TAX MOBILIZATION AND NORTH-SOUTH COOPERATION

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ENHANCING DOMESTIC RESOURCE MOBILISATION IN SUB-SAHARAN AFRICA

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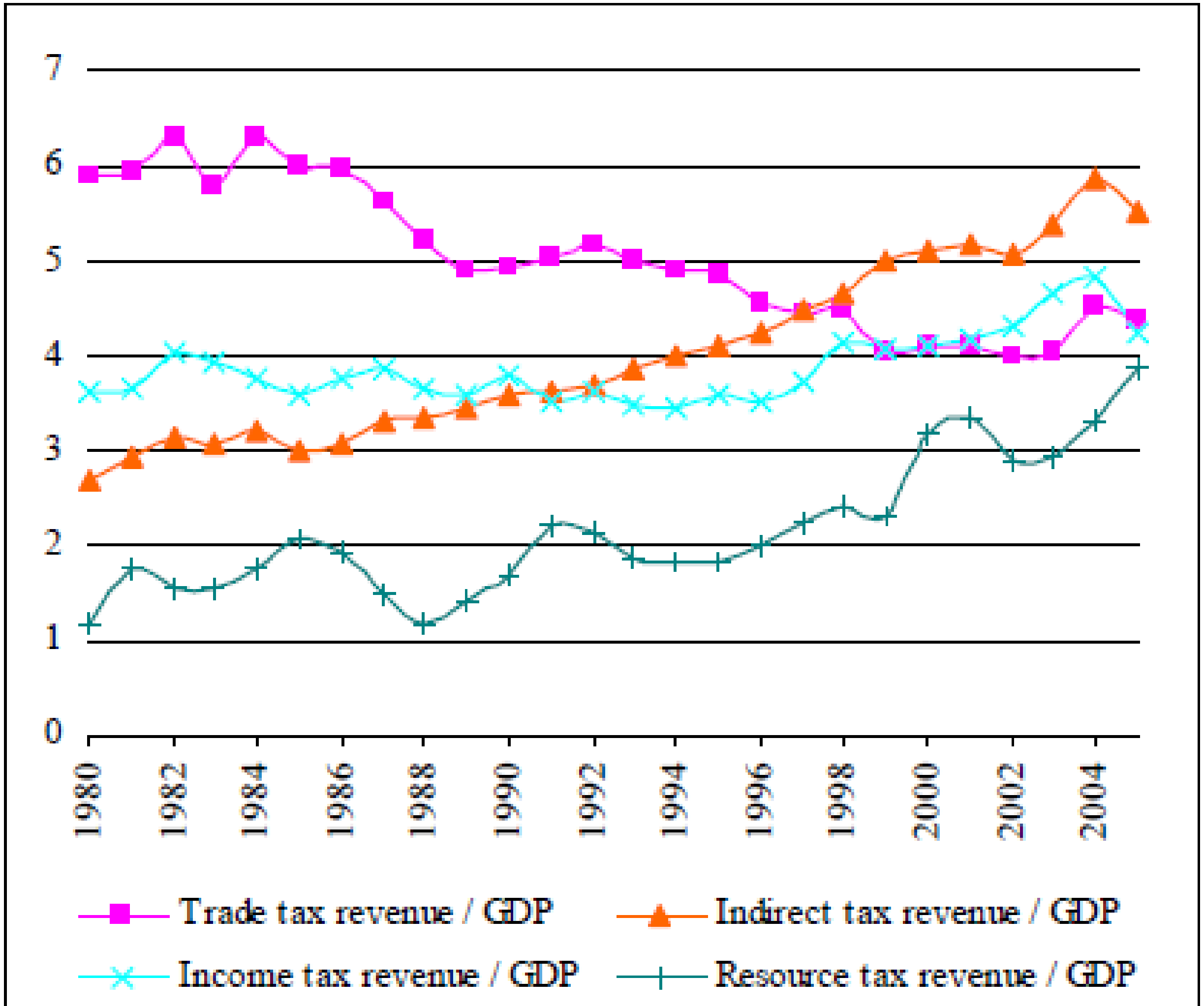
The issues

1. Need for enhanced tax revenue in SSA agreed by all: benefits include macroeconomic stability, debt service, infrastructure provision and poverty reduction; marginal impact on growth.
2. Impressive progress on indirect taxation (shift towards VAT) in SSA has only compensated for loss of external trade duties; while resource taxes are rising they are problematic.
3. Very low direct tax (personal and corporate): top decile of households in SSA have about 35% of consumption (and thus up to 50% of pre-tax income) but income tax yield is only 4% of GDP

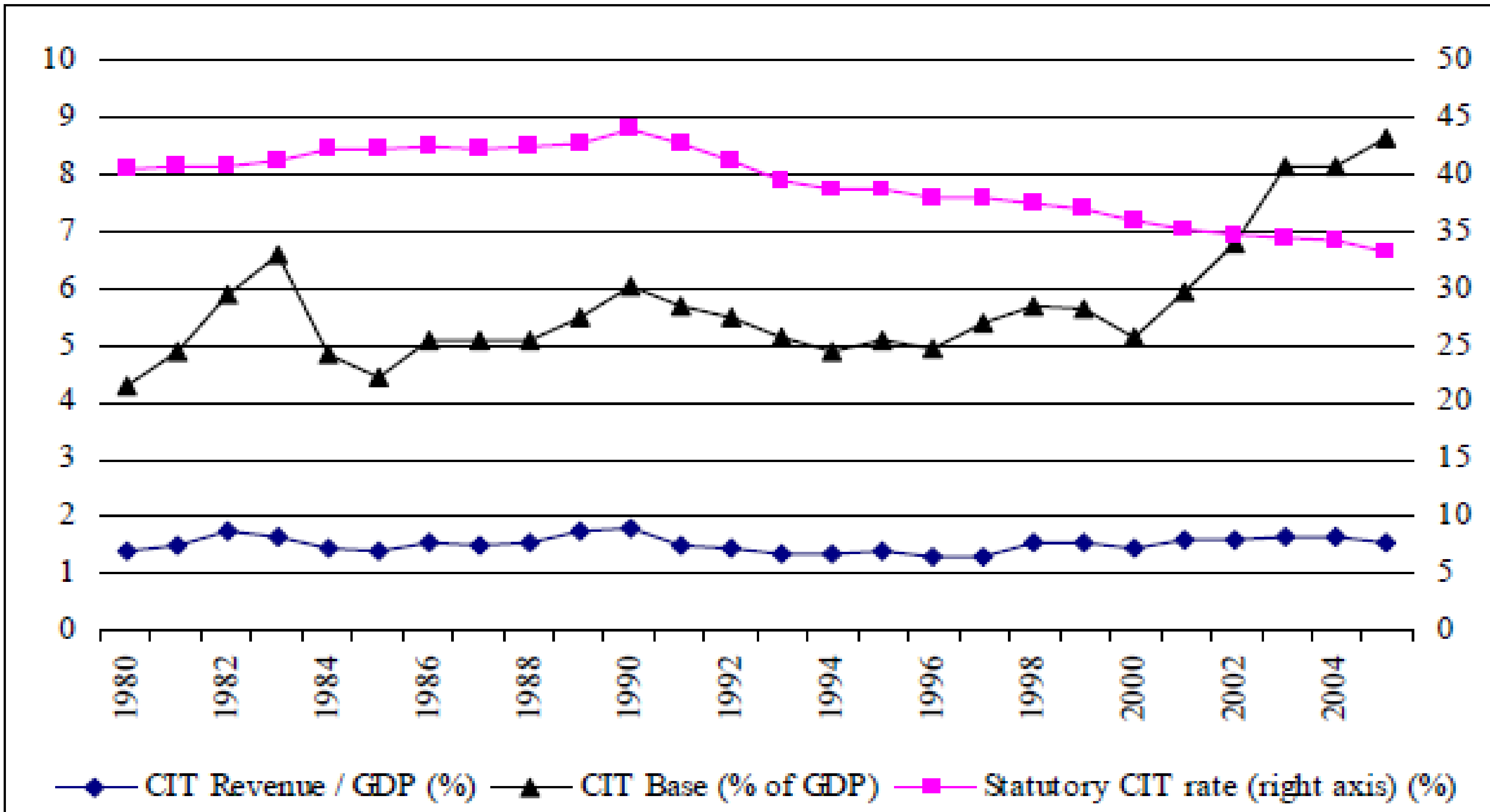
Figure 1: **Composition of the Tax/GDP Ratio in SSA, 1980–2005 (IMF 2009)**



Why CIT is so low

- though CIT/GDP has not declined despite lower rates (improved collection, not Laffer); the implicit *base* (8% of GDP) is still very low by international standards
- Three reasons for this:
  - Informalisation of the domestic economy (no registers of income, activity, property); lack of administrative capacity; and corruption...
  - Tax expenditures on incentives to investment designed to stimulate growth despite no evidence for this; also cause harmful tax competition between neighbours.
  - Capital is internationally mobile (profit shifting). Textbook says tax only immobile factors: but property taxes difficult (old cadastres, weak municipalities, communal land etc).

Figure 2: **CIT Rates and Nonresource CIT Revenues in SSA, 1980–2005 (IMF 2009)**



The problem

- Profits easily be shifted internationally due to disconnected tax/accounting jurisdictions.
- Foreign corporations reduce domestic tax liability as part of global “tax planning”
- SSA domestic wealth holders hold large undeclared assets overseas ($300 bn +)
- Large loss of potential tax revenue to SSA ($10bn + a year) and lack of transparency

The solution

- Tax cooperation between *all* jurisdictions should support the emerging global financial architecture – not just within the OECD
- International tax models should be equitable between levels of development; through DTTS and full information exchange
- Development cooperation should be redefined as a *fiscal* relationship involving tax revenue sharing and budgetary support

Recent steps to improve cooperation

- UN International Tax Committee efforts to improve information exchange are limited; but do emphasise mutual debt collection
- OECD and EC increasing cooperation; taking first steps towards automatic information exchange, withholding taxes and OFC transparency
- But these measures do not (yet) include developing countries – even those of G20; who have a great deal to gain (over $200bn a year).

Systems for information exchange rather than tax harmonisation

- Key issue: give developing country tax authorities information on residents’ assets abroad plus country-by-country accounts of MNCs
- In essence, this would involve building on the OECD system, adding lessons from the US and EC systems, and extending it southwards.
- Tax harmonisation to prevent a “race to the bottom” is best pursued regionally; but sharing of revenue should be redistributive north-south

UK Government on international tax and development cooperation

- DFID 2009 *White Paper* p 32:
  - 2.48 There is increasing concern that tax systems in developing countries are undermined by international banking secrecy, including in tax havens. ... the UK will work to ensure that ... developing countries to benefit from the new co-operative tax environment.
  - 2.51 In addition the Government is discussing with its international partners whether ... country by- country reporting of tax payments, could offer an effective and suitable means of advancing the tax transparency agenda.

A new development finance paradigm?

- There is no appetite for a global development tax, Tobin or otherwise; proposed “bank tax” will be to insure G20 banks
- Tax cooperation allows for shared fiscal responsibility; towards a model similar to that within (say) a federal state, or indeed the EU
- Redistribution of income from overseas assets should reduce aid dependency and strengthen social contract (citizenship)

appendix

Table 1. CIT Rates and Nonresource CIT Revenues in SSA, by Income Level and Resource Status, 1980–2005 (Simple Averages)

	1980	1990	2000	2005
Low income				
Corporate tax rate (%)	45.3	46.0	37.2	33.8
Non-resource CIT revenue / GDP (%)	1.3	1.6	1.5	1.4
Implicit tax base (% of GDP)	3.1	3.7	3.9	4.1
Lower-middle-income				
Corporate tax rate (%)	39.0	39.2	36.2	31.7
Non-resource CIT revenue / GDP (%)	1.4	2.8	1.9	2.3
Implicit tax base (% of GDP)	3.8	4.9	4.6	6.5
Upper-middle-income				
Corporate tax rate (%)	37.3	39.2	30.0	31.5
Non-resource CIT revenue / GDP (%)	1.9	2.0	1.0	1.7
Implicit tax base (% of GDP)	6.0	9.2	8.1	14.8
Resource countries				
Corporate tax rate (%)	40.0	41.9	35.7	35.4
Non-resource CIT revenue / GDP (%)	1.6	2.3	1.7	1.7
Implicit tax base (% of GDP)	4.5	7.0	5.5	9.0
All SSA countries				
Corporate tax rate (%)	40.4	44.0	36.0	33.2
Non-resource CIT revenue / GDP (%)	1.4	1.8	1.5	1.5
Implicit tax base (% of GDP)	4.3	6.0	5.1	8.6

Some further reading

Ajayi, S. I. (1997) An Analysis of External Debt and Capital Flight in the Severely Indebted Low Income Countries of Sub-Saharan Africa *IMF Working Paper No. 97/68* Washington DC: International Monetary Fund

DFID (2009) *DFID White Paper 2009: Eliminating World Poverty: Building our Common Future* London: HM Department for International Development

FitzGerald, V., 'International tax cooperation and capital mobility', *CEPAL Review no. 77* (August 2002), pp. 65-78.

High-level Panel on Financing for Development (2001) *Report* New York: United Nations

Keen, M and M Mansouri (2009) Revenue Mobilization in Sub-Saharan Africa: Challenges from Globalization *IMF Working Paper WP/09/157* Washington DC: International Monetary Fund

Keen, M. and Ligthart, J.E., 'Information sharing and international taxation: a primer', International Tax and Public Finance, vol. 13, no. 1 (January 2006), pp. 81-110.

Ndikumana, L and J K Boyce (2008) New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options *Department of Economics and Political Economy Research Institute Working Papers Series 166* University of Massachusetts, Amherst

Norway (2009) *Tax havens and development Status, analyses and measures* Report from the Government Commission on Capital Flight from Poor Countries. Oslo: Ministry of Environment and International Development

OECD (1997) *Model Double Taxation Convention on Income and Capital* Paris: OECD

OECD (1998) *Harmful Tax Competition: an Emerging Global Issue* Paris: Organization for Economic Cooperation and Development

OECD (2010) *Promoting Transparency and Exchange of Information for Tax Purposes* Paris: Organization for Economic Cooperation and Development

Tanzi, V. and H.H. Zee (1999) 'Taxation in a Borderless World: the role of information exchange' in B. Wiman ed *International Studies in Taxation* The Hague: Kluwer Law International

UN (2000) *Revised United Nations Model Double Taxation Convention between Developed and Developing Countries* New York: United Nations

UNCTAD (1995) *Incentives and Foreign Direct Investment,* Geneva: United Nations Conference on Trade and Development.

Estimating lost tax

The tax base (*Y*) is composed of two components

- The unregistered ('illicit') outflows of profits ('capital flight') in any one year (*F*)
- The undeclared annual income (*R*) from overseas assets (*X*) held by residents

Flows (F) and stocks (X) are clearly related, but stocks are not a simple sum of past flows because

- Only a fraction (*a*) of the flows (*F*) are attributable to residents and thus enter into the stock (*X*)
- The accumulated asset value (*X*) should also take into account the reinvested portion (*b*) of earnings (*R*), net of tax, inflation etc

The estimation formula

- The potential tax revenue (*T*) from this tax base (*Y*) depends therefore on the rate of return (*r*) on overseas assets (*R = rX*) and the effective corporate or income tax rate (*t*) applicable after incentives, deductions etc.

[illegible]

[illegible]

The OECD sums up the current state of knowledge as:

20. Offshore financial centres, broadly defined, reduce revenue available to developing countries where they act as a destination for income streams and wealth protected by a lack of transparency and show a refusal or inability to exchange information with revenue authorities who may have taxing rights in respect of that income or those assets. Data on revenues lost by developing countries from offshore non compliance is unreliable. Most estimates, however, exceed by some distance the level of aid received by developing countries—around USD 100 billion annually. (OECD 2010, p. 6)