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Digital financial services and digital IDs: What potential do they have for better taxation in Africa?

Summary of Working Paper 137 by Celeste Scarpini, Fabrizio Santoro, Laura Munoz, Wilson Prichard and Giulia Mascagni

New digital technologies, such as Digital Financial Services (DFS) and digital IDs, are gaining momentum in Africa and lower-income countries (LICs) more broadly. These technologies could have an impact on an increasingly digitised and IT-driven tax administration, since they hold potential to improve a number of core functions of a revenue authority. Yet, increasing evidence on existing technology in tax administration indicates a number of barriers, which are likely to mute these gains.

Against this background, this paper summarises critical questions relevant to research and policy to make more effective use of digital technology in contexts of weak fiscal capacity and IT development:

- What is the nature and potential of DFS and digital IDs in the specific context of LICs?
- Given the scarce evidence relating to DFS, digital IDs and taxation, what can be learned from how existing data and technology is used in LICs' revenue authorities?
- How can tax administrations make the best use of DFS and digital IDs in the future?

The potential of DFS and digital IDs in LICs

There are many potential benefits to tax administrations and taxpayers from DFS and digital IDs in LICs:

Identifying taxpayers. Connecting every taxpayer to a verified ID would improve the management of taxpayer registries by providing higher quality taxpayers' data, improved ability to link businesses to individual owners, and effective communication with taxpayers.

Monitoring and enforcement. DFS allow for tracing transactions through the digital trail left by mobile money or other digital payments. Such third-party data would potentially enable cross-checks of tax declarations and payments and more data-driven audits, as well as a more transparent tax administration that relies on verifiable data.

Management. Higher quality data brought by digital payments and digital IDs can enable a shift towards a more data-centric approach and higher reliance on metrics and indicators in targeting and monitoring performance, ultimately improving the governance and management of revenue authorities.

Improve taxpayer experience. By automating the taxpaying process, DFS could reduce compliance costs (time spent on transport, waiting in queues, etc.). More broadly, such technology would make the whole taxpayer experience less burdensome by providing more information online and limiting scope for corruption.

Can the promise of DFS and digital ID be realised? Insights from existing evidence on data and IT in tax administration

Although there is no robust evaluation of the impacts of DFS and digital IDs, at least five main insights can be identified from recent research on existing technology and data in LIC's tax administration:

1. Barriers to take-up can be sizeable. Factors such as ownership of a bank/ mobile money account, access to a device as well as to internet, IT-savviness, and trust towards a new solution can create relevant digital divides. Governments should consider such barriers as the benefits from DFS and digital ID would be maximised when take-up is almost universal.
2. Taxpayers tend to respond to technological innovation by adjusting their tax affairs to minimise their tax payments in ways that are not easily monitorable. Thus, DFS and digital IDs might not yield the promised benefits in terms of revenue if not coupled with more traditional enforcement tools (e.g., audits and checks).
3. DFS and digital IDs might generate a huge amount of valuable data, but there are challenges in tax administrations to unlock the full potential of such data. These challenges range from issues with data quality

and missing information, to limited technical capacity and skills among staff – as well as resistance to share data across institutions.

4. Mistakes can be made in the rollout of new IT, if introduced in isolation rather than as part of a comprehensive strategy, supported by strong political will. New technology tends to be resisted by staff if they don't receive adequate incentives and training, and by the public, if not appropriately assisted and made aware.
5. Broader regulatory and political barriers can significantly limit data sharing. Regulatory gaps around data privacy and missing data sharing agreements imply that revenue authorities cannot easily access data from DFS providers. Also, the implementation of digital IDs in not fully democratic countries might have unintended consequences by increasing the governments' ability to control citizens. Lastly, deciding whom to target when relying on digital ID and DFS data has political implications.

The "informal sector" mostly consists of small, subsistence-level traders, while larger entities and wealthy individuals are usually hardly targeted, mainly due to political hesitancy.

An agenda for policy and research

Considering the benefits and the challenges above, an agenda for both policy and research on DFS and digital IDs in tax administration could address the following aspects:

- What are the revenue authority's baseline situation, current practices and challenges with data and IT and how would they affect the success of DFS and digital ID technology?
- What does the broader context look like in terms of constraints to uptake and behavioural factors, change management, regulatory framework and political barriers?
- Which IT solutions are most appropriate for the development level and priorities of the revenue authority, considering the practices and context above?
- What is the broader, long-term reform strategy to support DFS and digital ID development, and how would these impact the tax system's performance, equity, and progressivity?

Researchers should start filling this gap in knowledge by working alongside policymakers and helping inform their decisions.

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Further reading

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