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Taxes Rates, Economic Crisis and Tax Evasion: Evidence using Zimbabwe and South Africa Bilateral Trade Flows

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Tax evasion involves taxpayers purposefully distorting the true value or quantity of goods traded to the tax authorities in order to reduce their tax liability. In trade, tax evasion includes misstatement of imports or exports in a bid to avoid tax liability by traders. The acts closely linked to tax evasion is trade mis-invoicing and mislabelling. Tax evasion is illegal and punishable by law. The fear of the punitive effect of the law forces traders to be involved in tax evasion secretly and makes it difficult to detect. The decision to evade tax is affected by the probability of being detected by the authorities, the magnitude of the penalty imposed on the offender as well as the wealth effect. If there is a low probability of detection that is compounded by a higher income return from evading tax, importers and exporters put a huge effort into evading tax. Consumers evade tax as a way of reducing the cost of importing commodities.

This paper investigates the relationship between tariff (tax) rates and tax evasion using highly disaggregated trade data for Zimbabwe and South Africa. A number of studies have explored the effect of tax rates on tax evasion but none have investigated the effect on a country experiencing economic crisis. The study uses cross-sectional data analysis for three periods: pre-crisis (1980 to 1999), crisis (2000-2008) and post-crisis (2009-2014). The results show different responses of tax evasion to tariff changes in the three periods. During both the pre-crisis and post-crisis periods, a decrease in tariff rates is associated with a reduction in tax evasion, while during the crisis period, a decrease in tariff rates is associated with an increase in tax evasion. The results suggest that tariff reduction during an economic crisis is not always associated with a decrease in tax evasion

The study concluded that cumulatively imports reported in Zimbabwe from South Africa were dominantly lower than exports reported by South Africa to Zimbabwe for the low and moderate value goods importers suggesting prevalence of tax evasion on goods traded. The regression results from baseline analysis show that during the pre-crisis and post-crisis periods, a decrease in tax (tariff) rates is associated with a decrease in tax evasion. For example, during the post-crisis period, a 1% decrease in tariff rate is associated with a 0.93% decrease in tax evasion and it is statistically significant. The results for the crisis period show a negative relationship between tariff rate and tariff evasion, although the coefficient is statistically insignificant. Using the UNCTAD classification, regression results show that the consumer goods have the expected sign across all periods and the coefficient is statistically significant. This suggests that a decrease in tariffs on consumer goods led traders of consumer goods to pay taxes or report the true value of

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imported products for duty purposes. Further, during the crisis period, the raw materials coefficient has a negative and statistically significant relationship between tax rates and tax evasion. It shows that, generally, during a crisis period, tax rates reduction resulted in an increase in tax evasion on raw materials. Importation of raw materials did not respond positively to tariff changes during the crisis period. The study also concluded that there is a limit to tax evasion as tax changes.

Policy recommendations

Government should understand responsiveness of commodities to tax before imposing taxes for them to maximize revenue. There is a need for government to understand economic conditions on which a tax policy is implemented in order to maximize benefits. Reductions in tariffs generally reduce tax evasion especially on consumer goods. Although reduction in tariffs is associated with reduction in government revenue, tariff reduction may improve welfare of citizens through the wealth effect. Economies must invest in low cost production methods and innovation in order to compete internationally in the absence of tariffs. Tariffs imposed by governments have a limit to revenue collection as well as tax evasion.