United Nations
Economic Commission for Africa

Scaling Up Domestic Revenue Mobilization

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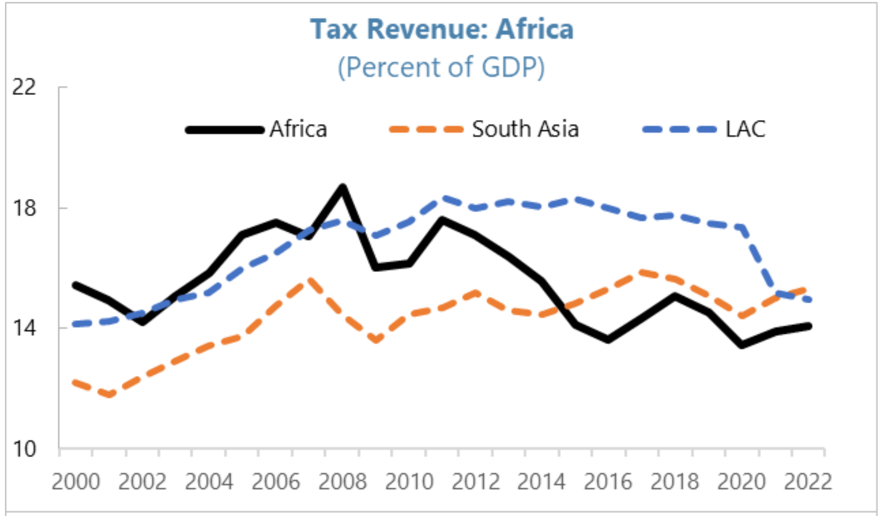
ideas for a prosperous Africa
IdeastoAction

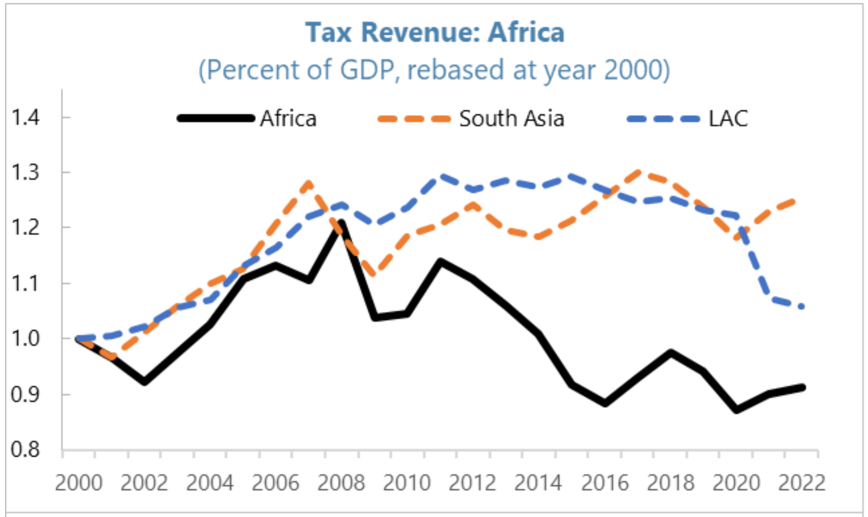
Tax revenue in Africa remained largely below par since 2000.

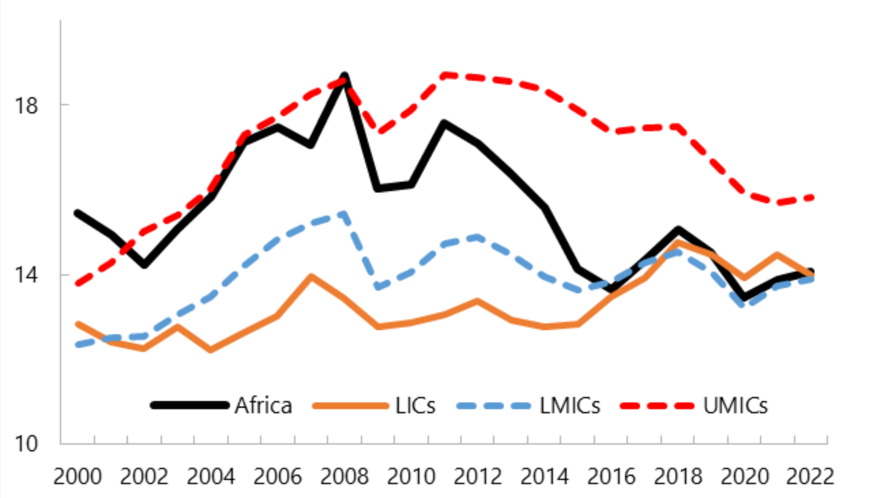
DECADE OF ACTION

- Domestic revenue mobilization remained stagnant since early-2000s.
- African tax revenue is below all peers.

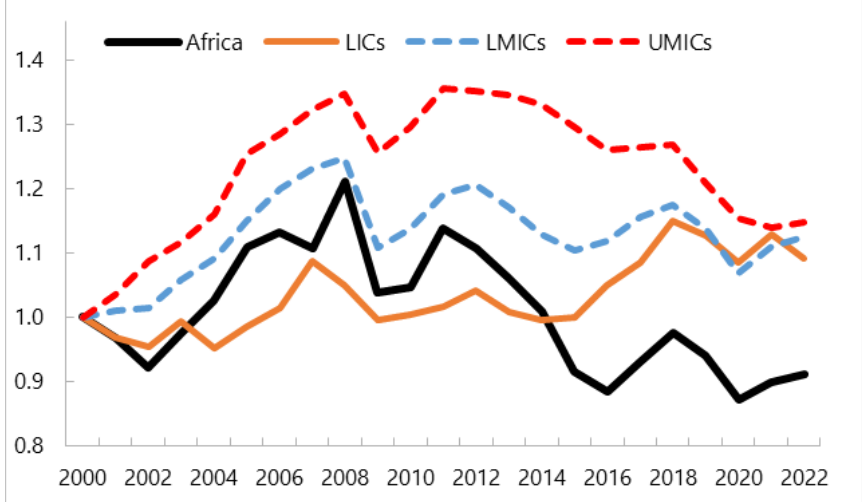
- Since 2000, every peer in geographical and income group shown progress.
- Only Africa recorded a <u>significant decline</u> compared to 2000 tax revenue levels.







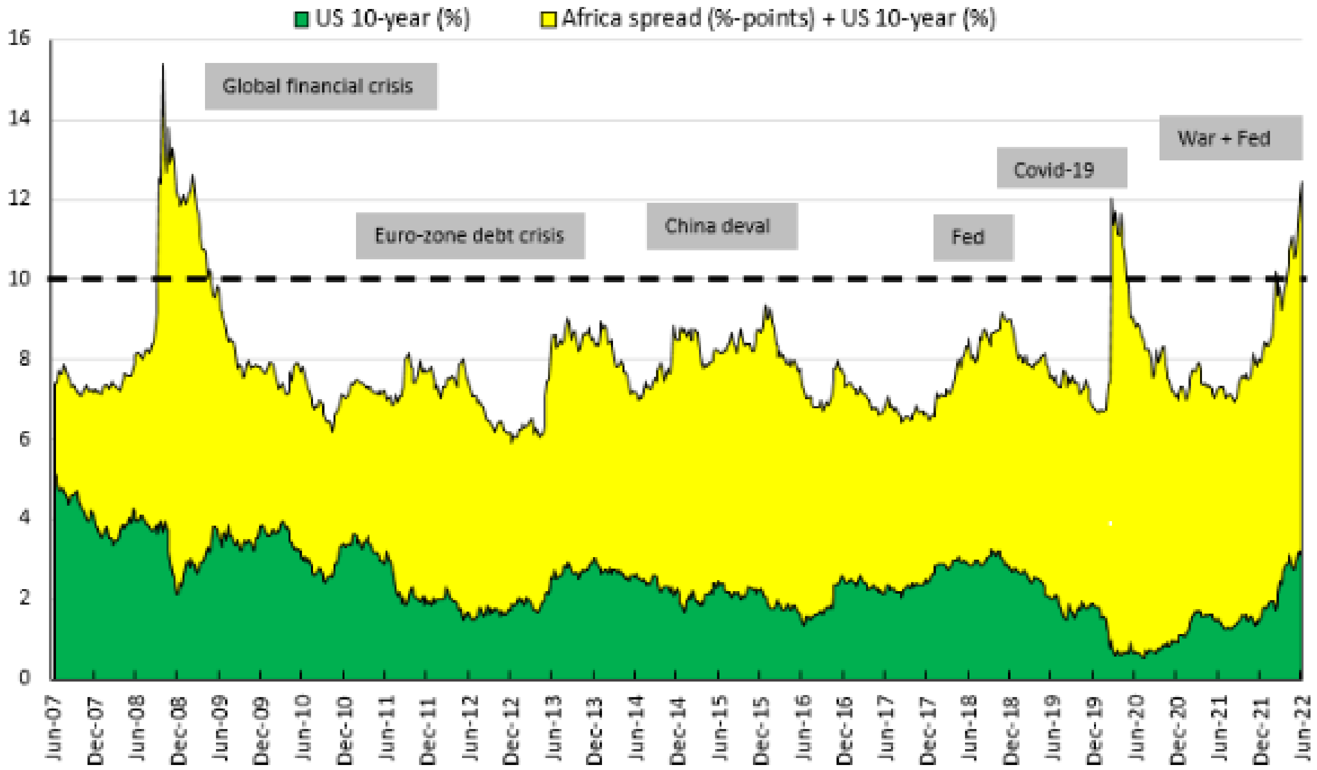
Sources: IMF WEO database, ECA calculations.



Sources: IMF WEO database, ECA calculations.

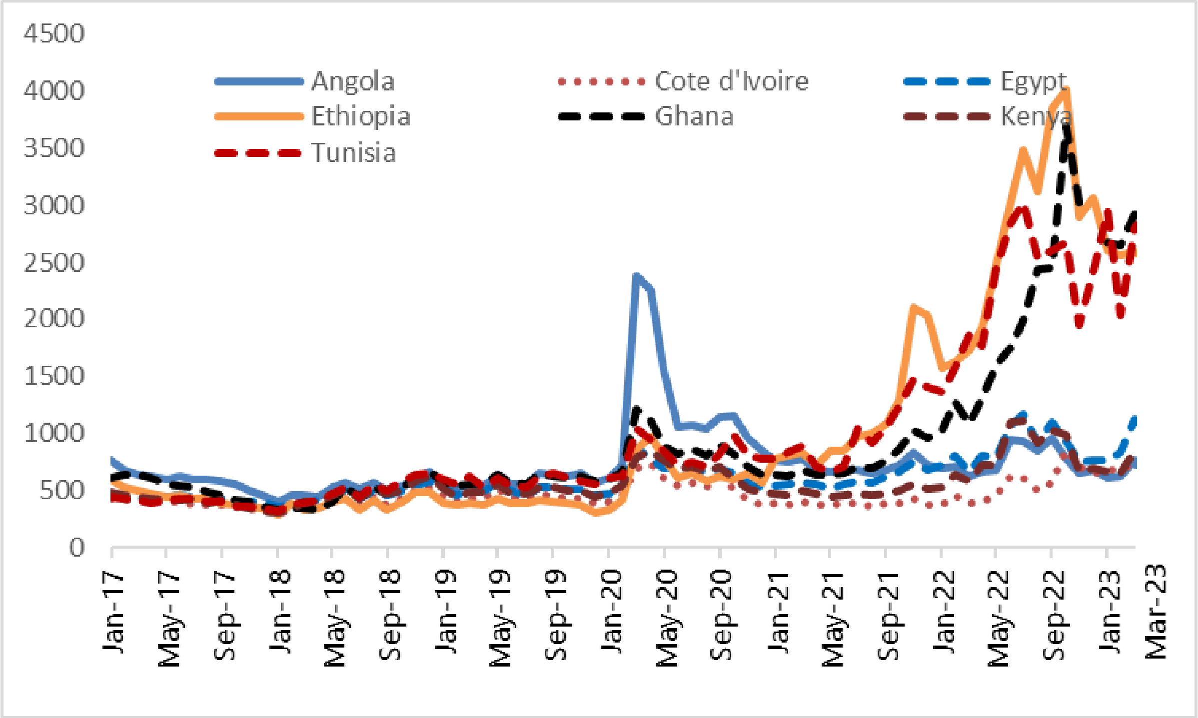
Meanwhile, global financing is getting scarcer, and costlier.

Potential borrowing costs, percent



Source: Smith, G. (2022), and IMF (2022).
Note: The 'Africa spread' refers to average spread for Africa.

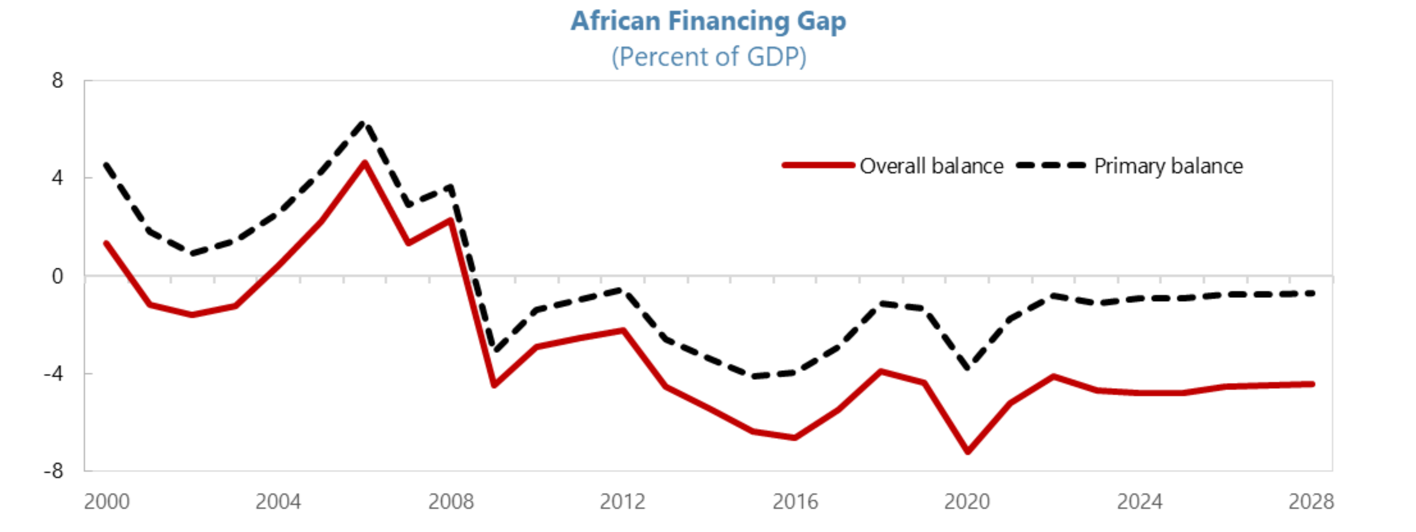
Sovereign spreads, basis points



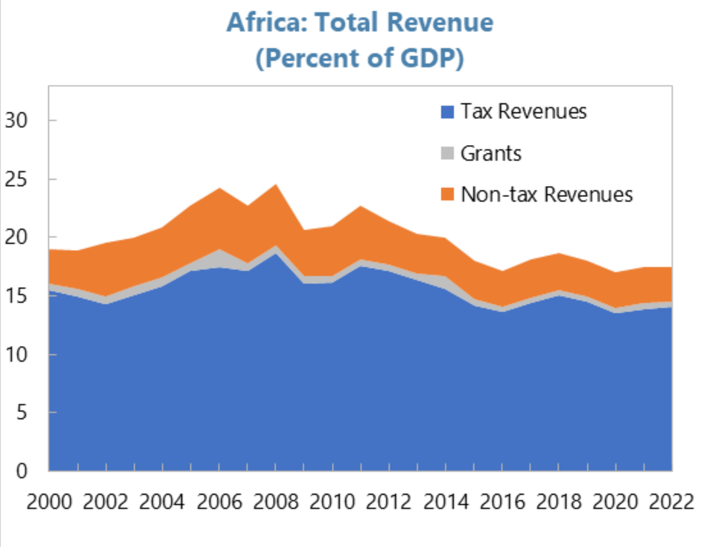
Source: Bloomberg.

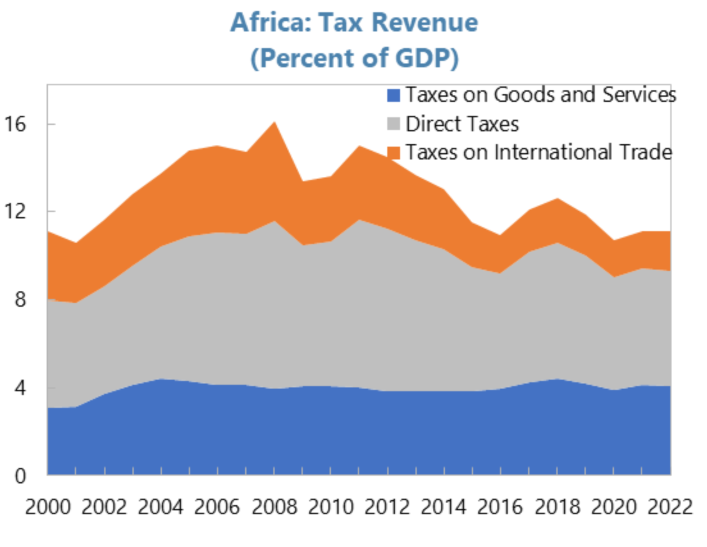
The financing gap poses a serious challenge going forward.

- The financing gap, driven largely by the primary deficit, is high and expected to persist for the full forecast horizon.
- Public debt is high, grants are low, external financing is scarcer and costlier.
- Thus, scaling up DRM is a critical step for African development.



- Revenue on G&S taxes and direct taxes are inert, and trade taxes are steadily declining.
- Given AfCFTA, coupled with Egypt and Ethiopia joining BRICS, trade taxes will naturally diminish
- At this juncture, Africa must utilize any untapped tax revenue potential.



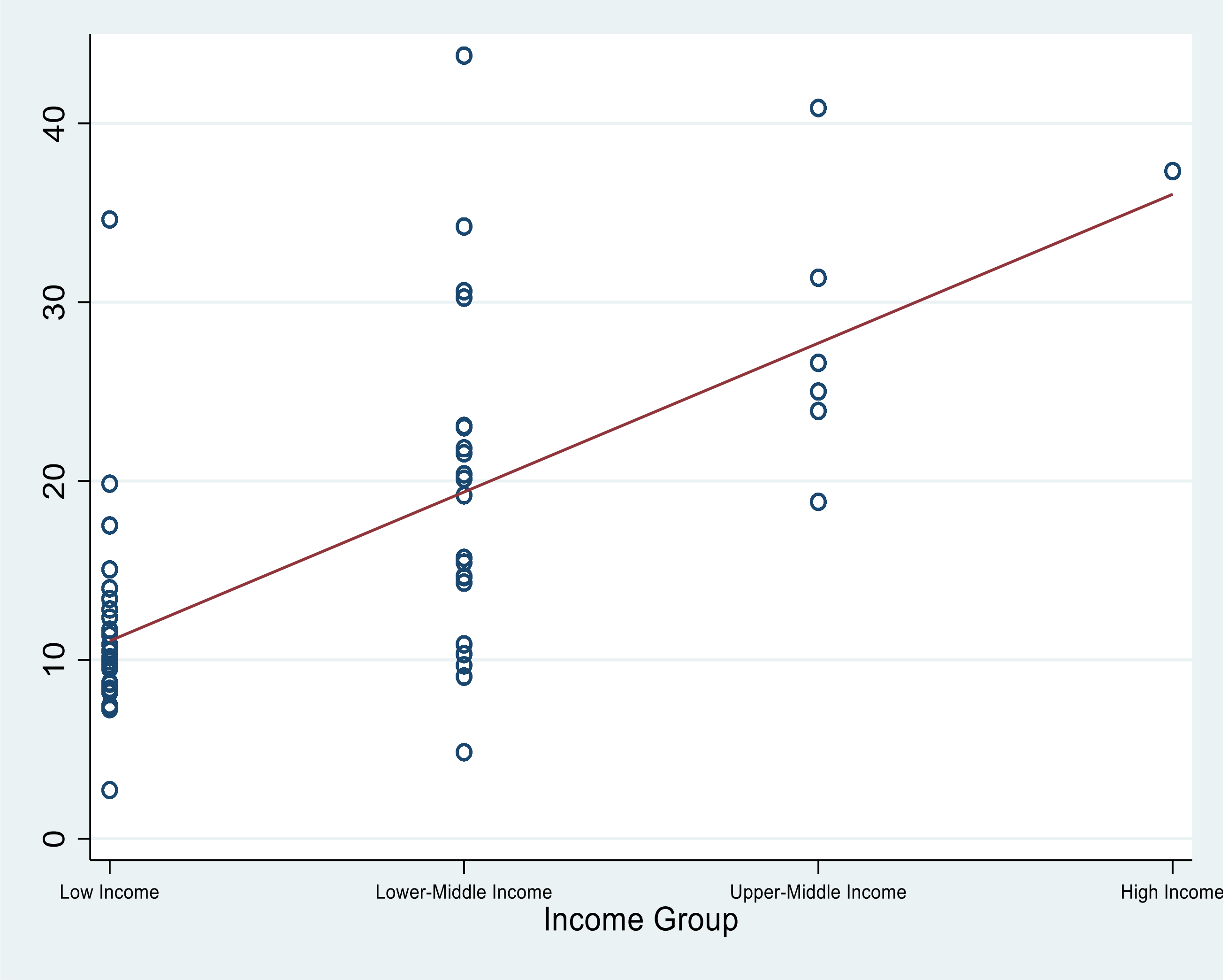


Sources: IMF WEO database, ECA calculations.

.Two critical causes of low tax mobilization: low level of development and low tax effort

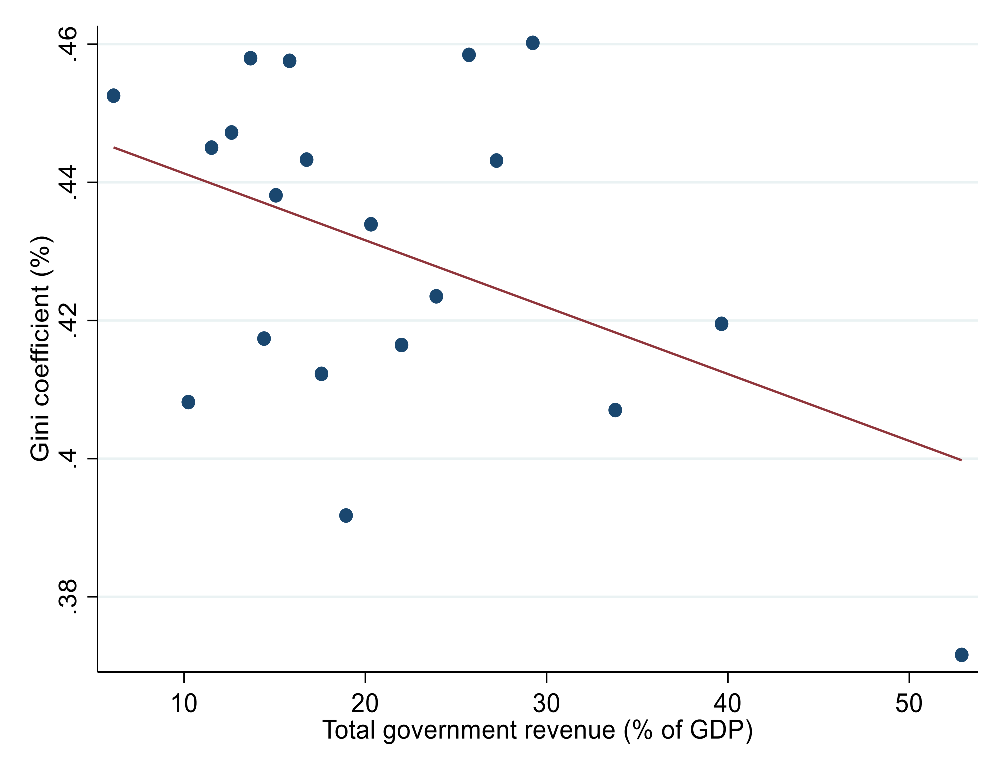
- Tax mobilization tends to increase with the level of development which expands the tax base or the extensive margin . Hence there is notable difference in the average tax mobilization rate by the level of development in Africa as well.

- The tax effort is generally low in Africa irrespective of the level of development due to weak tax administration, suboptimal tax structures and widespread informality in the economy



Countries that were effective in mobilizing taxes reduced income inequality significantly

- Improved tax mobilization could be an important policy instrument in fighting high and persistent inequality in Africa. Controlling for differences in per capita consumption levels, country fixed effects and time varying unobserved factors, higher tax as a ratio of GDP was associated with low GINI coefficient in Africa. This is a subject that would need further research at country and regional level to establish causal relationships between tax mobilization efforts and income distribution in Africa



Ineffective tax exemptions hinder development efforts

- The United Nations estimates that an annual funding gap of **US$200 billion** will need to be filled for African countries to meet the SDGs by 2030.
- Tax exemptions in Africa account approximately 6-7% of GDP resulting in significant revenue losses.
- Most exemptions are given against corporate income tax (CIT) and value-added tax (VAT) revenue.
- Tax exemptions granted to multinational companies and large corporates are estimated cost over $50 billion a year.
- Mining sector particularly prone to tax exemptions. 48 African countries offer some form of tax incentives.
- Tax exemptions, when granted without significant cross-checks, lead to substantial forgone revenue.
- In many cases, tax exemptions are granted without proper oversight and evaluation of their impact. Lack of transparency makes it difficult to assess their effectiveness.
- Countries need to evaluate costs and benefits of such policies to ensure they contribute to sustainable development.

Eliminating other sources are revenue leakage are equally important.

There is a **US$200 billion** annual gap to reach SDGs.

UNCTAD estimates almost **US$89 billion a year**, nearly half of the annual SDG financing gap, is **lost to IIFs**, equivalent to **3.7-percent of Africa GDP**.

A report by **AfDB** and **GFI** estimated a loss of **US$1.2 trillion to US$1.4 trillion** (in 2013 dollars) between 1980 and 2009 due to **IFFs**.

ECA estimated in 2018 that **base erosion and profit shifting (BEPS)** costs Africa **1.8-percent of GDP a year**, or about **US$44 billion**.

- Significant resources could be gained by eliminating the portion of tax benefits that are not producing economic return after a thorough analysis, which would recoup some of the lost **1- to 15-percent of GDP** due to tax expenditure.
- Furthermore, additional resources up to **8.5-percent of GDP** could be propagated by mitigating losses due to IFFs and BEPS.

African governments should tap into underutilized DRM avenues.

- Successful leveraging and implementation of property and land taxes produced direct revenue and indirect economic spillovers across the world.
  - In East Asian nations, the implementation of substantial land taxes combined with reduced taxes on productive industries has led to a decline in land speculation and has fostered increased investment in manufacturing.
  - As a prime driver of municipal revenue, a **1-percent land and property tax** in Kigali is estimated to generate over **US$60 million per year**– **over 4 times** the city's current revenue.
  - IGC reports that by implementing a points-based valuation system in Sierra Leone, cities had an impressive **200- to 450-percent** surge in local revenues between 2007 and 2011.
  - After successfully harnessing property and land taxes, Lagos was able to increase annual capital expenditure from **US$600 million in 2006 to US$1.7 billion** in 2011 (in 2012 dollars).
  - Currently African property tax administration is characterized by inadequate valuation practices, inadequate coverage of property, and low compliance; and underdeveloped property markets.

- Similarly, digitalization has shown remarkable success in scaling up DRM by ensuring transparency in tax payment and administration, such as the 2021 Automatic Exchange of Financial Account Information (AEOI) strategy.
- A report revealed that between 2014 and 2021, **US$244 million** was identified and mobilized by nine African countries through the Exchange of Information Request (EOIR) initiative.
- Rwanda launched **Unstructured Supplementary Service Data (USSD)** application to circumvent internet connectivity challenges, which has improved compliance in tax payments.
- By end-2022, 19 African countries have made e-filing of tax documents mandatory, which brings procedural simplification and control of payments and increased compliance.

Behavioral approaches - a new avenue for tax compliance strategies

- Employing behavioral approaches to muster tax compliance has received substantial attention.
- The literature sets the tools for behavioral approaches that tackle tax compliance as nudging (simplifying procedures), emphasizing social norms, creating economic games; incentives, rewards and penalties, personalized messaging, peer effects, and trust-building between the government and the taxpayer.

An experiment conducted in partnership with the Latvian Revenue Agency, where the informal economy looms around 25-percent of GDP (OECD average at 14-percent) yielded revealing insights.

Sending behaviorally-informed messages, declaring omission of tax declaration as a deliberate infraction, resulted in almost 10-percent higher compliance.

A ‘social norms’ message led to the most submissions 45 days after the deadline, by over 5-percent increase.

Perception of public benefits from compliance separately affect tax compliance. A Norway study reported increased compliance when they stated the taxes are used for publicly financed services.

THANK YOU