Financing for Development: The Call for Action on Domestic Resource Mobilization

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The Call for Action
Mobilizing domestic resources for development in sub-Saharan Africa has never lacked urgency. Lacking instead is the commitment to action. At the March 2015 Conference of Ministers in Addis Ababa, President Kagame of Rwanda cautioned that “we stop thinking about development as something we do with external resources”. The Ethiopian PM, Ato Haliemariam Dessale added “increased domestic resources mobilization is absolutely necessary and [it] should get first priority and greater attention…” Abdalla Hamdok of UNECA writing in the OECD 2014 Report remarked that Africa’s sustainable development will not come from aid.

The 3rd Financing for Development (FfD) meeting in Addis Ababa in July, 2015 echoed the importance of domestic resource mobilization as a key part of the international efforts to finance the Sustainable Development Goals.

The conference outcome committed to support countries that need assistance to develop domestic tax systems. The Addis Tax Initiative (ATI) emerged as the international community’s shared responsibility and commitment to this end. But how far can this initiative go and why is the development of domestic tax systems lagging behind in most SSA? Support for strong tax policy-making and effective revenue administration as part of sound public financial management will certainly help to boost domestic revenue mobilization. But, my viewpoint is that the real fulfilment of the ATI may depend on political will to action by country governments.

What is the record? For many SSA countries tax as a share of GDP in the past decade and a half has only increased marginally, and in some countries have stalled or declined. Common features of the structure of taxation in most SSA countries are that tax bases are narrow, taxes are barely progressive, exemptions are widespread, and there is a preponderance of the “hard to tax” (informal) economic activities. These features together create room for rampant tax avoidance and evasion, and a vicious cycle of low tax collection.

Moreover, while high income countries typically have total tax take as a percent of GDP of between 25 to 45 percent, SSA average, according to the World Bank, has
hovers around 16 percent compared to 22 percent for Latin America and 32 percent for East Asia and Pacific. And while taxes on income and profits and on goods and services (including consumption taxes) remain the workhorses for tax regimes in high income countries, reliance on international trade taxes remains relatively high in most SSA countries.

Undeveloped domestic tax policies and complex tax administration system also make tax evasion, avoidance and illicit financial flows (IFFs) possible. Other common revenue loss channels include corruption, poor compliance, tax holidays, transfer pricing, accelerated depreciation allowances, and the difficulties in taxing multinational corporations in general and resource companies in particular.\(^2\)

Writing in the Fall 2014 edition of the Journal of Economic Perspectives, Timothy Besley and Torsten Persson observed that: “the combination of an informal economic structure, reliance on income from specific commodities and natural resources, and the availability of aid…pushes many low-income countries into a low tax to GDP ratio on a narrow tax base and a narrow set of individuals”.

Towards Reform:

The following principles outlined by the Inter-American Development Bank for tax reform in Latin America apply with even greater urgency for SSA in carrying forward the Addis Tax Initiative.

Reforms must improve the progressivity and the real distributive capacity of country’s tax system. How well this is done depends on information that government has on the income status of citizens.

Reforms must establish tax systems that are simpler with broader tax bases. That means curtailing exemptions, often made possible by special treatments to privileged persons, institutions, corporate entities, sectors and activities. Although exemptions may be used to achieve public policy objectives the trouble in most jurisdictions is that they are often open-ended and politically motivated.

Reforms must strengthen tax administration so that all citizens and business meet their tax obligations, reducing loopholes and closing revenue loss channels. Strong technical capacity of revenue administrators is essential and must be complemented by reliable sources of information about tax bases and tax payers. For most jurisdictions there are serious technical capacity problems in mining, oil and gas revenue administration, often in ways that widen the loss channels of illicit financial outflows.

Finally, reforms must strengthen local governments’ resource generating capacity to be effective agents of local development, especially in the provision of basic amenities. Much of the great potential of local revenue is unexploited, especially in property taxation and rental income. As percent of GDP, Ghana for example collects just about 0.02 percent in property taxes compared to 0.6 percent for South Africa and about 2.5 percent for OECD countries, clearly an untapped source of local government financing. The rhetoric of decentralization has not been matched by a political will and an enabling revenue raising capacity of sub-national governments.

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Each country no doubt must develop its own approach to building a domestic tax system that reflects the above considerations. An important question to ask is why is it so difficult to make such improvements even with rapid growth in most SSA countries, in Nigeria and Ghana for example?

One reason, and increasingly an important one, is that a good domestic tax system depends not only on the clarity of country tax policy, but also on the platform of information and data gathering capacity of governments and the taxing authorities. What do we mean by this?

**Building Domestic Tax System and Information Requirements**

The inability of most SSA economies

(a) to develop adequate personal identification and business registration systems,
(b) to provide community identifiers through street naming and unique identification of properties, and
(c) the lack of clear identification of the ownership of property and title to land, all together undermine the capacity to develop a sound tax system.

In short, it is not possible to build a robust domestic tax system in environments where it is nearly impossible to uniquely identify persons, businesses, title to land, and ownership of property.

The ability to pay and benefit principles of taxation and the principle of equity or fairness of tax-transfer systems all require that the tax system can identify persons, businesses and property so that the system can allocate to each a fair share of the tax burden or the transfer of benefits. These are also essential for poverty alleviation and the reduction in inequalities through income transfer system and targeted subsidies.

Weak information capacity of governments about the nature of income flows and economic transactions has meant that most domestic tax systems are limited to a small segment of the labour force, mostly in the public sector, and a few large visible private enterprises (banks, insurance, hospitality, resource companies and manufacturing). That leaves a large segment of the self-employed professionals, artisans and the informal sector outside the tax net.

**Political Inaction**

What does politics have to do with this? Timothy Besley and Torsten Persson again observed that even though economic growth is important in widening the tax net, that has not been the case in many African countries. Governments faced with political challenges have only paid lip service to strengthening tax administration, and in some countries have instead under-developed their tax systems because of the opposition of the league of self-employed professionals, and the political entrepreneurial class who dread losing their tax evasion and tax avoidance status.
As economies become information-rich, yet more complex, the failure to develop the information base that supports a comprehensive tax system is central to understanding governments’ growing inability to raise conventional domestic taxes. For sure, it accounts for the decline in tax effort even as SSA countries record unprecedented growth accompanied by increases in per capita income. The greater sophistication of domestic economies, weak internal coordination of institutions that collect and build demographic data, poor business registry and industrial census, weak system of tax coordination across countries, and accessibility of tax havens, increasingly mean that taxpayers can find more methods by which to avoid or evade taxes.

But, whether it is in taxing the informal sector, building a fair and progressive tax system, curtailing exemptions, and closing revenue loss channels, these measures can be formulated creatively within each tax jurisdiction if there is the political will for action across regimes.

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**Recommendations**

- Reforms must improve progressivity and the real distributive capacity of country’s tax system.
- Reform tax systems to be simpler with broader tax bases and limited exemptions and special treatments.
- Strengthen tax policy-making capabilities and tax administration in general, especially in mineral, oil and gas revenue administration.
- Strengthen local governments’ revenue generating capacity, especially through property taxation.
- Develop adequate personal identification systems through registry of births and deaths.
- Develop adequate business registration systems, especially for small, medium scale enterprises.
- Develop community identifiers through street naming and unique identification of properties.
- Develop a registry of ownership of property and title to land, as the basis of property taxation and taxation of rental income.