CHAPTER 8

CONCLUSIONS AND POLICY RECOMMENDATIONS

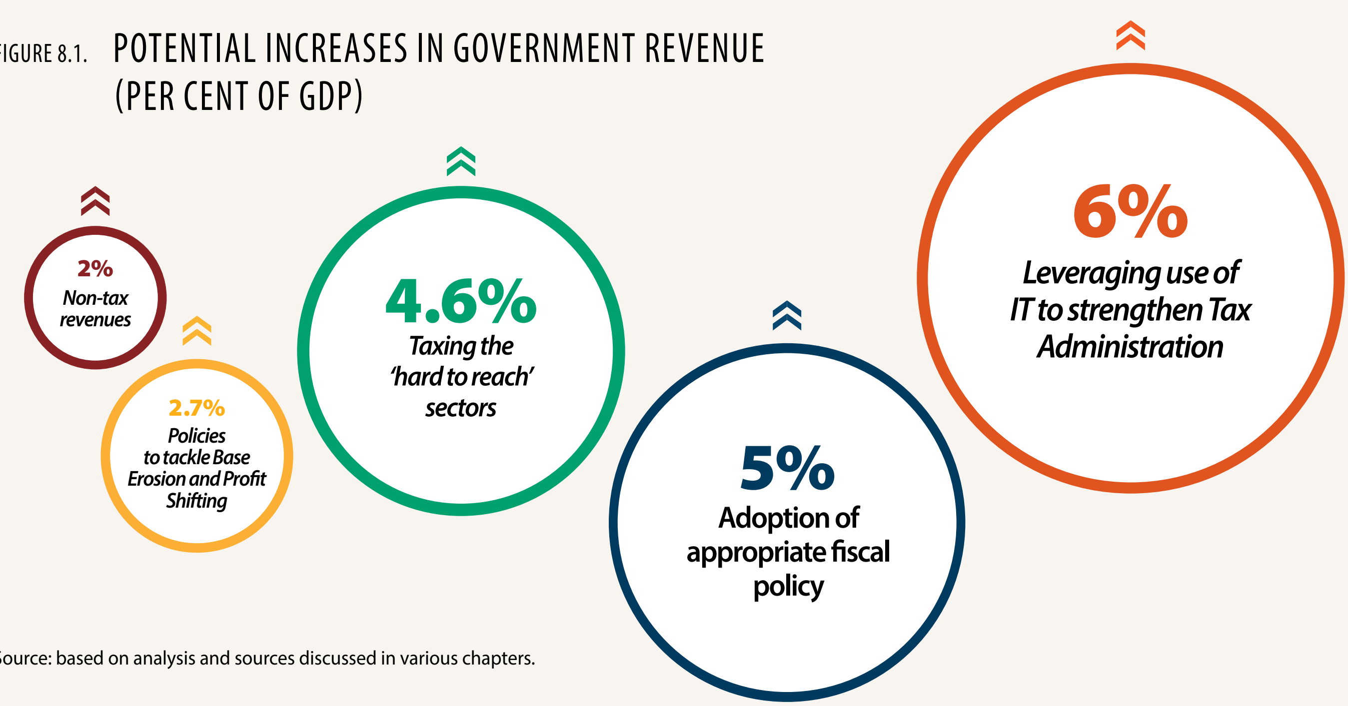
Over the past two decades, African countries made notable progress in mobilizing domestic resources to finance their development goals. However, despite the fiscal reforms undertaken by many African countries since 2000, government revenue, at 21.4 per cent of GDP in 2018, remains low relative to the continent's potential and the financial resources needed to achieve national development aspirations. The incremental financing needs for Africa to achieve the Sustainable Development Goals (SDGs) are huge, with estimates ranging from $614 billion to $638 billion a year between 2015 and 2030. The incremental financing needs are particularly high in low-income countries and lower-middle-income countries, at as much as $1.2 trillion a year. This translates into an estimated financing gap of 11 per cent of GDP between 2015 and 2030.

Against this backdrop, this Report analyses the state of fiscal policy and finds that African countries can broadly increase government revenue by 12–20 per cent of GDP (figure 8.1). It identifies potential means of increasing revenue, including adopting appropriate fiscal policy; taxing hard to reach sectors such as agriculture, the informal sector and the digital economy; improving mobilization of non-tax revenue; leveraging information technology and digitalization to broaden the tax base, reduce revenue collection costs and improve tax administration; and strengthening policies that tackle base erosion and profit shifting, tax avoidance and tax evasion.

The report uses secondary data as well as primary data collected from 10 case study countries to examine the institutional and policy factors that influence the effectiveness and efficiency of fiscal policy. Fiscal performance and public revenue collection during 2000–2018 receive special attention.

This chapter summarizes the key fiscal policy issues in Africa and presents the salient findings. It proposes a policy framework for adoption by African countries that offers a menu of policy options for raising additional revenue to meet the SDGs.

FIGURE 8.1. POTENTIAL INCREASES IN GOVERNMENT REVENUE (PER CENT OF GDP)



Source: based on analysis and sources discussed in various chapters.

ECONOMIC GROWTH, MODERATE IN 2018, IS EXPECTED TO PICK UP IN THE MEDIUM TERM

African economies grew by 3.2 per cent in 2018, down slightly from 3.4 per cent in 2017. Growth was underpinned by recovering commodity prices, consumption growth and the momentum of sustained government investment in infrastructure. Countering that, however, was the difficult external environment, with a strengthening US dollar, a slowdown in global trade and a decline in capital inflows in response to domestic political and policy uncertainty. Growth is projected to pick up again, to 3.4 per cent in 2019, supported by global growth, improved trade conditions and sustained increases in commodity prices.

However, the current pace and quality of growth are not sufficient for African countries to achieve the SDGs and meet the aspirations of Agenda 2063. Indeed, with slow value addition and structural transformation, Africa's growth has not been conducive to adequate job creation, equity and broader social development. To accelerate sustainable and inclusive growth, Africa needs to enhance productivity by boosting investment to 30–35 per cent of GDP and increase revenue in order to finance spending to support achievement of the SDGs. Fiscal policy is an important tool for development and an anchor for macroeconomic stability.

To advance more rapidly towards the priorities of greater prosperity, poverty reduction and sustainable development, African countries need to enhance the efficiency of government spending by improving public financial management. And countries need to reduce maternal mortality and gender disparities in education and employment to reduce inequality.

FISCAL POLICY COULD FOSTER INCLUSIVE GROWTH IN AFRICA

Africa has the second highest income inequality in the world, after Latin America. Inequality increased in 20 countries between 2000 and 2015 and fell in 17 countries. Analysis of data for 42 countries shows a positive and significant effect of government spending on the inclusivity of growth. A 1 percentage point increase in government spending leads to about a 0.27 percentage point increase in growth inclusivity, other things remaining unchanged. Government spending that is more effectively targeted to the poor could reduce inequality if accompanied by measures to ensure that government transfers and subsidies do not distort prices in the economy.

Analysis of data for 42 countries shows a positive and significant effect of government spending on the inclusivity of growth.

ACYCLICAL FISCAL POLICY CAUSED MACROECONOMIC INSTABILITY

Of 45 African countries examined, 34 practiced acyclical fiscal policy, seven practiced procyclical policy and only four countries practiced countercyclical fiscal policy. Acyclical fiscal policies, which do not take the business cycle into account, had adverse effects on macroeconomic stability, leading to a deterioration in macroeconomic indicators such as public debt. On average, total public debt increased, with more than half of the 45 countries exceeding the debt threshold of 50 per cent of GDP between 2015 and 2017. In addition, fiscal balances, which were positive in 2000, deteriorated, exacerbated by the double shocks of the 2008 global financial crisis and the 2014 commodity price drop. Oil-exporting countries were the hardest hit.

GOVERNMENT REVENUE HAS RISEN SINCE 2000 BUT HAS TRENDED DOWN IN RECENT YEARS

With the large number of fiscal reforms implemented over the last two decades, (weighted)

African countries should not rush to adapt low-tax policies; doing so would reduce revenues thatare critical for development without increasing investment.

fiscal performance varied across African countries, however. Some countries implemented fiscal reforms, boosting revenue over 2000–2018. The number of countries collecting revenue equivalent to 11–20 per cent of GDP rose from 25 to 35, while the number collecting revenue equivalent to 21–30 per cent rose from 5 to 8. Angola, Eswatini, Lesotho, Namibia, Seychelles and South Africa consistently collected revenue equivalent to more than 25 per cent of GDP between 2012 and 2015, indicating that economies of all sizes could achieve high rates of revenue collection. Average government revenue as a share of GDP in Africa increased from 22.8 per cent in 2000 to 31.4 per cent in 2008 and was 21.4 per cent in 2018. Of 51 countries, the tax revenue to GDP ratio dropped in 29, including in major economies such as Angola, Ethiopia, Kenya, Morocco and Nigeria.

COUNTERCYCLICAL FISCAL POLICY COULD BOOST REVENUE BY UP TO 5 PER CENT OF GDP

Countercyclical fiscal policy could enable African countries to increase revenue, improve fiscal balances, reduce debt to more sustainable levels and expand fiscal space. Countercyclical fiscal policy emphasizes macroeconomic stability by taking into account the business cycle. It focuses on ensuring that the economy does not overheat when demand pressures are high, while stimulating the economy during periods of low demand. The four African countries that practiced countercyclical fiscal policy (Ethiopia, Morocco, Nigeria and Zimbabwe) collected more revenue on average—by as much as 5 per cent of GDP—than countries that practiced acyclical or procyclical fiscal policy.

African countries should, therefore, adopt countercyclical fiscal policy to improve revenue mobilization to finance investment and growth and at the same time promote macroeconomic stability. To safeguard macroeconomic stability, countries must align their fiscal policy with the business cycle, raising taxes and reducing spending to curb supply- side pressures during booms, while lowering taxes and increasing spending to boost the economy when economic activity slows down.

Synchronizing fiscal policy with the business cycle will require countries to adopt medium term planning frameworks (see box 8.1) and strengthen forecasting tools to inform medium-term planning.

In the long run fiscal policy affects development by encouraging investment. A recent wind of change has swept through tax policy, with developed economies lowering taxes as an incentive for investment, employment creation and retention, and income growth. However, in African countries taxes have very little influence on foreign investment decisions. An analysis of 45 African countries over 1980–2015 finds only a very small impact of tax policy on investment. A 1 per cent increase in investment comes at a cost of a 20 per cent decline in total tax revenue. An investor survey of 7,000 firms operating in Africa found that tax incentives rank 11 out of 12 factors that influence investment decisions. African countries should not rush to adapt low-tax policies; doing so would reduce revenue that is critical for development without increasing investment.

INDIRECT TAXES WERE THE MAIN SOURCE OF TAX REVENUE

Africa's tax revenue to GDP ratio increased from 17.9 per cent in 2000 to 19.9 per cent in 2005 but has since trended downward and was estimated at 12.7 per cent in 2018. Tax revenue was driven

BOX 8.1. MEDIUM-TERM REVENUE STRATEGY

In response to the concerns of developing countries, the Platform for Collaboration on Tax, a joint undertaking of the International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations and World Bank, drafted a report and toolkit providing analysis and options for the tax treatment of offshore indirect transfers (Platform for Collaboration on Tax, 2018 [2015]). The Platform for Collaboration on Tax also submitted a paper on a Medium-Term Revenue Strategy (MTRS) in July 2016 to the G20 Finance Ministers meeting in Chengdu, China. The development and adoption of MTRS are a fundamentally new approach to strengthening developing countries' revenue mobilization.

Implementation of an MTRS requires the comprehensive and consistent development of its four core elements:

1. Building broad-based consensus in the country for medium-term revenue goals to finance needed public expenditure.
2. Designing a comprehensive tax system reform covering policy, administration and legal framework to achieve these goals.
3. Committing to steady and sustained political support to implement the strategy over several years.
4. Securing adequate resources (from domestic sources as well as donors and development partners) to support implementation of the MTRS.

largely by indirect taxes, such as value-added taxes (VAT), import duties and excise taxes. Revenue from indirect taxes as a share of GDP rose from 11.4 per cent in 2000 to 12.6 per cent in 2004 and then dipped to 9.0 per cent in 2018. Performance of corporate income tax revenue as a share of GDP was mixed, rising from 1.6 per cent in 2000 to 2.3 per cent in 2006 and declining thereafter to 1.2 per cent in 2018. Corporate taxes contributed a large share to tax revenue in some countries (as much as 6.0 per cent of GDP in Seychelles), while lagging behind in others.

BROADENING THE TAX BASE BY TAXING HARD TO TAX SECTORS COULD BOOST REVENUE BY 4.6 PER CENT

Some economic agents, especially in the hard to tax sectors of the informal economy, agriculture and the digital economy, operate beyond the reach of tax authorities. Governments face difficulties bringing these economic agents into the tax net. They range from small enterprises operating in the informal sector to medium and large economic agents that simply evade taxes or report only portions of their income as subject to tax. These agents represent an opportunity for governments to increase revenue by bringing them into the tax net.

Broadening the tax base requires a major change in the mindset of policy makers, who need to pursue innovative means of reaching hard to tax economic agents. Policy makers need to shift their focus from the easy target of compliant taxpayers, often burdened by unproductive bureaucratic procedures, to tax avoiders and tax evaders.

The inability to tax certain sectors and activities and the administrative challenges of tax collection result in lost revenue of up to 4.5 per cent of GDP in African countries. In 2001 Rwanda replaced its 15 per cent goods and services tax with a 15 per cent VAT, later raised to 18 per cent, which boosted tax collection by 1.5 per cent of GDP. Kenya lowered its VAT from 18 per cent to 16 per cent in 2003 and

Broadening the tax base requires a major change in the mindset of policy makers, who need to pursue innovative means of reaching hard to tax economic agents.

Non-tax revenue is an under-tapped source of government revenue in a majority of African countries, equivalent to just 2.6 per cent of GDP.

reduced the list of exempt and zero-rated items in 2013. As a result, VAT receipts rose by about 1 per cent of GDP in 2003 and another 0.5 per cent 2013.

NON-TAX REVENUE COULD INCREASE GOVERNMENT REVENUES BY 2 PER CENT OF GDP

Non-tax revenue is an under-tapped source of government revenue in a majority of African countries, equivalent to just 2.6 per cent of GDP. Oil-exporting countries have been the best mobilizers of non-tax revenue through natural resources rents. One disadvantage, however, is the vulnerability of natural resources rents to commodity price changes. This non-tax revenue peaks during commodity price booms and declines during commodity price lows.

External grants are the main source of non-tax revenue in Africa, at 33.3 per cent of total non-tax revenue in 2016. African countries need to move away from this reliance on grants and build internal sources of non-tax revenue that are more robust to uncertainties in trade-related events. Several countries that have reformed their system of non-tax revenue and shifted some of the burden to taxes on property income have reaped large revenue benefits (Botswana, Cameroon, Congo, Egypt, Mauritius, Morocco and Tunisia). Various levies on sales of goods and services are another important source of non-tax revenue in Africa, contributing 16.7 per cent of total non-tax revenue in 2016.

Over half of African countries (55 per cent) collect less non-tax revenue than they could. Improving efficiency could boost non-tax revenue collection by up to 2 per cent of GDP. Some African countries collect much more non-tax revenue as a share of GDP; Botswana and Congo collect as much as 16 per cent. Non-tax revenue falls short of potential in most countries because of lack of overall policy coherence, poor coordination between central and subnational authorities, lack of transparency, weak political will and inadequate infrastructure. Improving skills at the subnational level and strengthening revenue collection infrastructure would create more transparent institutions while bumping up revenue collection.

Over half of African countries (55 per cent) collect less non-tax revenue than they could. Improving efficiency could boost non-tax revenue collection by up to 2 per cent of GDP.

REFORMS HAVE BOOSTED THE EFFICIENCY AND EFFECTIVENESS OF TAX ADMINISTRATION IN THE REGION

Several countries have adopted tax administrative reforms, with the most popular reforms in Anglophone Africa being the establishment of semi-autonomous revenue authorities. The intention was to increase tax compliance and reduce collection costs by creating greater trust among taxpayers.

Another major reform has been the digitization of tax collection, which ensured the separation of tax

BOX 8.2. **OPPORTUNITIES FOR FISCAL POLICY THROUGH DIGITALIZATION**

African governments are using digital solutions for tax and expenditure policy, public financial management and public service delivery. Fiscal policy can benefit from digitalization in at least three ways.

DIGITAL IDENTIFICATION

Digital identification can broaden the tax base by making it easier to identify and track taxpayers and helping taxpayers meet their tax obligations. By improving tax assessments and administration, it enhances the government's capacity to mobilize additional resources. Digital ID systems yield gains in efficiency and convenience that could result in savings to taxpayers and government of up to $50 billion a year by 2020 (Boston Consulting Group, 2012). At least 23 national identification programmes were introduced in Africa over 2000–2016, compared with 15 in the prior four decades.

AUTOMATION AND FILING

Automating tax administration systems provides multiple advantages for governments and taxpayers, including greater compliance and lower compliance cost, savings in tax collection time and costs, and more efficient assessments because of increased data. Seventeen African countries have introduced electronic filing and payment systems (Angola, Botswana, Cameroon, Eswatini, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Togo, Tanzania, Uganda, Zambia and Zimbabwe), and three of them have made it compulsory for all taxpayers to pay their taxes electronically (Kenya, Uganda and Zimbabwe).

PUBLIC FINANCE MANAGEMENT

Digitization can enhance fiscal discipline through use of information technology systems that record, monitor and track budget numbers based on a country's medium-term expenditure framework, underpinned by its national development plan. Such systems enable tracking changes in a country's development financing gap, information that can be used to strengthen the planning process and ensure that priority areas receive the required attention.

Information technology systems can enhance reporting and therefore the transparency and accountability of public finance. Transparency reduces opportunities for corruption and political influence, and by building taxpayer trust in the system boosts compliance. Addressing these challenges could raise tax revenue to GDP ratios, now at 13–18 per cent, by 3.5 per cent of GDP (IMF, 2018).

assessments and tax payments and has been more efficient than the previous physical verification system. By enhancing data collection, digitization has increased the availability of data for assessments. In addition, by enabling taxpayers to use technology such as payment through the banking system, digitization has saved time and strengthened data and records management. Digitization has also enhanced fiscal policy (box 8.2).

Rwanda adopted e-filing, which boosted revenue by 6 per cent of GDP. In Benin the tax division in charge of large corporate taxpayers saw its portfolio grow from 303 companies to 490 in 2017, thanks to a data exchange platform with customs and a revised system of public procurement. The country's Integrated Tax and Related Management System, launched in March 2018, enables filing tax returns online and is ultimately expected to automatically manage more than 90 per cent of taxpayers in a large database. Tanzania undertook reforms in 2004 and 2012 that included automation of documentation, registration, tax collection and e-filing systems. Filings of VAT returns increased from less than 500 in 2009 to more than 4,000 in 2014, and revenue increased by 21 per cent between 2007 and 2011. In South Africa the introduction of e-taxation reduced both compliance time and cost by more than 22 per cent.

Use of information technology and digitization could enhance revenue mobilization by up to 6 per cent.

Digitalization of tax system can significantly boost fiscal revenue generation and management. Indeed, the use of information technology and digitization could enhance revenue mobilization by up to 6 per cent. African countries that digitized their tax administration strengthened data collection for tax assessment and saved on compliance costs. Even more can be saved on compliance costs by interfacing systems, which would reduce time for assessments and revenue monitoring.

Educating taxpayers on use of systems, tax obligations and the benefits of paying taxes should be a priority. In addition, countries will need to train tax collectors in how to use the data generated through digitization to make assessments more efficient.

TACKLING ILLICIT FINANCIAL FLOWS COULD BOOST TAX REVENUE BY AT LEAST 2.7 PER CENT OF GDP

Africa continues to suffer from revenue losses as a result of illicit financial outflows. These take place through aggressive tax planning, trade misinvoicing, misclassification of the quantity or quality of natural resources extractions, tax treaty shopping and cost inflation or overvaluation of expenses. The natural resources sector is particularly affected, because it is dominated by multinational corporations, with complex networks of affiliated businesses, and because of the large rents available in the sector. Fragmentation of oversight has also contributed to poor governance.

To reduce and halt illicit financial flows, countries have to gain a better understanding of the natural resources sector and of how illicit financial flows operate at the national level, which will allow them to negotiate better contracts with multinational firms and resist pressure for tax giveaways. Countries also need to develop a coordinated response to tax assessment and to information sharing across government agencies responsible for natural resources–related policy making and implementation.

The African Tax Administration Forum (2018) estimates that tax collections increased by about $170 million after African countries adopted customized tools to tackle tax avoidance and illicit financial flows between 2017 and 2018. Fully addressing base erosion and profit shifting by multinational corporations would boost tax revenue by 2.7 per cent of GDP (Cobham and Janský, 2018); other estimates put the gains at 1–6 per cent of GDP (Moore, Prichard and Fjeldstad, 2018).

To maximize natural resources revenues, countries need to deepen their understanding of the vulnerabilities that make illicit financial flows possible. They can use this information in developing national action plans to coordinate the responsibilities of government agencies in dealing with illicit financial flows. National action plans should include an approach to taxing multinational corporations that is equitable, administratively straightforward and difficult to manipulate.

One method is to apply formulary apportionment (allocation of multinational corporation profits

Debt levels rose over 2011–2016 as revenue collections declined and spending increased, especially on infrastructure. General government debt for Africa increased from 40.1 per cent of GDP in 2011 to 59.1 per cent in 2017.

across countries based on sales, payroll and capital base in each country) to determine the share of income to be taxed. Another is to reduce reliance on corporate income tax and taxing other variables that are harder to manipulate, such as gross sales of minerals, payments to factors of production (capital, labour and land) that are located in country or domestic utility payments. Exchanging information internationally, increasing transparency and avoiding overly -generous tax incentives and fiscal stabilization clauses will also be important. African countries should strengthen their oversight of the natural resources sector, in particular, including through better coordination among government agencies with responsibilities in this area.

LOWER THAN EXPECTED REVENUE COLLECTION INCREASED DEBT LEVELS AND REDUCED DEBT SUSTAINABILITY IN AFRICA

Debt levels rose over 2011–2016 as revenue collections declined and spending increased, especially on infrastructure. General government debt for Africa increased from 40.1 per cent of GDP in 2011 to 59.1 per cent in 2017. After the 2008 financial crisis, African countries faced severe constraints as financing from traditional donors on concessional terms declined. To meet their commitment to the SDGs and Agenda 2063, countries turned to borrowing in both domestic and international markets.

Concessional debt as a share of total debt peaked in 2004 at 55.4 per cent then sank to 35.8 per cent in 2016. The increase in commercial debt and the decrease in concessional debt meant that debt became more expensive. As the financial markets tightened in response to monetary policy in the West, the cost of borrowing in international financial markets rose. Tougher borrowing conditions included shorter debt maturities as investors anticipated changing financial conditions in the West. As a result, the stock of debt maturing in one year rose from 4.9 per cent of GDP in 2012 to 7.6 per cent of GDP in 2017.

> To prevent further deterioration of fiscal and debt positions, African governments need to rebalance their policy frameworks to maintain stable income and expenditure flows to sustain policies to achieve the SDGs.

As both debt stock and debt servicing costs rose, so did vulnerabilities, with some countries facing high risk of debt distress, including Chad, Congo, Eritrea, Mozambique, South Sudan and Zimbabwe, which were vulnerable to commodity price shocks or fragility. The joint International Monetary Fund and World Bank debt sustainability analysis finds that only six African countries are at low risk of debt distress (Kenya, Lesotho, Rwanda, Senegal, Tanzania and Uganda).

African countries need debt strategies that will improve debt management, including strengthening the fiscal framework by increasing revenue collection, taking a longer term approach to borrowing and restructuring the composition of debt, including increasing domestic local currency–denominated debt.

To prevent further deterioration of fiscal and debt positions, African governments need to rebalance their policy frameworks to maintain stable income and expenditure flows to sustain policies to achieve the SDGs. Countries also need to strengthen their capacity to conduct complex assessments of risks to public debt sustainability as well as risks to public borrowing for long-term development infrastructure projects.

* * *

Countries will need to achieve a fine balance between raising revenue and incentivizing investments.

The financing needed to enable African countries to achieve the SDGs and Agenda 2063 is substantial. The changes in global financial markets and the global economy mean that African countries need to look inward for financing, particularly through prudent fiscal policy. Coordinating fiscal and monetary policy is vital, since both tools must work together as stabilizers if they are to be effective in achieving the triple goals of growth, employment and stability. Taxation and spending must take the business cycle into account. It will be imperative to understand the sources of revenue and how countries can ramp up their revenue collection to support development.

Countries will need to achieve a fine balance between raising revenue and incentivizing investments. Fiscal policy has the potential to reduce social inequities by reducing poverty and inequality. By advancing long-term growth and development, fiscal policy can help countries achieve the SDGs.

Finally, it is worth noting that analysis in this Report was limited by unavailability of detailed and comparable fiscal data for many African countries. We call upon these countries to address data gaps and make data accessible to enable analysis of country performance as well as useful comparisons across countries and subregions for experience sharing.

Fiscal policy has the potential to reduce social inequities by reducing poverty and inequality. By advancing long-term growth and development, fiscal policy can help countries achieve the SDGs.

REFERENCES

ATAF (African Tax Administration Forum). 2018. *African Tax Outlook, Second Edition 2018.* Pretoria, South Africa: African Tax Administration Forum.

Boston Consulting Group. 2012. "The Value of Our Digital Identity." Liberty Global Policy Series. London: Liberty Global, Inc. and Boston Consulting Group.

Cobham, A., and P. Janský. 2018. "Global Distribution of Revenue Loss from Corporate Tax Avoidance: Re-estimation and Country Results." *Journal of International Development* 30 (2): 206–232. Available at: https://onlinelibrary.wiley.com/doi/full/10.1002/jid.3348 (Accessed 17 December 2018).

ECA (United Nations Economic Commission on Africa). 2014. *Economic Report on Africa: Dynamic Industrial Policy in Africa*. Addis Ababa, Ethiopia: ECA.

Elhiraika, A. 2007. "Fiscal Decentralization and Public Service Delivery in South Africa." African Trade Policy Centre Note 58. Addis Ababa, Ethiopia: ECA.

IMF (International Monetary Fund). 2018. *Regional Economic Outlook for Sub-Saharan Africa: Domestic Revenue Mobilization and Private Investment*. Washington, DC: IMF.

Moore, M., W. Prichard and O.-H. Fjeldstad. 2018. *Taxing Africa: Coercion, Reform and Development*. London: Zed Press and the International Africa Institute.

Platform for Collaboration on Tax. 2015. *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses Including a Supplementary Report on Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form*. Washington, DC: IMF, OECD, UN and World Bank.