and energy) commands the largest share of resources at Le1.01 trillion (37.32 percent) of the total resources devoted to poverty reduction priorities—the predominance of this Pillar comes from the disproportionate allocation made to it under capital spending both from domestic resources (commanding 59.65 percent of them) and foreign resources (commanding 48.78 percent of them). It is encouraging that the government attaches heavy weight to Accelerating Human Development Pillar, which is next to International Competiveness in share, and commands the second largest share of total recurrent spending at Le371.853 billion (36.02 percent), after Governance and Public Sector Reform at Le396.94 billion (38.36 percent).

3.1 Profile of Government expenditure allocated to administration: 2011-2015

Out of the actual total expenditure for the period 2011-2013, on average 25 percent was allocated to administration by the main functional categories, whilst all the allocations to miscellaneous and contingency were accounted for under administration. Similar percentage trends are maintained for 2014 and 2015 financial years. The trend in budgetary allocation (25%) to administration from 2011 to 2015 by all functional categories seems to suggest some arbitrariness in the process and could be a cause for concern as one would expect allocation to be based on activities and programmes not predetermined ratio as suggested in Table 1.

Table 1: Proportion of expenditure allocated to administration: 2011-2015 budget

Functional Category	2011	2012	2013	2014 est.	2015 budget
General Services	25.0	25.0	25.0	25.0	25.0
Security Services	25.0	25.0	25.0	25.0	25.0
Social Services	25.0	25.0	25.0	25.0	25.0

Economic Services	25.0	25.0	25.0	25.0	25.0
Miscellaneous Services	100.0	100.0	100.0	100.0	100.0
Contingency Expenditure	-	100.0	100.0	100.0	100.0
Transfers to Local Councils	4.7	4.0	4.2	4.9	4.5
Total	**30.5**	**28.4**	**23.7**	**23.8**	**26.5**

Source: Computed by the Researchers from budgetary Profiles

3.2 Key Expenditure issue

From the expenditure front, government is confronted with the need to make tough choices. And under the current fiscal squeeze imposed by the Ebola epidemic, BAN lauds government's rational decision to prioritise in its budget for fiscal year 2015 key spending decisions including focus on key poverty domains such as rebuilding health systems; rejuvenating the education sector; promoting agriculture; and supporting social protection for the most vulnerable. However, there are some concerns on this budget about translation of rational priority spending pronouncement into commensurate allocation, especially as related to planned spending on social protection and women and children welfare development.Thus, BAN would like to advance for engagement with relevant state authoritiesand development partners the following observations on state budget for FY2005 for consideration:

1) Spending share to Social Protection Pillar of the Agenda for Prosperity (which is Government Poverty Reduction Strategy) is extremely small for FY2015, yet the greatest challenges posed by the Ebola virus have been "heightened cases of vulnerability, destitution, orphanage, and hopelessness" due to the disease and these require more spending than ever. Only 1.80 percent (Le 48.60 billion) (US$9.95 million) is allocated to this Pillar out of the total planned poverty spending.
2) Gender and Women's Empowerment Pillar is a key dimension of social protection, but there has not been any capital resources allocated to this Pillar, and its recurrent allocation is proportionately negligible at 0.06 percent of total amount allocated to poverty priorities (Le 1.57 billion) (US$0.32 million).
3) We are facing a deadly virus that has demised thousands, whilst rendering many children orphan and women widows; conditions of the aged, disabled and general rates of vulnerability and poverty have become grimmer. It could be argued, under these circumstances, in the immediate term, that resources should be reallocated from hardware projects such as planned new road and energy programmes towards social protection.
4) Although spending on education, health and sanitation are colossal in the budget relative to other functions, there is great need to consider increasing budget to these sectors in light of the current epidemic implications for human, economic and sustainable development of Sierra Leone.
5) Some arbitrariness observed in budgetary allocation particularly to administration and office supplies by all functional categories. Such action is prone to corruption and poor accountability.The Accountant General's report 2011-2013 seem to corroborate this view as a total of Le4.08 billion was mismanaged[1] in the administration of fuel across the MDAs.

[1]This could not be unconnected to the arbitrariness in budgetary allocation particularly for this budget line item (i.e. Administration and Office Supplies).

4.0 Revenue generating options

This study shows that the EVD has significantly affected domestic revenue collection. Therefore, plans in the form of policies should be formulated in order to mitigate the overall negative impact in both short-and medium -term.

On the revenue side, the following short-to medium term revenue enhancement measures are identified: *adjustment in the personal income tax (PIT) maximum rate, collection-led reform in the withholding 10 percent tax on rented properties, and the elimination of discretionary customs duty on import tax.*

- ***Restructuring of the PIT Maximum Rate:***this study argues that the current Personal Income Tax Maximum Income level of 1.55 violates distributional fairness of taxation (horizontal equity); and is too low when compared to MRU whose highest marginal tax rate is levied on income that is 10.3 times the per capita income; Ecowas with 7.4 times the per capita income and sub-Sahanran Africa (6.30). The PIT maximum rate of 30% in Sierra Leone is also low when compared to the unweightedPIT maximum rate averages of 41.3%, 38.2% and 34.2%,for MRU, ECOWAS, and SSA respectively. The modal PIT maximum rate for MRU and SSA is 35%. To enhance fairer distribution of the PIT regime therefore would require that government should create another band and tax at 35 percent which is the modal rate for the sub-region.Using data for fifteen (15) institutions and MDAs, the analysis generated additional PIT revenue of Le5.55 billion (US$1.14 million). In order to see the actual potential of such a policy, there is needtoexpand the sample size to near 100% and also include other taxable incomes such as allowances and benefit-in-kind that were not captured in this computation.
- ***Potentials in withholding 10 percent tax on rented properties:***Revenue collection has been relatively too low considering the amount of commercial properties in the form of shops, stores, office spaces and dwelling places rented throughout the country. Using 2013 property data from the Local Government Finance Department for businesses premises only, a total amount of Le21.84 billion (US$5.04 million) could have been realised as compared to actual collection of Le6.01 billion (US$1.39 million), about 27.5 percent of its potential in 2013.
- ***Minimize the discretionary component of tax waiver:*** In the last four years, significant amounts have been granted to the discretionary component ("others")of duty waiver. Specifically, in ten (10) months, January-October, 2014, the total amount granted in duty free to 'Others' was Le158.19 billion (47.6% of the total duty free granted). Out of this amount, Le8.69 billion was granted as discretionary duty waiver on health related emergency imports to fight the Ebola epidemic during the period May-October, 2014; which can be classified as "shock tax expenditure" and should be accommodated. This leaves the actual discretionary duty waiver for the 10 months period at Le149.50 billion. Maintaining this trend with an average monthly duty granted to 'Others' of Le14.95 billion, the discretionary duty to be granted in 2014 will be Le179.40 billion. Furthermore, the growth in "others" from 43 percent in 2013 to 47.6 percent despite the scaling down of economic activities in 2014 owing to the EVD outbreak is a concern.

Summarised in the table below are the potential revenue mobilisation options.

Table 2: Summary of potential revenue sources

S/No.	Source	Potential Amount (Le'billion)	
1	Proposed Adjustment in the personal income tax maximum limit if: *-- incomes above Le5million are taxed at 35%*		*5.55*
2	Withholding 10% Tax on Rent		
	- Potential Withholding 10%	*21.84*	
	Less - Actual Withholding 10% reported in 2013(see Revenue Table attached*)*	*6.01*	
	Expected Addition to Domestic Revenue from withholding 10% tax on rent		15.83
3	Complete elimination of discretionary tax waiver		179.40
	Expected Addition to Revenue in Le'billion		**200.48**
	Expected Addition Revenue in US$'million		**41.05**

Source: Computed by the Researchers

Specific guide towards spending cut

1) There is need for a reduction in allocation to Administration and Office Supplies across sectors falling under General Services; Economic Services; and Transfers to Local Councils; and also to allocate the entire miscellaneous budget (which is not a clear budget line as to how it has been spent under administration) be reallocated to capital component of Social Services.The expenditure cut constitute vehicle purchases, maintenance and fuel; travel (international and local); office and general; telephone and other communication; official reception, entertainment and hospitality; electricity; water; etc.
2) Spending on Administration and Office Supplies is targeted for reduction for MDAs falling under the following broad spending categories: General Services; Economic Services; and Transfers to Local Councils; as well as Miscellaneous Services and Contingency.
3) We will recommend exemption for recurrent spending cuts under Economic Services for (i) Agriculture and Fishery sectorwhich employs the vast majority of the labour force and low-income people; (ii) Water Resources Sector because of its extreme socioeconomic importance and as an infant sector; and (iii) Environmental Protection Sector because of its currently small budget allocation and importance for sustainable development. Also, Security is top priority for any nation, so no reduction is recommended in this area.
4) Against these guidelines, the study works out expenditure cut scenariosfor government's consideration or to guide it in possible spending revision as follows:

Two options for recurrent expenditure:

a) **Option1**:-Say, a recurrent spending of 10% is cut as per guidelines above across sectors falling under General Services; Economic Services; and Transfers to Local Council, as well as Miscellaneous and Contingencies, for budget in Fiscal Year 2015. Based on this, about Le56.83 billion (US$11.64 million) can be saved towards Social Services.
b) **Option 2**: Or say, the entire miscellaneous budget (which is not a clear budget line as to how it is spent) be reallocated to Social Services, in addition to, say, 10% cut in recurrent spending across other suggested sectors above. Based on

this, about Le57.54 billion (US$11.78 million) can be saved towards Social Services.

c) **Additionality from Capital Component**: Further savings can be earned from the capital component. We suggest spending cut consideration in domestic capital expenditure that government has control over; and,say,a 10% expenditure reduction is done on all Pillar expenditure except Accelerating Human Development and Social Protection towards which reduced amounts are additionally allocated. Based on this, about Le34.81 billion (US$7.13 million) will be additionally generated towards Human Development and Social protection.

5.0 Conclusion

The study identifies unfair distribution in the personal income tax structure, weak enforcement in the collection of rental income tax, excessive discretionary import tax duty, and huge recurrent expenditure items particularly those classified as miscellaneous are key fiscal issues that require a review. Estimates from these practices amounted to annual additional revenue of Le 292.116 billion or US59.813 million which is 5.9 percent higher than outlays of US$10 million on security to enforce quarantine measures and food for quarantined zones, particularly for women, children and the most vulnerable groups that are hardest hit by the EVD. The additional revenue of Le 292.116 billion is also 6 times higher than the average allocation to the health sector between 2011 and 2015 and twice the average allocation to the education sector. But it is 50.5 times higher than allocation to the Social Welfare, Gender, and Children's affairs ministry, a critical ministry to provide safety net for the widows and orphans of the EVD.

6.0 Recommendations

The following are recommended to the government:

1. Civil society should push for better tax policy and administration. Such efforts hold the potential to stimulate further growth and investment whilst also allowing for increased levels of tax collection by curbing corruption, elite privileges and base expansion. Specifically, the following are suggested to enhance better taxation:

- Eliminate discretionary import duty waiver granted individuals and commercial entities. This will help reduce the tendency for corruption and undue favour granted individuals and companies against others who are not opportune to benefit such incentive. It can also eliminate the use of tax incentives as an instrument to promote political patronage.

- For accountability and transparency, all MDAs should be made to include in their budget submissions to the Ministry of Finance and Economic Development, exhaustible lists of all goods in respect of their operations during the financial year. Import duties and other import related charges will then be computed and included as part of their budgetary expenditure during the fiscal year.

- Government to improve on the distributional fairness of the PIT regime by introducing another tax bracket for very high income earners and tax at 35 percent, consistent with the un-weighted regional averages.

- The Revenue Authority to embark of revenue collection-led reform, particularly for withholding 10 percent withholding tax. Institutionalized third party collaboration could be a starting point. For instance, the NRA can sign a formal Memorandum of Understanding with local councils nationwide that have well-structured cadastral database system for businesses and existing rental properties to share information on commercial properties in their jurisdictions. Or with other valued service providers such as the Electricity Corporation to demand receipt for payment of rental tax before allowed to recharge their electricity. Of course this may require a cost on the service providers, such as adjusted in information in their software or system, which could be negotiated by the NRA.

2. Promote transparency and accountability in budgetary process and allocation. To achieve this, the following measures are suggested:

- Ensure that spending warrants are informed by forecast commitments from the spending MDAs.
- MoFED should consider increasing transparency in future planned budget in terms of further disaggregation of proposed spending items. Particularly, critical budget lines such as Administration and Office General or Supplies should be further disaggregated in the budget profile across the MDAs.
- Increase monitoring of donor funded projects.

7.0 Area for future research

This study has only considered short-to medium term revenue enhancement measures in the mist of EVD. However, with relative stability there will be need to quantify the revenue implications of the following practices in the revenue administration in Sierra Leone: Transfer pricing and other tax avoidance practices; ineffective taxation of property transfer and capital gains; and the non-taxation of informal sector.

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