POLICY BRIEF

Mobile Money Consumption Taxes: What are the Distributional Impacts

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The Context

The mobile money industry has conferred numerous benefits to consumers from all segments of income distribution. Given the rapid ascent of the industry, policymakers have grappled with its effective taxation. A key reason underlying this is a poor understanding of the distributional effects. This policy brief investigates a controversial tax that was instituted on mobile money withdrawals in Tanzania in 2021. Almost immediately after its introduction, transaction volumes across mobile money platforms plummeted. Tanzanian policymakers revised the tax multiple times before eventually removing it altogether. Given this U-turn, we investigate how the tax affects different consumer groups. Our findings revealed that salaried workers in urban areas as being more likely to reduce consumption of mobile money services. These results suggest that less wealthy respondents in rural areas with fewer substitutes were forced to contend with this tax while wealthier urban respondents substituted into different financial services. To relieve the rural poor of the onerous burden of this tax, we suggest revising the burden on wealthier segments to ensure that the incidence of taxation leaves them indifferent to contending with the tax as opposed to substituting into different financial services.

The conundrum: How can mobile money consumption be taxed effectively?

A key impediment to the realization of development goals across sub-Saharan Africa has been the inability of governments to fund their spending priorities and development objectives. When compared to advanced economies, countries across sub-Saharan Africa have comparatively lower tax to GDP ratios (15.6 percent vs. 24.1%). Given this persistent challenge, domestic revenue mobilization stands as a policy imperative within international fora such as the United Nations Sustainable Development Goals. Of late, this imperative has received renewed attention in the wake of multiple macroeconomic shocks. Specific to Tanzania, in early 2021, the government's national budget was experiencing significant pressures emanating from the adverse shocks of the COVID 19 pandemic and large existing commitments.

Considering these shocks, policymakers attempted to plug the revenue shortfall by instituting consumption taxes on mobile money withdrawals. Shortly after their introduction, mobile money consumption across all Mobile Network Operators declined precipitously. Given the widespread discontent, the government revised the tax multiple times before removing it altogether by September 2022. Given this about face, authorities were concerned with the

following repercussions:

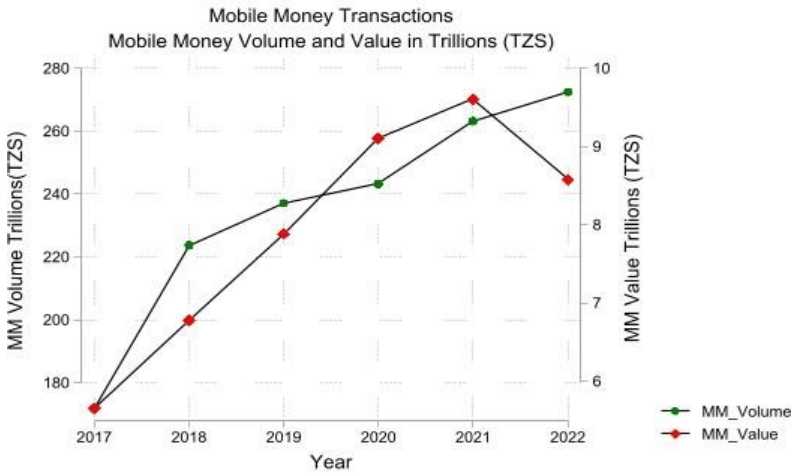
- **Changes in Tax Revenue:** If mobile money transactions continued to decline, the government would realize less corporate taxes from this booming sector.
- **Implications for financial inclusion:** A reduction in mobile money transactions also signifies a migration away from the digital economy and a return to paper-based cash transactions.
- **National Development Priorities:** Without any revisions, the government would risk failing to achieve its stated target of achieving 80 percent connections in digital and financial inclusion by 2025.

Area of Research

Given this about face, our research explores how the tax impacts different consumer segments. This serves as a precursor to understanding where the greatest level of consumer churn took place. We believe this provides additional context on the distributional impacts of consumption taxes on mobile money usage and greater clarity on why there are poor compliance levels.

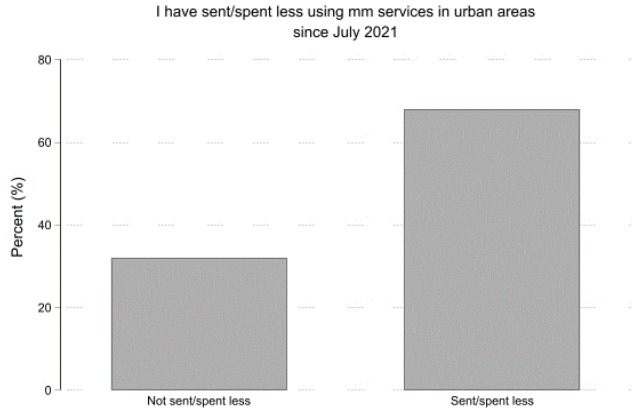
Key Findings

Our findings reveal that higher transaction values contributed to the greatest decline in activity on mobile money platforms.

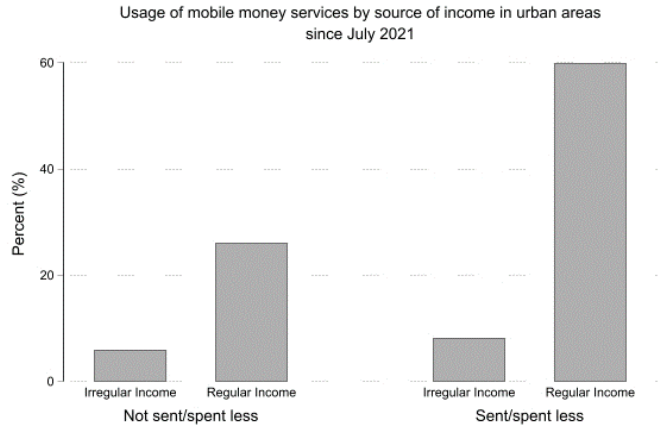


Source: BOT data 2017 - 2022

In addition, we found that wealthier, salaried workers based in urban settings were most likely to reduce transacting on mobile money platforms after the tax was introduced.



This implies that low income urban and less wealthy rural respondents were the ultimate payers of this tax as they were unable to substitute away into other financial services.



Policy Recommendations

As the tax was changed three times, the three revisions provide different points where we can calculate and estimate the substitution effects at each price point. This includes understanding the threshold at which users start seeking alternative payment methods, the elasticity of demand for mobile money, and the overall impact on financial inclusion. As such, the first recommendation is to conduct additional analysis on the three price changes. After this, our subsequent recommendation is to revise the tax in a manner that reflects the consumers' sensitivity to substitution. By implementing a tax structure reflective of these sensitivities, the tax burden can be redistributed more accurately, and the authorities would retain access to this revenue source. This approach ensures that taxes do not disproportionately impact lower income populations. While

reintroducing the tax at this juncture may be impractical, the option can remain for periods where the resource envelope is facing an adverse shoc

Mission

To strengthen local capacity for conducting independent,
rigorous inquiry into the problems facing the management of economies in sub-Saharan Africa.

The mission rests on two basic premises: that development is more likely to occur where there is sustained sound management of the economy, and that such management is more likely to happen where there is an active, well-informed group of locally based professional economists to conduct policy-relevant research.

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