PUBLIC RESOURCE MOBILISATION AND AID IN AFRICA

African Economic Outlook

The 2010 edition of the **African Economic Outlook (AEO)** will be launched during the Annual Meetings of the African Development Bank in Abidjan, on May 26th, 2010.

Its special theme is **Public Resource Mobilisation and Aid in Africa**, with emphasis on the revenue side of taxation policies. The report will:

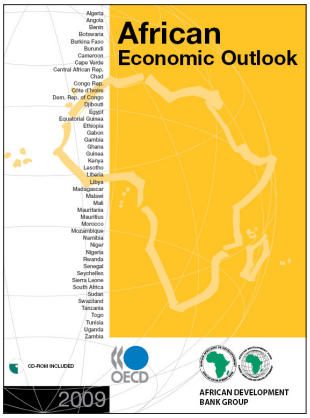
- assess the extent and sustainability of the sector's contribution to Africa's development
- review best practices in taxation policies, tax administration and multilateral agreements
- provide recommendations for meeting future challenges on the continent, in particular by identifying innovative solutions to the challenges of informality, capacity bottlenecks, tax evasion and the uneasy complementarity between Official Development Assistance (ODA) flows and efforts at mobilising domestic resources better.

This initiative aims to underpin ongoing and new policy dialogue on how to **improve the mobilisation of domestic resources for development in Africa**, by:

- supporting African policy makers in taxation and financial administrations, including members of the African Tax Administration Forum (ATAF)
- supporting the OECD Development Assistance Committee's reflection on the future of aid and possible exit strategies
- providing input into the African Development Bank's work on financial governance.

AFRICAN DEVELOPMENT BANK GROUP

The African Economic Outlook 2010



Every year, the **AEO**, a joint report by the OECD Development Centre (DEV), the African Development Bank (AfDB) and the UN Economic Commission for Africa (UNECA), investigates a key topic for Africa's economic development. This AEO annual theme is analysed in a special chapter of the report, and in dedicated sections in each of the country notes. The AEO 2010 report covers 50 African countries (out of a total of 53). It will be launched during the annual meetings of the African Development Bank, in Abidjan (Côte d'Ivoire) on May 26, 2010. It will be fully and freely available from www.AfricanEconomicOutlook.org.

The **annual AEO theme** is decided upon jointly by partner institutions. Since 2008, the Development Centre has handed over the lead responsibility of the project to the AfDB, which now coordinates the production of the bulk of the report's content, and manages the AEO network of African think tanks and consultants. The division of labour foresees that the Centre retains the leading role in coordinating the annual theme. After focusing on Privatisation (2003), Access to Energy (2004), SME Financing (2005), Transportation Infrastructure (2006), Access to Water and Sanitation (2007), Technical and Vocational Training (2008) and Information and Communication Technologies (2009), the 2010 edition of the AEO report will focus on "Public Resource Mobilisation and Aid".

The choice of this theme is partly the result of the Development Centre's efforts to bring together **several OECD streams of work on fiscal policy and development**: DEV (on Latin America), the African Partnership Forum Support Unit (on domestic resource mobilisation), the Centre for Tax Policy and Administration (on tax and development, and in support of the African Tax Administration Forum), the Development Cooperation Directorate (on Governance and Accountability) and the Directorate for Financial Affairs (in the context of the NEPAD-OECD initiative), all of which were invited to contribute to this meeting. This initiative provides input into the OECD Global Forum on Development —whose theme for 2010 is "Domestic Resource Mobilisation for Development"—, operated in partnership with the secretariats of the Development Assistance Committee and the Committee on Fiscal Affairs. See last page for a list of DEV events related to the theme of "Public Resource Mobilisation and Aid in Africa".

The topic is of **central importance to Africa's development**: neither is it possible nor desirable for African economies to fund their development needs exclusively from external sources, and particularly via ODA, because (i) external flows are volatile and unpredictable, adding to the challenges of macroeconomic management in developing economies; (ii) dependence on external flows weakens ownership, preventing states from pursuing the development agenda that they see fit given their local needs and constraints;

(iii) overreliance on aid and foreign investment implies that the policy-makers of developing nations are often more accountable to international donors and multinational firms than they are to their own citizenry. Hence the strategic importance for African economies of mobilising their domestic resources better. For public resources, this requires effective, efficient and fair taxation systems. As for private resources, home-grown solutions for better financial intermediation are needed to effectively channel Africa's saving potential to productive investment projects.

The AEO 2010 will lay emphasis on the revenue side of taxation policies. The aim is to (i) assess the extent and sustainability of the sector's contribution to Africa's development, (ii) review best practices in taxation policies, tax administration and multilateral agreements and (iii) provide recommendations for meeting future challenges on the continent, in particular by identifying innovative solutions to challenges of informality, capacity bottlenecks, tax evasion and uneasy complementarity between external Official Development Assistance (ODA) flows and efforts at mobilising domestic resources better. Subject to discussions with the African Development Bank and approval by the Centre's Governing Board, this work on domestic resource mobilisation may be extended in the next PWB to the expenditure side of fiscal policies, and to private sector resource mobilisation and financial intermediation.

It should also bring about **two new datasets**: (i) A database that will help specialists analyze the key features of taxation systems over time and across African countries. It will be updated on an annual basis in partnership with the African Development Bank and will be available from www.AfricanEconomicOutlook.org. (ii) A taxonomy of African states with respect to their tax capacity. This measure of tax capacity as a function of the structural characteristics of the economy can be used as a benchmark to contrast a state's current level of tax collection with its tax effort.

This initiative aims to **underpin ongoing and new policy dialogue on how to improve the mobilisation of domestic resources for development in Africa**. In particular, it aims to (i) support African policy makers in taxation and financial administrations, including the African Tax Administration Forum (ATAF); (ii) support the OECD Development Assistance Committee reflection on the future of aid and possible exit strategies; (iii) provide input into the African Development Bank's work on financial governance.

The AEO 2010 Experts Meeting

Expert meetings are an important step in the production of the African Economic Outlook report: after four months of in-depth literature survey, and simultaneously with field missions conducted in every country covered by the AEO, this meeting gathers leading experts on the theme, to make sure that cutting-edge, up-to-date knowledge from academics as well as practitioners is adequately reflected in the report. Participants in this informal meeting are invited in their own capacity. The Chatham House rule applies.

The AEO 2010 Experts meeting was held on 14 December 2009 in Paris. It brought together e**xperts from public and private sectors from African and OECD countries**. Several representatives of African tax administrations who had taken part in the launch of the African Tax Administration Forum in Kampala in November 2009 were present, as well as academics, donor agency specialists, NGO and Parliamentary network experts.

All contributors agreed to make their **papers and presentations** available from the Centre's dedicated webpage: www.oecd.org/dev/. The following paragraphs offer a very preliminary take on the main points that emerged from the discussions; they do not necessarily reflect a consensus, and will be analysed further in the final AEO chapter.

Tax Administration and Taxation Policy in Africa

Tax levels in Africa are already high by international standards. Over the past decade, various African countries have undergone tax administration reforms to increase domestic revenue collection. One implication could be that African countries, rather than trying to increase their overall level of revenue, should focus on broadening their tax base and reducing the complexity of the tax structure, with a view to lowering the tax burden, especially on firms.

This supposes in particular to **tax informal *activities*** in a cost effective manner, while avoiding to increase pressure on subsistence activities. A large portion of the informal sector is in fact taxed: micro and small firms do pay taxes through the VAT on intermediate goods, which they cannot claim back. They cannot easily afford paying more taxes and are too small to provide large tax revenues. Efforts for broadening the tax base should thus focus on non-registered and fraudulent activities by medium and large-worth companies and individuals, rather than trying to reach out to the myriad of individual and micro enterprises.

The structural shift from direct taxation to **indirect taxation** may have increased inequality in Africa: the poor bare the tax burden disproportionally as they are subject to VAT, while in many cases evasion of direct taxes is pervasive amongst politically connected and economically powerful agents. Experts pointed out that VAT had often not yielded significant progress, as most revenue improvements resulted from corporate taxes and commodity taxes. In addition, VAT is too complex to administer for small and medium enterprises, because it requires a credit and debit accounting.

Asset based taxation could be an alternative, with lump sum taxes levied on owners of productive assets such as sewing machines or trucks. **Land property** was also mentioned as a high potential and underused tax. However, complex patterns land property often characterised by the nonexistence of cadastral registers slow down progress on this front, especially in rural settings.

Increasing **tax legitimacy** by improved transparency and accountability of expenditure is essential to convince citizens to embrace tax reforms. Restructuring the tax administration requires strong political support at the highest level and the commitment of a capable and duly incentivized tax administration.

A useful framework for analysing tax legitimacy is to break it down into three fundamental components: **equity, reciprocity, process**. Equity concerns the equitable sharing of the tax burden. Corruption is strongly damaging equity. Reciprocity is the proportionate return of benefits to the tax payers under the form of public goods and services.

Increasing tax revenue **collection** and fomenting tax citizenship requires both “carrot and stick”. Voluntary tax compliance must be facilitated through the improvement of business conditions, the creation of a friendly tax culture and building tax awareness. Strong enforcement of anticorruption laws and penalties for tax evasion must be observed.

Mapping the taxpayer base is a priority. Special emphasis should be laid on high potential tax payer segments. This requires to know who they are and what their needs are. This basic information is often missing and should be built using surveys.

The trend of creating **single revenue-authorities** has been observed, although whether this or other systems is optimal depends on the national context.

The Political Economy of Taxation in Africa

Increasing domestic resources requires short-term, concrete measures within a long-term framework of reform. The low perceived cost of not paying taxes and the small risk of being caught causes **tax compliance** to be very low in Africa.

The most pressing challenge for the majority of African economies is to overcome the **diminishing revenues from trade taxes** following bilateral, regional and multilateral trade liberalisation processes. Countries that have been most successful at shifting away from trade taxes are not necessarily those that have relied on VAT, but those that have diversified their tax base.

Without taxes, there is no viable State and there cannot be transparent, good governance. In many countries of the continent, poor revenue performance is in essence the result of **political resistance** of the ruling class and elites. Multinationals and elites bargain their own tailored tax cuts and exemptions, willingly granted by the government to appease those segments of society. Tackling the challenges of fiscal reforms is a sensitive political undertaking and must be embarked upon only after having built a strong constituency supporting the planned reforms. Fiscal pacts can be promoted jointly by the private sector and parliaments to foster reforms.

Advocates of revenue **decentralisation** and property taxes argue they can help local levels of government generate resources and enhance fiscal legitimacy, pending local authorities are empowered through the insertion of their rights and obligations in the constitution. Sceptics argue that, based on experience, political and administrative challenges are huge, and capacity is usually very limited at local level.

Aid donors are an integral part of the political economy of taxation. They can help raising revenue collection, e.g. through technical capacity building. In some cases, however, ODA serves as a substitute for domestic resource mobilisation. Removing tax exemptions on ODA-funded goods and services, as well as matching donor contributions and collected taxes were mentioned as ways of promoting greater coherence between tax policy and aid for development purposes.

Fiscal Competition and Profit Repatriation

Contrary to general belief, MNEs do not consider **tax incentives** as a relevant factor in their investment decision. They rather focus on natural resource endowments and/or the level and quality of infrastructure and services. Bargaining to improve fiscal conditions comes after the decision to invest. African governments therefore wrongly assume that tax incentives are needed to attract investors.

Tax competition results in lower overall tax rates on commercial profits. To avoid losing revenue, this effort must be accompanied by the elimination of **tax holidays** and the broadening of the tax base. Resource-extracting MNEs in particular can hardly justify asking for tax incentives.

A large portion of international trade is intra-MNEs, hence the need for a new and transparent regulation on **transfer pricing** (intra-company purchases and sales, financing schemes of intra-group transactions, pretax profit, etc.), including through country-by-country reporting and the adaptation of international accounting standards.

Fighting capital flight effectively requires better **information on capital flows** to and from a given country. The consequences of capital flight go beyond the estimated loss in revenues: it feeds money laundering practices and corruption, finances terrorism and encourages drug trafficking. Local authorities have limited capacity to tackle this problem. The global financial architecture should be scrutinized as it actually encourages the existence of tax havens and capital flight.

Taxation and Aid for Domestic Resource Mobilisation

The literature on aid and domestic resource mobilisation does not clarify whether aid helps or hinders domestic resource mobilisation. The statistical **evidence is mixed** and the optimal level of aid depends on the quality of the domestic expenditure. The review of the literature raises more questions than it answers. In the long term international redistributive systems will emerge in which the poor regions of the world will be treated in a similar way that OECD countries treat the poor regions of their own countries..

Property taxes are underutilized in African countries. They could be an important source of domestic revenues but can only if policymakers implement profound property tax reforms, with strong political support. Donor agencies and other development partners can help, particularly in supporting tax administration reform processes through **capacity building** in the areas of fiscal decentralization, governance, technical and management skills, training, computerization, collection and enforcement procedures.

Public Resource Mobilisation and Aid in Africa

OECD Development Centre
2009-2010 Timetable

September 25, 2009, OECD, Paris

Development Finance Network (DeFiNe) seminar "Domestic resource Mobilisation and Development"

December 14, 2009 – OECD, Paris

AEO informal experts meeting "Public Resource Mobilisation and Aid in Africa"

January 28, 2010 – OECD, Paris

OECD Global Forum on Development "Domestic Resource Mobilisation for Development: The Taxation Challenge"

May 27, 2010 – Abidjan, Addis Ababa, Paris, Berlin

Launch of African Economic Outlook 2010

June 11, 2010 – Ministry of Economy, Industry and Employment, Paris

Xth OECD / AfDB / UNECA International Economic Forum on Africa.

June-July, 2010 - Worldwide

African Economic Outlook 2010 dissemination and dialogue in Africa, Europe, Middle-East, North America, Asia.

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