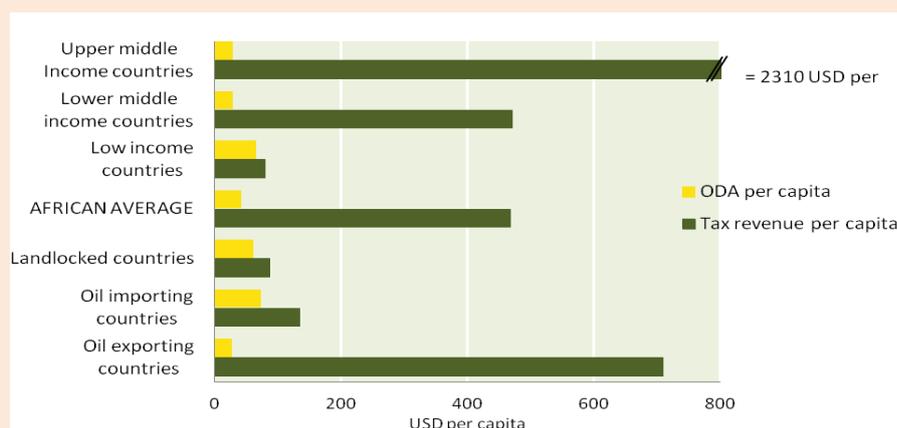


TAX AND DEVELOPMENT IN AFRICA

Policy brief no.5 – April 2011

Taxation is an integral part of development policy. It provides governments with a predictable and stable flow of revenue to finance development objectives such as infrastructure; shapes the way government activities are undertaken; and plays a central role in domestic resource mobilisation.

Figure 1. Tax Revenue vs.aid per capita in Africa (2008)



Source: African Economic Outlook 2010, OECD/African Development Bank

The 2002 Monterrey Consensus on Financing for Development recognised taxation's key role in domestic resource mobilisation, as did the 2008 United Nations *Financing for Development* conference. An efficient tax administration system, characterised by certainty and consistency of tax regulations, equality in tax treatment, and measures to avoid double taxation, is also an important element of a sound business climate. Taxation also

plays a key role in helping African countries to reach their *Millennium Development Goals* (MDGs) by providing governments with resources for fighting poverty. Indeed, tax revenue per capita is significantly higher than aid per capita in most African countries, although oil exporters outperform their African counterparts in their tax revenues (see Figure 1).

This document is part of a series of policy briefs produced by the United Nations Office of the Special Advisor on Africa (OSAA) and the NEPAD-OECD Africa Investment Initiative for African policymakers and their development partners. The policy briefs provide an overview of key economic and development issues affecting Africa today. They are available at www.un.org/africa/osaa, and at www.oecd.org/daf/investment/africa. For more information, please contact: David Mehdi Hamam, Chief (OSAA) at hamamm@un.org or Karim Dahou, Executive Manager (NEPAD-OECD Initiative) at karim.dahou@oecd.org.



United Nations
Office of the
Special Advisor on Africa

NEPAD-OECD AFRICA INVESTMENT INITIATIVE

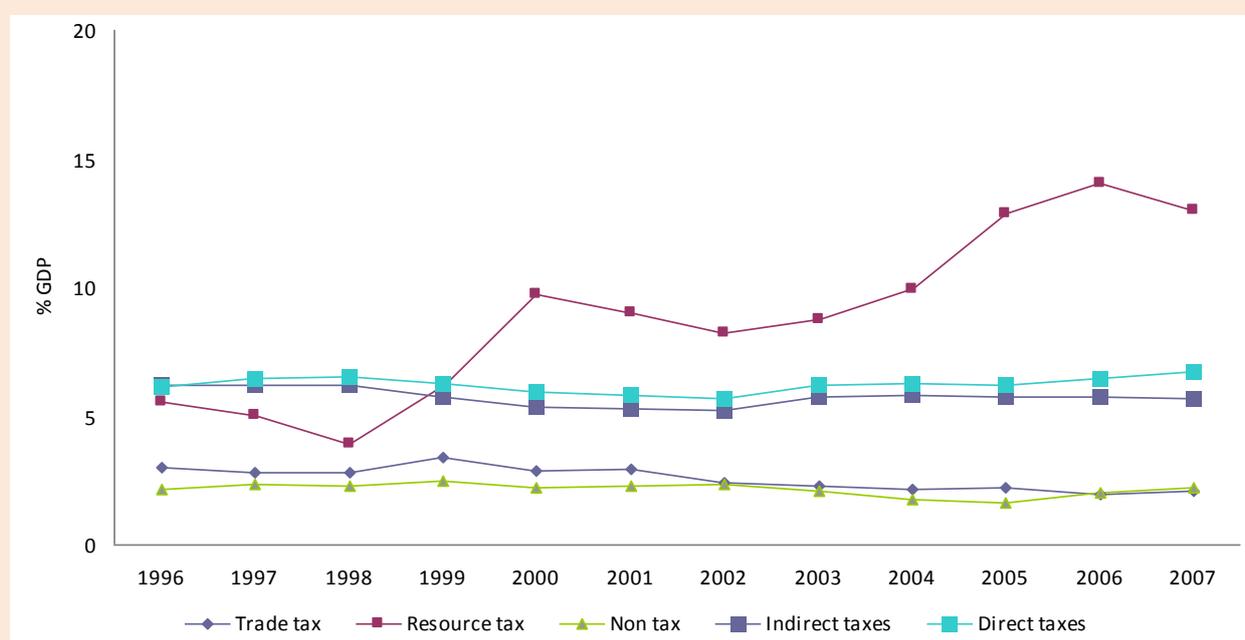


Recent Developments

After a period of flat growth between the early 1990s and early 2000s, total government revenue as a share of GDP has steadily increased in most African countries. Domestic revenue¹ increased by almost four percentage points of GDP between 2002 and 2007, reaching an average of over 25% in 2007 for the whole of sub-Saharan Africa.²

However, a significant share of the increase in tax revenue in the region came from natural resource taxes (see Figure 2).³ This includes income from production sharing, royalties, and corporate income tax on oil and mining companies. Non-resource related revenue increased by less than 1% of GDP over 25 years.⁴ Overall, when compared to the 36% of tax-to-GDP ratio of the OECD countries (2006 unweighted average)⁵, it is clear that African governments suffer from a large revenue gap.

Figure 2. The Tax Mix in Africa 1996-2007
Amounts by Type of Tax (2008)



Source: African Economic Outlook 2010, OECD/African Development Bank

At the country-level African economies are also engaged in a fierce competition to attract foreign investment using taxation. Compared to the 1980s, tax incentives in sub-Saharan Africa are now more widely used as more than two-thirds of African countries offer tax holidays to attract investment. The establishment of export zones offering tax holidays has also increased. However, such incentives raise the risk of a “race to the bottom” as countries try to outdo each other to the ultimate detriment of their interests. Moreover they do not necessarily succeed in increasing investment if they are not well-coordinated with other policies aimed at improving the business climate such as infrastructure or education policies. In addition they usually result in

high administrative burdens.⁶

In some African countries tax laws are unclear, leaving too much discretionary power to tax enforcers. Tax officials may, for instance, have discretion over important decisions such as those related to the provision of tax exemptions, determination of tax liabilities, selection of audits, and litigation.⁷ To improve tax administration and collection some countries have simplified their tax structure. Egypt, for example, has adopted a 20% flat corporate tax rate accompanied by a reduction in the number of incentives, while Botswana has one of the simplest and most comprehensive tax regimes in the world.⁸

Policy challenges and opportunities

Domestic resource mobilisation and broadening the tax base

Developing countries typically have a narrow tax base with a relatively small part of the population subject to personal income tax. Tax reform needs to be promoted to widen the tax base and bring a larger part of the population into the formal economy.

Furthermore, many African countries rely on tariffs for an important share of government revenue. While opening up trade is expected to bolster long-term economic growth, countries participating in trade negotiations, such as the Doha Round and the Economic Partnership Agreements (EPAs), are required to cut their tariffs and are thus likely to collect less revenue. In some African countries up to 30% of non-resource tax revenue (4% of GDP) is still raised through trade related taxes. Losing this source as a result of trade liberalisation is likely to have significant budgetary consequences and alternative revenue sources need to be available before tariffs are phased out.

Tax evasion

Countering the loss of revenue caused by tax havens is a vital element of the G20's and G8's global responses to the global crisis. Developing countries lose vital revenue through tax evasion and the siphoning of money to tax havens. Naturally it is very difficult to find robust estimates of tax evasion

through international schemes but given that the formal sector of the economy in many African countries, particularly LDCs, is composed fundamentally of subsidiaries of Multi National Enterprises (MNEs), it is evident that a well developed tax system for that sector is crucial.

Investment climate and enterprise development

The economic growth and investment dynamics of a country are largely affected by taxation. Both foreign investors and small businesses require clarity when dealing with tax issues to operate and grow. Despite recent reforms African countries' tax structures often remain complex thus dampening the business climate and hindering growth prospects. Reducing the tax burden on companies is therefore key to improving the investment and business climate.

Tax policy can also help African economies become more formalised. The informal sector makes up a large part of African economies, with 50% of non-agricultural employment in the informal sector, for example⁹. Small businesses that stay outside the "tax net" are unable to access formal business funding and credit schemes. However, high associated costs such as the minimum threshold investment to register for the Value Added Tax (VAT) pose major challenges for businesses to formalise so requirements such as these should be reconsidered to lower the barriers for formalisation.

Good governance

Effective taxation underpins effective governance, especially as taxation presents an avenue to

Impact of the Crisis

The impact of the global crisis on the continent was felt through a slash in growth to 2.5% in 2009 from a previous three year average of 6%. The crisis has revealed that Africa depends too much on external revenue flows, commodity prices and export revenues. This has reinforced the need for domestic resource mobilization and hence taxation. As seen above, tax evasion is a major hurdle for increased public revenues for African governments. The OECD, mainly through its Centre for Tax Policy and Administration (CTPA) is spearheading the global efforts to counter cross-border tax evasion and tax havens by encouraging higher standards of transparency and exchange of information in tax matters. The OECD also works closely with the African Tax Administration Forum (ATAF) to identify the needs of African tax administrations and to develop and deliver responses tailored to their current priorities, including through the recently launched Informal Task Force on Tax and Development.

citizens. A key component of a capable state is the existence of an efficient and effective tax administration. Also, co-ordination between the central and local authorities is crucial in administering tax policies.

Some tax administrations suffer from corruption, poorly-trained and underpaid officials and a weak administrative structure. Improving revenue performance will require a major improvement in tax administration through better service delivery, taxpayer education, effective use of automated systems, better co-operation between tax administrations to counter tax evasion and strengthening audit and human resource management capability.¹⁰

To address these needs African governments have been partnering in recent years with private actors for revenue collection at the local government level. Donor countries have helped fund this partnership. In addition, over the past two decades, more than 20 developing countries (mostly from Anglophone Africa) have established revenue authorities, such as the South African Revenue Service (SARS), whereby the tax administration is moved out of the Ministry of Finance and placed under the jurisdiction of a semi-autonomous entity. The motivations for such a structural move usually include improving the performance of revenue collection; increasing efficiency; fighting corruption and tax evasion; and opening the door for broader tax administration reforms.¹¹

Outlook and prospects

Improving taxation in Africa goes beyond reaching competitive tax rates. It requires governments to strike a balance between providing solid taxation governance structures and tax administrations, and improving domestic resource mobilisation. In this way, governments can increase investment while being able to offer public provisions financed through tax revenues and promote Africa's development.

Development agencies and donors need to go beyond recognising the central importance of taxation to developing programmes to boost the quantity and quality of taxation in practice. Donors can do more to support revenue-raising efforts in partner countries. To illustrate, of the USD 7.1 billion spent in 2005 on bilateral aid for government administration, economic policy and public-sector financial management, only 1.7 per cent was directed to tax-related assistance. In 2006 less than 1% of aid was allocated for tax. If development is to take off, this ratio will have to be dramatically increased. Development partners need to demonstrate that assisting developing countries build effective tax systems is a vital and central part of the development process¹².

Notes

- 1 Defined as tax and non-tax public revenues excluding grants
- 2 P. 13, OECD, Development Financing in Africa, from Monterrey to Doha, 2008 www.africapartnershipforum.org/dataoecd/63/17/41656352.pdf
- 3 OECD Africa Economic Outlook, p.84
- 4 IMF Finance and Development Magazine, Sept 2008, Vol 45, No. 3, "Mobilizing Revenue"; <http://imf.org/external/pubs/ft/fandd/2008/09/gupta.htm>
- 5 OECD tax database, 2006, http://www.oecd.org/document/60/0,3343,en_2649_34533_1942460_1_1_1_1,00.html#trs
- 6 P.9, OECD, Checklist for Foreign Direct Investment Incentive Policies, <http://www.oecd.org/dataoecd/45/21/2506900.pdf>
- 7 P.v, Fjeldstad, Rakner, 2003
- 8 Botswana Export Development & Investment Authority (BEDIA), http://www.bedia.co.bw/article.php?id_mnu=44
- 9 www.unevoc.unesco.org/southernafrica/.../MAR-Munbodh-Infomal.doc
- 10 P. 54, OECD, African Economic Outlook 2009
- 11 Fjeldstad, 2005
- 12 OECD Centre for Tax Policy and Administration, 2009