Taxation in Africa: Myths, facts and challenges

Odd-Helge Fjeldstad
Chr. Michelsen Institute
www.CMI.no

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Talking points:

I. Perspectives on taxation and development

II. Myths and facts about taxation in Africa

III. Strengths and weaknesses of the current tax reform agenda

IV. Towards governance focused reforms: Building the social fiscal contract

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I. Perspectives on taxation and development

- Tax is not an end in itself, but a means towards a well-functioning state:

  - Governments dependent on taxes, will be inclined to pursue policies to expand the economy and thus the tax base

  - Dependence on taxes requires states to develop tax raising capacities

  - The development of an effective tax administration may stimulate the development of institutions in other parts of the public sector

  - Bargaining over taxes is central to building relations of accountability between state and citizens based on mutual rights and obligations

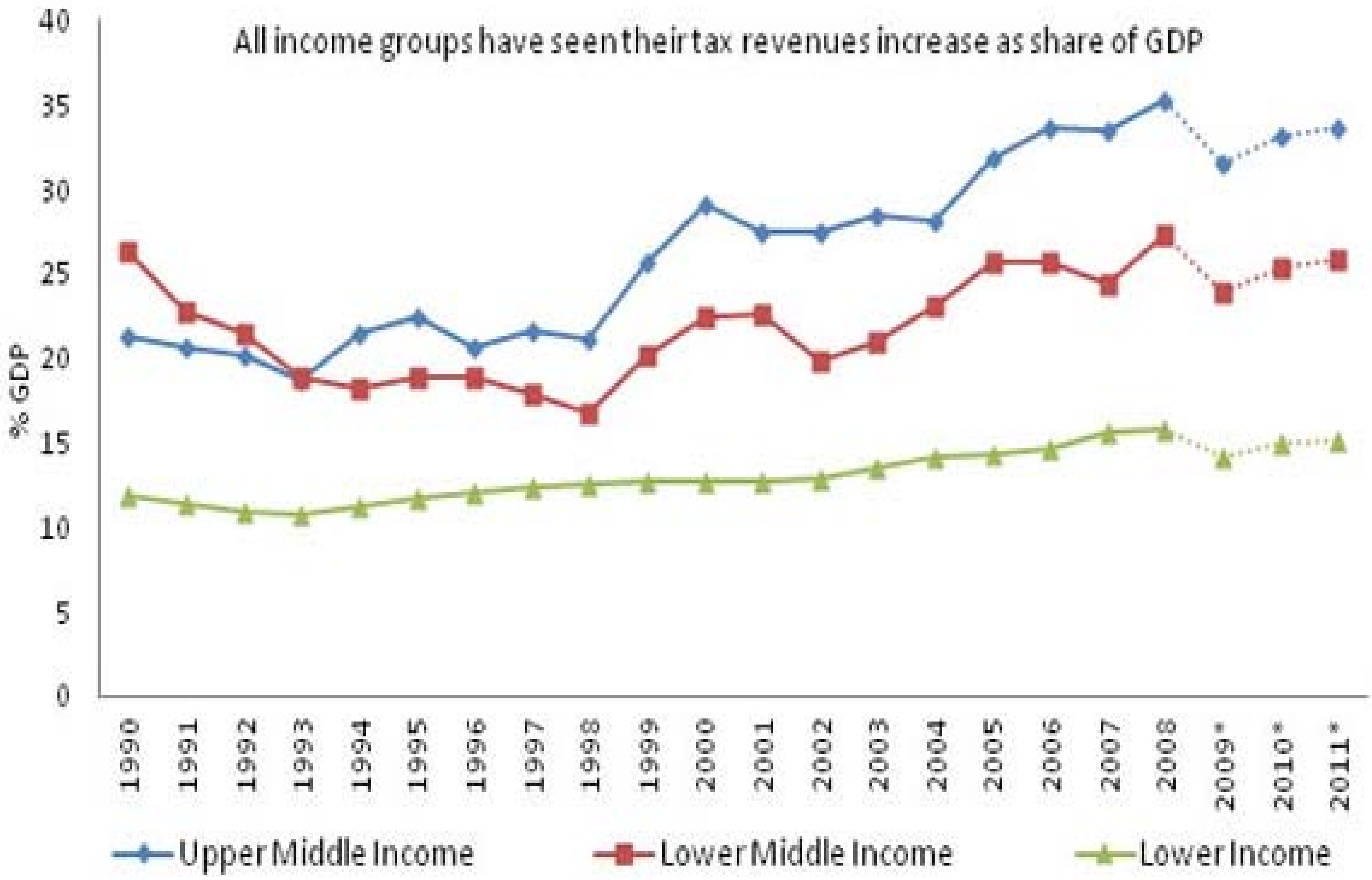
- Bad governance is often correlated with limited state reliance on revenues from taxation of its citizens and businesses:

  - Non-tax revenues tend to leave regimes more free to make whatever expenditures they wish without their having to be concerned about the likely reactions of citizens

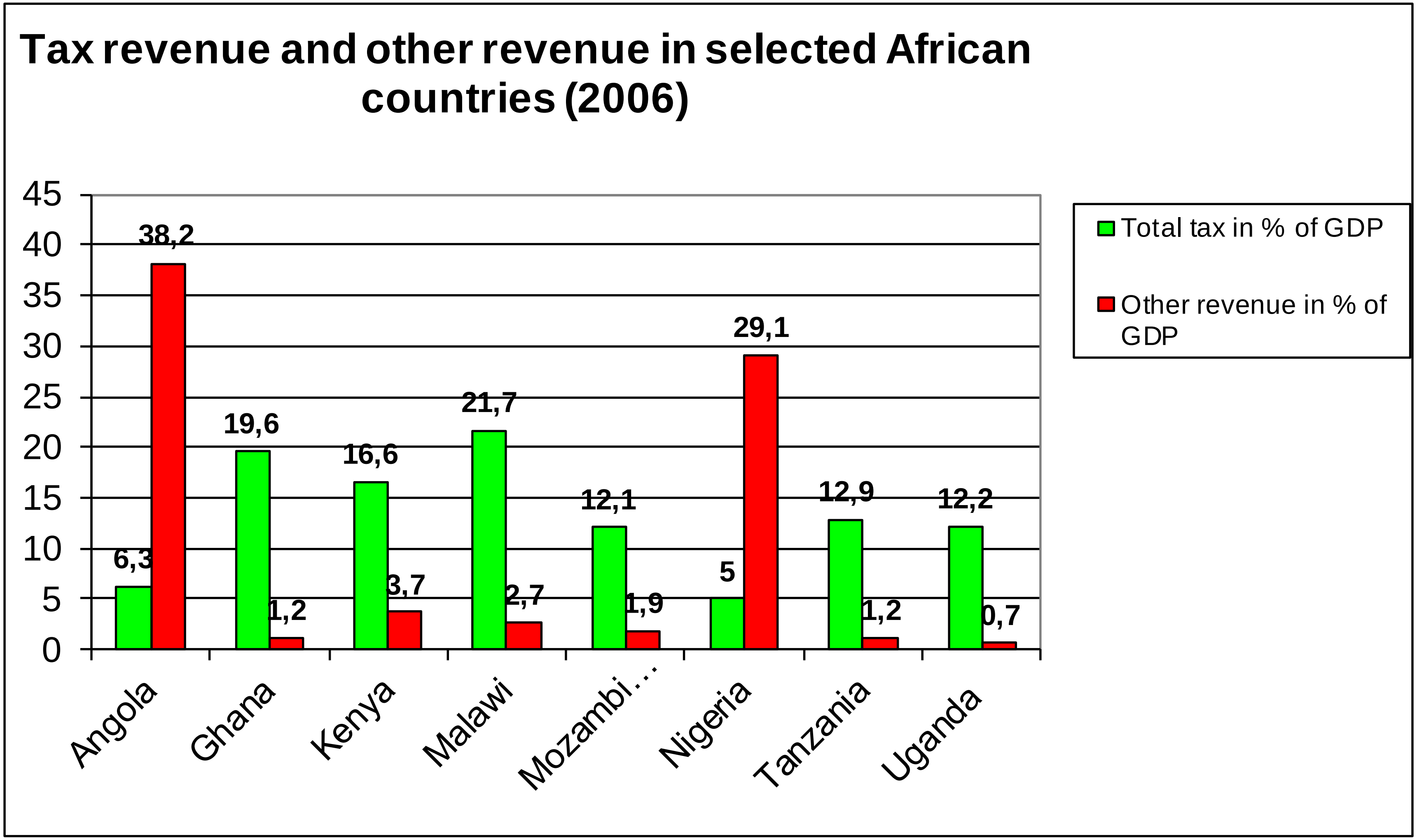
  - Rentier states have limited incentives to build up institutions to collect and administer tax, or to extend the reach of the government to poorer, more remote regions

  - In particular, large oil and mineral revenues are associated with low levels of democracy and states unbound by law

MYTH 1: There is hardly any taxation in Africa

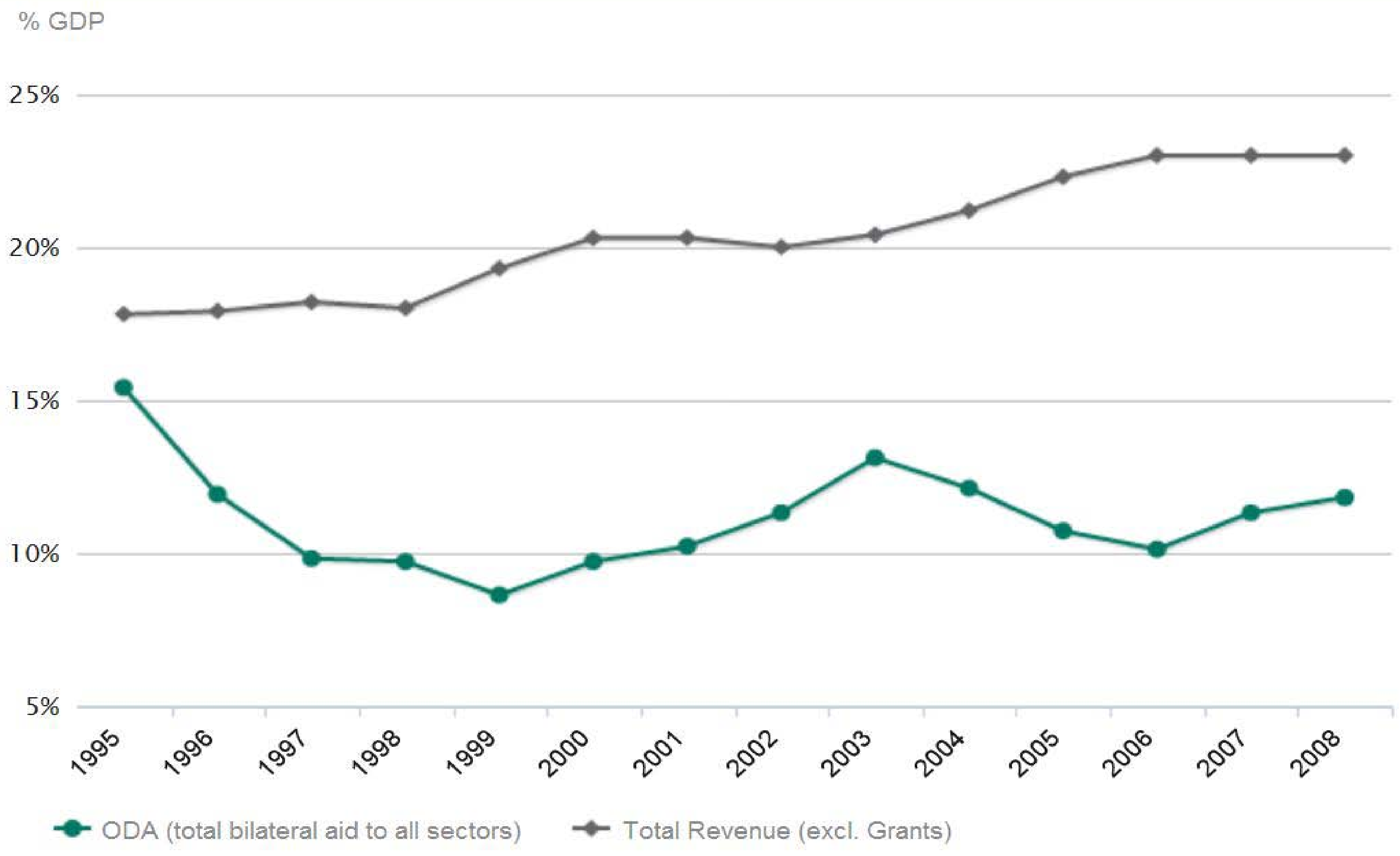


Large differences in Tax-to-GDP ratios between African countries



MYTH 2: Africa is totally dependent on aid

Figure 3: ODA and fiscal revenue as a share of GDP



MYTH 3: Aid is the only external financial inflow to Africa

1. Foreign aid (2007):
   - USD 104 billion (from OECD-DAC countries)
   - USD 8 billion (from non-DAC donor countries)

2. Foreign direct investments in Africa (2008)
   - USD 88 billion
   - Mostly to extractive industries
   - Nigeria, Angola, Egypt, South Africa

3. Remittances from Africans living abroad (2008)
   - USD 41 billion

4. Philanthropy
   - ?

MYTH 4: Tax reforms are not on the policy agenda in Africa

- **Actually, there are a number of good things to report:**
  - Simplification of the tax system (but still a way to go)
  - Improved tax administrations at the central government level
  - Improved attitudes of tax administrations towards (some segments of) taxpayers

- **but also worrying problems in many countries**

1) Taxation generally *not* high on the domestic political agenda

2) The political and economic elite often not part of the tax base

3) Extremely narrow tax bases

4) Large untaxed informal sectors

5) Extensive/increasing tax exemptions

6) Massive revenues from natural resources are lost

7) Illicit capital flows facilitated by tax havens entrench inefficient tax systems

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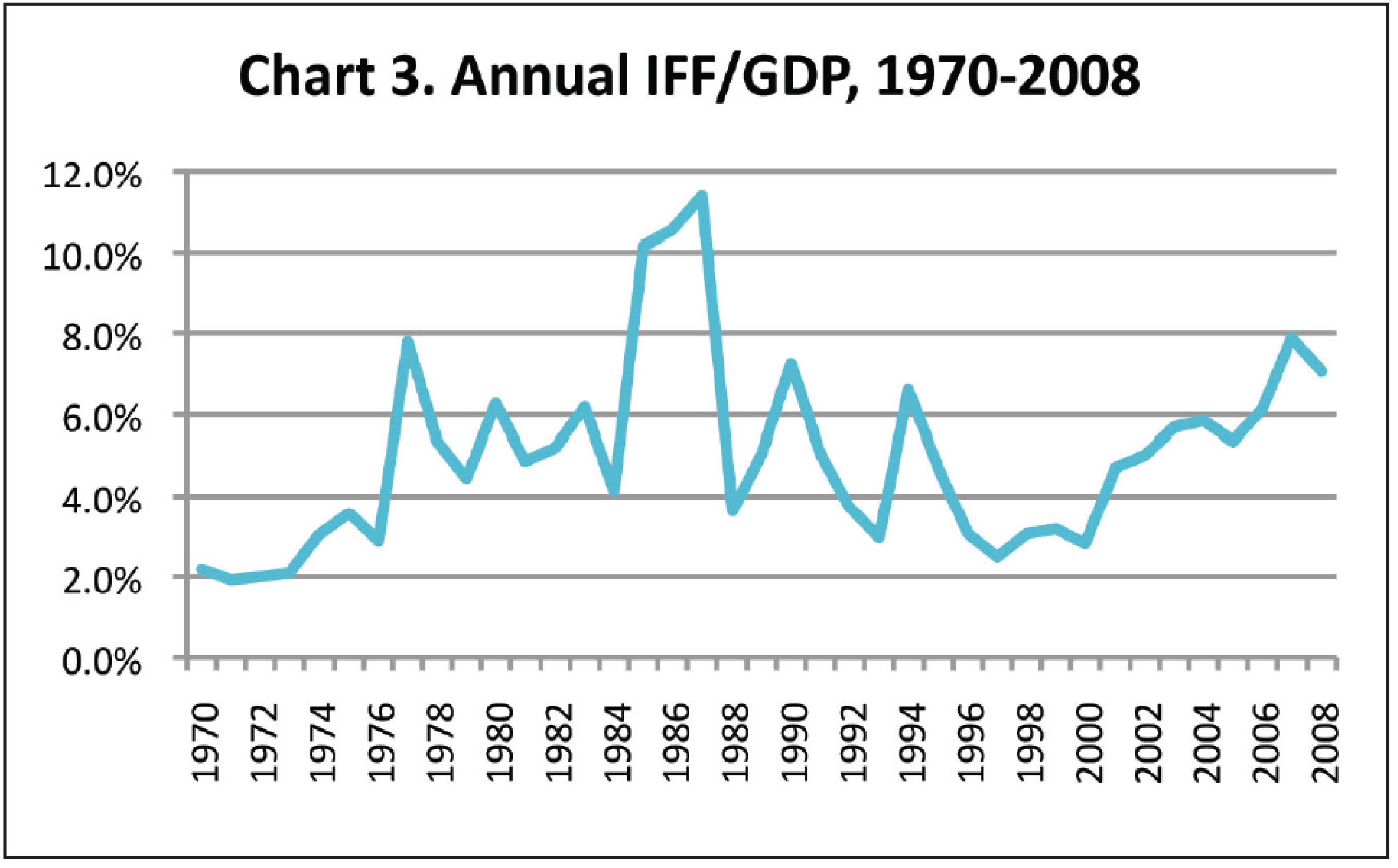
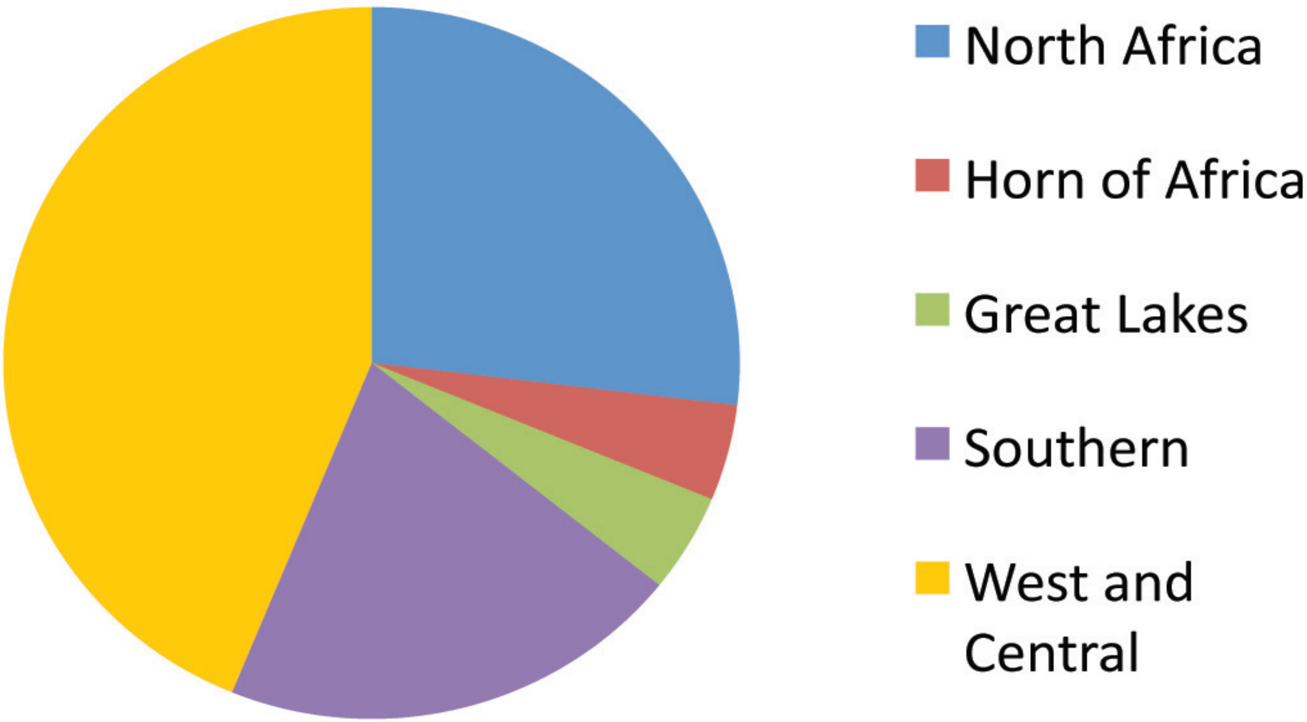
Illicit flows from Africa are massive

Proceeds from commercial tax evasion account for 65%



GFI (2010)

Chart 2. Distribution of Illicit Flows Cumulative 1970-2008



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Tax evasion facilitated by tax havens undermine national tax systems and increase the costs of taxation

- Tax havens (secrecy jurisdictions) make it harder to tax enterprises
  - Transfer pricing commonly practiced by multinational companies

- Taxation of business transactions and profits are the most important tax bases in most developing countries

- Consequently, tax revenue falls - or to compensate - taxes are levied at a too high rate on the few remaining tax bases: this hampers growth

- In some countries, capital flight may also have reduced the political elite's interest in local economic growth and development

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Revenue targets - the rule of the game

- Strong pressure on tax administration to meet revenue targets

- Tax administration responds with a combination of:
  - A tighter squeeze of registered and easy accessible taxpayers
  - 'Hunting in the zoo'

- Attempts to meet externally set Tax-to-GDP targets may undermine democratic accountability if legal processes and taxpayers' rights are set aside in response

>> Narrow tax base and tax exemptions major parts of the problem

- The principal challenge is neither to raise more tax revenue nor to tax more equitably across income groups, although both are urgent needs in many contexts

- The overall challenge is to tax better, i.e. more consistently, simply, transparently, fairly, predictably, efficiently and honestly

IV. TOWARDS GOVERNANCE FOCUSED TAX REFORMS:

Building the social fiscal contract

➢ Considerable opportunities to build on the existing tax reform agenda with a view to:

- Making it more responsive to the needs of African countries

- Focus on reforms that simultaneously facilitate:

  ✓ Revenue growth

  ✓ Build state capacity

  ✓ Build accountability

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Building state capacity: Making tax reform a 'motor of change'

1. Focus on data gathering and transparency

2. Reduce/eliminate tax exemptions

3. Strengthen tax administrations
   - Professional learning networks (ATAF, OECD Outreach)
   - Specialised expertise/capacity to tax natural resource extraction

4. Find more effective ways to tax the informal sector

5. Improve local government taxation

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Build accountability: Encouraging constructive state-society engagement around taxes

1. Mobilising citizens by taxing them

2. Build a culture of transparency and accountability
   - Bring private sector and CSOs into tax reform process
   - Continuous monitoring of tax adm's performance → indicators

3. Levy taxes as consensually and as transparently as possible

4. Establish better links between taxes paid and service delivery

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- "In a well attempered polity .... the government should rely on itself, and not on foreign aid, nor on the good will of a majority of foreign states - they might be equally well-disposed when there is a vicious form of government - but on the general willingness of all classes in the state to maintain the constitution."

  - Aristotle in "Politics" (350 B.C.)

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