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Taxation in Africa: The path to economic independence

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The global economic crisis has made it painfully clear that Africa is over-dependent upon external financial flows. Falling commodity prices and export revenues, uncertain future aid flows and expected declines of FDI in the medium term have resulted in a general shortfall of external finance amidst high levels of indebtedness across Africa. Public resource mobilisation, namely taxation, is a precondition to Africa achieving greater economic independence. Over the long term taxation can not only reduce the region's dependence upon aid, but it can also increase its ownership of the development agenda and reinforce the social contract between state, citizens and the private sector. In short, Africa needs more effective, efficient and fairer taxation systems.

The good news is that the 2010 *African Economic Outlook* (AEO) finds that the average African tax revenue as a share of GDP has been increasing since the early 1990s. The bad news is that this has been mostly induced by taxes on the extraction of natural resources. Obtaining natural resource rents distracts governments away from more politically demanding forms of taxation, such as corporate income taxes on other industries, personal income taxes, Value Added Taxes (VAT) and excise taxes. Indeed, income taxes (mainly personal and non-resource corporate) have stagnated over the period. Trade liberalisation in Africa has translated into a reduction of revenue from trade taxes since the late 1990s. Further trade liberalisation will leave a critical gap in public resources if it is not purposively sequenced with domestic tax reform.

Why aren't African governments taxing better?

African tax administrations generally suffer from large capacity constraints underpinned by lack of support from donors, making it difficult to assess and collect taxes. Other constraints include:

- **Lack of fiscal legitimacy.** A general lack of trust on the part of citizens in the quality of public spending.
- **Shallow tax base.** Governments are unable to bring informal actors— large and small— into the tax net. In particular, the existing tax base is eroded by the excessive granting of tax preferences and the inefficient taxation of extractive activities.
- **Unbalanced tax mix of African countries.** Many countries rely excessively on a narrow set of taxes to generate revenues for their state and some stakeholders are disproportionately represented in the tax base.

Source: African Economic Outlook 2010, AfDB/OECD/UNECA.



What can African governments do?

In the short-run, strategies towards more effective, efficient, and fair taxation in Africa typically lie with deepening the current tax base in an administratively feasible way. Policy options include removing tax preferences and taxing extractive industries more fairly and more transparently. The international community has a key role to play in enhancing administrative capacity, while southern partners should provide peer learning opportunities and share best practices.

In the longer-term, the capacity constraints of African tax administrations must be released to open up policy space and allow for the generation of tax revenues through a more balanced tax mix. Indeed, identifying potential tax payers is crucial. A wide tax base is more stable because it relies on a diversified set of tax revenues. It is also more efficient by helping to keep the tax burden mild on each type of taxpayer and each type of economic activity. Additionally, it engages a wide range of stakeholders in the national political process. The AEO identifies urban property taxes as a tax policy instrument that can be made administratively feasible with the aid of development partners. It is progressive and can scale up with Africa's explosive pace of urbanisation and the corresponding need for urban infrastructure.

The quality of taxation matters as much as the quantity raised by taxes. Ideally, taxes should be levied at low and relatively flat rates on bases that have been broadened through the elimination of exemptions and other loopholes. Lower, simpler taxes are not only easier to collect and administer but are a more effective policy to stimulate the development of the private sector.

What constitutes best practice?

Morocco is a good example of the potential of a strong, comprehensive fiscal reform. The AEO Morocco country survey explains how the government succeeded in balancing its tax mix and broadening the tax base, lowering the average tax share. As a result, new sectors were incorporated into the fiscal net such as construction, banking and telecom services. In addition, the government modernised their tax administration, enabling them to implement the planned reform. This resulted in a 10 per cent increase of the share of direct taxation, while VAT realised its full potential after a wide range of exemptions were eliminated.

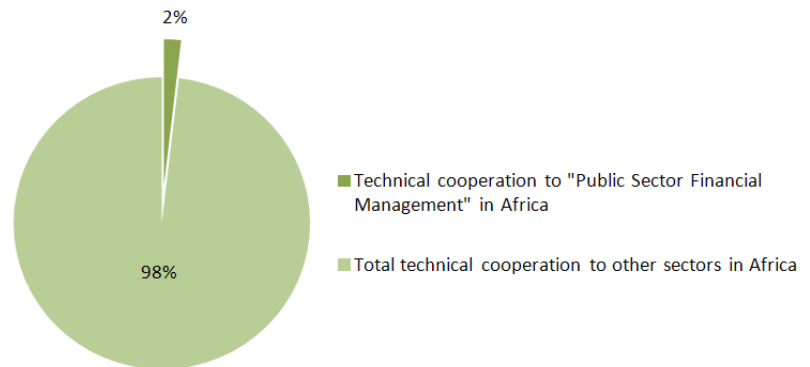
Successful reforms in the region have common characteristics:

- Fiscal reforms succeed when there is a high level of political support and long term commitment to undergoing a reform process. Support and commitment at the highest level is key to sheltering a tax administration from political interference and to fighting corruption amongst tax administrators.
- Successful reforms address the entire tax system; centralise all tax laws put under the responsibility of the Ministry of Finance/ Treasury in one legislative document; and are accompanied by a reform of the administration responsible for its implementation.
- Strong human resources with a high degree of professionalism, a high sense of responsibility and motivation constitute the central element in strengthening the capacity of tax administrations for better resource mobilisation.
- Tackling the challenges encountered during fiscal reforms is a sensitive political undertaking and must be embarked upon only after having built a strong constituency that supports change. The Moroccan experience has shown that this process is helped by conducting a fiscal expenditure survey that identifies the cost of exemptions granted to corporations and individuals and by bringing this survey to the attention of members of Parliament and other stakeholders.

What can the international community do?

There needs to be a stronger emphasis on aid for public resource mobilisation. Aid used to stimulate public resource mobilisation can have a ten-fold multiplier effect on a country's resources. And yet, donors have spent little attention on public resource mobilisation and improving fiscal policies.

Figure 1. Public sector financial management as a share of technical cooperation to Africa in 2008



Source: OECD DAC Aid Statistics (2010)

Figure 1 shows that public sector financial management represented a mere 2% of aid spent on technical cooperation in Africa in 2008. Given that technical cooperation is a subset of aid and that tax administration is itself a subset of technical cooperation for public sector financial management, donors support to African tax administrations is less than 2%. The AEO's country surveys confirm that there is a lot of room to increase aid in this area.

There is a growing trend among international agencies, however, to improve Africa's public resource mobilisation capacity and related global governance issues. One effort that receives strong donor support is the African Tax Administration Forum (ATAF), an African-led initiative. Its objective is to become a platform for articulating African tax priorities and building the institutional capacity of the continent's fiscal administrations through peer learning. The importance of ATAF cannot be understated on a continent where countries often compete for tax revenues and investment from multinationals. ATAF represents not only the most systematic effort at improving tax administration in Africa but it also provides needed opportunities for coordination and information sharing between national tax administrations.

Improving capacity and regional co-operation alone, however, will not ensure that Africa gets its fair share of taxes. Fortunately, there is a convergence of interest on the international tax agenda. Confronted with very large budget deficits, governments around the world are seeking to maximise their fiscal revenues by strengthening the enforcement of anti-fraud tax evasion laws. In this context, the OECD has invited African countries to participate in the international tax dialogue. Indeed, the G20 has prioritised the enforcement of international standards against tax havens; such a fight will require countries to collaborate around the world. That said, donors, African governments and the international community need to ensure that, in the context of this international dialogue on tax, the interests of African countries are not subsumed by those of richer nations.

Further information

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Related reading

OECD (2010), *African Economic Outlook 2010*, OECD Publishing.
<http://dx.doi.org/10.1787/19991029>

www.africaneconomicoutlook.org