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Public Resource Mobilisation and Aid

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Executive Summary

1. The global economic crisis has given a new impetus to the dialogue on domestic resource mobilisation across Africa. 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 generally high levels of indebtedness across Africa. Notwithstanding an improved macroeconomic management over the previous decade, poverty is still widespread and public service delivery is often subject to unstable and unpredictable external flows and/or donor financing. This report explores how public resources can be better mobilised for development through more effective, more efficient and fairer taxation systems.

2. Africa faces three types of challenges respect to further mobilisation of public resources. First, there are cross-cutting structural bottlenecks: high levels of informality, a lack of fiscal legitimacy and strong administrative capacity constraints, under-pinned by insufficient support from donors. Second, the existing tax-base is shallow as it is eroded by excessive granting of tax preferences, inefficient taxation of extractive activities and inability to fight abuses of transfer pricing by Multinational Enterprises. Third, the tax mix of many African countries is unbalanced. Hence, these countries rely excessively on a narrow set of taxes to generate revenues for their state and some stake-holders are disproportionately represented in the tax base. Indeed, the lack of urban cadastres and population censuses makes collecting urban property taxes particularly challenging for local African administrations on top of the difficulty of collecting taxes on the elite. Additionally, trade tax revenues are bound to be further challenged by trade liberalization agreements.

3. In the short-run however, strategies towards more effective, efficient, and fair taxation in Africa typically lie with deepening the current tax base in administratively feasible way. Policy options include removing tax preferences, dealing with abuses of transfer pricing techniques by MNEs 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.

4. In the longer-term, the capacity constraints of African tax administrations must be released to open up policy options and enable generating tax revenues through a more balanced tax-mix. Indeed, taxing new 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 taxpayers and each type of economic activity. Additionally, it engages a wide range of stakeholders in the national political process. The report identifies urban property taxes as a tax policy instrument that can be made administratively feasible with the aid of development partners, is progressive and can scale up with Africa's explosive pace of urbanization and the corresponding need for urban infrastructure.

5. Considering the administrative bottlenecks, options to pursue redistributive tax policies are usually few in the short-run and take different forms than in industrialized countries. To pursue a genuinely redistribute tax strategy, better candidates are: raising fees on tertiary education, introducing road tolls and car registration fees as these are important consumption items for richer Africans. Excise taxes could be used more intensively. Elites that are more likely to pay these taxes have an incentive to frustrate this kind of legislation. By improving public service delivery African governments need to convince elites that they have a stake in a better funded state. As a consequence, it is often more effective to deal with inequality on the expenditure side.

6. Undeniably, the quality of taxation matters as much as the quantity raised by taxes. States need tax revenue to function and taxes are the primary platform for political negotiations among a country's stakeholders in the form of a social contract. There's no representation without taxation. Furthermore, increasing fiscal revenue on a sustainable basis increases ownership of government policies, paving the way for Africa to graduate from aid in the long run. 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 a more effective policy to stimulate the development of the private sector.

7. We find that the average African tax revenue as a share of GDP has been increasing since the early 1990s mostly induced by taxes on the extraction of natural resources. Obtaining natural resource rents distracts governments away from more politically demanding forms of taxation. Indeed, income taxes (mainly personal and non-resource corporate) have stagnated over the period. Trade liberalization in Africa has translated into a reduction of revenue from trade taxes since the late 1990s, although largely offset by indirect taxes, corporate taxes and resource-related tax revenues.

8. This positive trend hides significant differences in the performance of individual countries. Annual taxes per capita range from as low as USD 11 to USD 3600. In fact, our tax effort estimates confirm that some countries collect as little as half of what they would be expected to while others collect up to 2 to 3 times what they would be expected to, while some African resource-rich countries switch from a high tax effort to a low tax effort when excluding resource-related tax revenues.

9. Aid represents less than 10% of total collected taxes on the continent but the paradox is that most African countries are still heavily dependent on aid. In fact, aid used to stimulate public resource mobilisation can have a high -up to tenfold- multiplier effect on a country's resources. And yet, donors have only spent little attention to public resource mobilisation and improving fiscal policies. Confronted with very large budget deficits, governments around the world are seeking to maximise their fiscal

revenues by strengthening enforcement of tax evasion and fraud; besides, the G20 has made a priority of enforcing internationally agreed standards against tax havens.