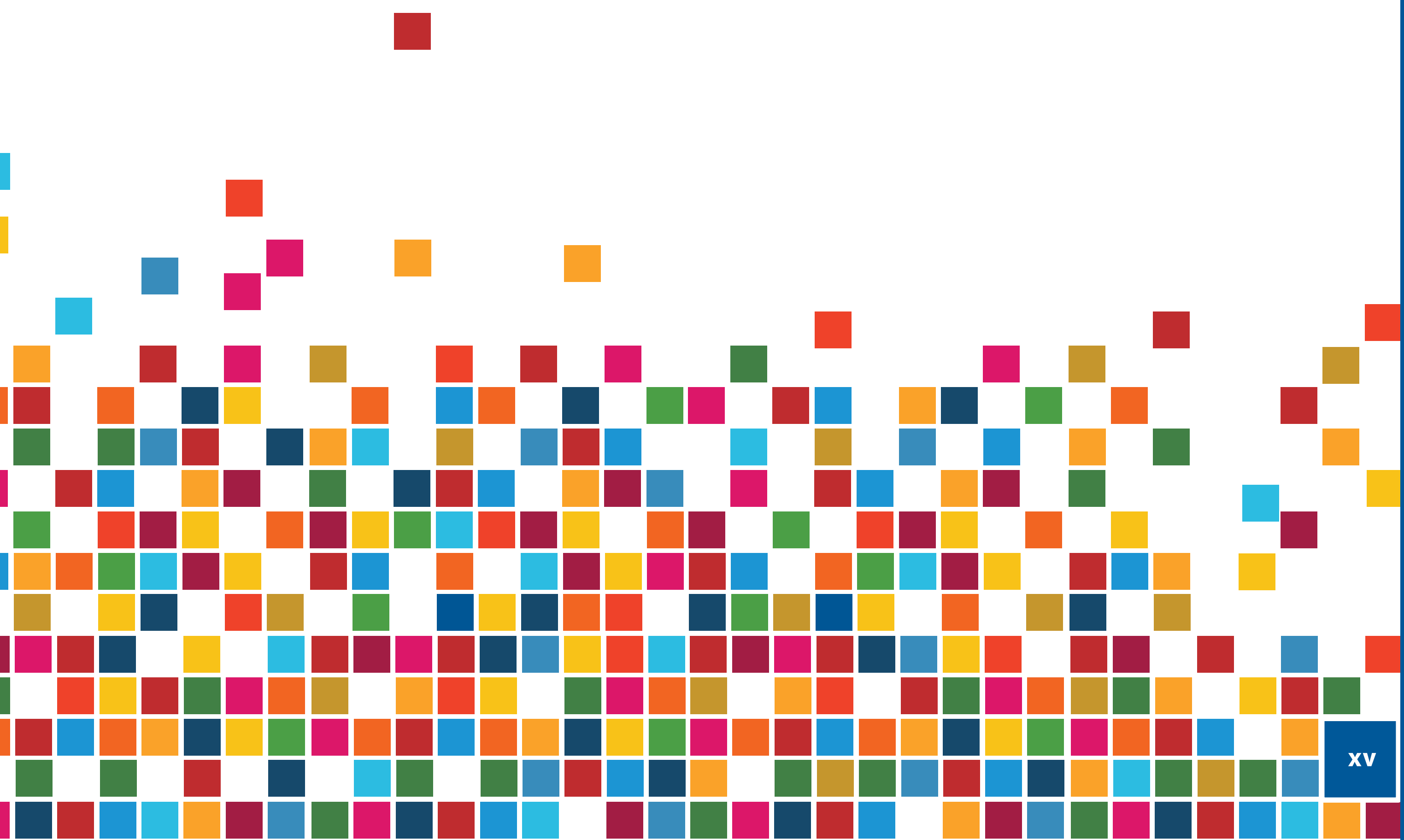
# EXECUTIVE SUMMARY



# BACKGROUND

Transitioning to the Africa we want is within our reach. Africa is making steady progress in building the critical ingredients for sustainable and resilient societies, but progress towards achieving the Sustainable Development Goals (SDGs) is slow and uneven across the continent. Access to basic infrastructure such as energy, water and sanitation services is improving but falls well below the global average.

Effective implementation of Agenda 2063 and the 2030 Agenda for Sustainable Development requires African countries to scale up investments in science, technology and innovation to promote rapid and inclusive growth. The costs of these investments are enormous and require increased resource mobilization.

The Addis Ababa Action Agenda of 2015 provides a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities. It recognizes the importance of domestic public resources, supplemented by international assistance, in attaining sustainable development and achieving the SDGs. However, despite the numerous fiscal reforms undertaken by many African countries since 2000, government revenue as a share of GDP (21.4 per cent in 2018) remains low relative to the continent's potential and the financial resources needed to achieve national development aspirations. African countries can boost the government revenue by 12–20 per cent of GDP by implementing countercyclical fiscal policy, taxing hard to reach sectors, tapping non-tax revenue, introducing e-taxation and fighting tax evasion and avoidance, particularly in the natural resources sector.

The financing needs across the continent to meet the SDGs are huge, and the financing gap is wide. Estimates of the financing needs range from $614 billion to $638 billion a year (UNCTAD, 2014). Africa's annual financing needs for infrastructure, food security, health, education and climate change mitigation alone are estimated at $210 billion (UNCTAD, 2014). To narrow the financing gap, African countries need to enhance domestic resource mobilization, and that requires sustained improvement in the efficiency and efficacy of fiscal policy.

This Report provides an evidence-based assessment of the nature and performance of fiscal policy in Africa. It analyses both challenges and opportunities and identifies best practices in order to draw policy recommendations and facilitate exchange of experiences. This can help member states to undertake necessary fiscal policy reforms and improve macroeconomic management.

The Report addresses critical questions of fiscal policy and financing of the SDGs in Africa. These include the nature and role of fiscal policy; the potential of fiscal policy, including tax and non-tax revenue, to enhance domestic resource mobilization; and the role of fiscal policy in macroeconomic management and achievement of the SDGs. The Report examines the key opportunities as well as the challenges in making fiscal policy more effective and efficient and offers policy lessons and recommendations to inform fiscal policy reforms in Africa.

Data for the Report's analysis include secondary sources and primary data and information collected from 12 African countries (Angola, Benin, Chad, Ethiopia, Ghana, Kenya, Mauritius, Mauritania, Mozambique, South Africa, Sudan and Zimbabwe).

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The number of countries included in the analysis of each issue depends on data availability. While the intention was to cover as many countries as possible, for some topics coverage is limited to a handful of countries with adequate data.

# KEY FINDINGS

## GLOBAL ECONOMIC GROWTH AND FAVOURABLE DOMESTIC CONDITIONS UNDERPINNED AFRICA'S ECONOMIC PERFORMANCE, BUT PROGRESS ON SOCIAL DEVELOPMENT HAS BEEN SLOW

Economic growth in Africa, which moderated from 3.4 per cent in 2017 to 3.2 per cent in 2018, was supported largely by solid global growth, a moderate increase in commodity prices and favourable domestic conditions. In some of Africa's largest economies—South Africa, Angola and Nigeria—growth trended upwards but remains vulnerable to shifts in commodity prices. At the subregional level East Africa remains the fastest growing, at 6.1 per cent in 2017 and 6.2 per cent in 2018. West Africa's economy expanded by 3.2 per cent in 2018, up from 2.4 per cent in 2017, while Central, North and Southern Africa's economies grew at a slower pace in 2018 compared to 2017.

Although domestic demand, public investments and stronger trade between Africa and global markets supported growth, commodities remain a key driver of growth in Africa, exposing economies to commodity price volatility. Consequently, although the macroeconomic stance for African countries improved in 2018, with narrower fiscal and current account deficits, stable exchange rates and lower inflation, revenue streams have narrowed since the commodity price shocks of 2014, leading to higher debt levels as countries increased borrowing to ease fiscal pressures.

Africa has made notable progress in education, health and other social outcomes. Progress in poverty reduction has been steady. The poverty rate dropped from 54.3 per cent in 1990 to 36 per cent in 2016. However, the pace of poverty reduction is also slow, and inclusive growth—leaving no one behind—remains elusive. The poverty gap, which measures the depth of poverty, remains high, at 15.2 per cent against a global average of 8.8 per cent, partly because of high income-related inequities in access to public services. Income inequality is also high, at 0.44, measured by the Gini coefficient, despite being on the decline. Unemployment stood at just above 7 per cent in 2017 and is projected to remain there in 2019 as countries intensify efforts to diversify their economies.

## FISCAL POLICY CAN BE AN ANCHOR FOR MACROECONOMIC STABILITY AND A KEY TOOL FOR ACHIEVING THE SUSTAINABLE DEVELOPMENT GOALS

While growth is projected to pick up in the medium term, current growth rates are not adequate to eradicate poverty or achieve the other SDGs in Africa. Accelerating growth is necessary to achieve the SDGs, but it is not enough.

African governments need to harness the fiscal policy instruments at their disposal to accelerate

efforts to achieve the SDGs. That means rethinking fiscal frameworks and directing them towards the achievement of the SDGs, as well as towards rebuilding fiscal space. Recalibrating fiscal policy could increase revenue collection. That includes taking business cycles into account in implementing fiscal policy to avoid the adverse impacts for macroeconomic stability that come with ignoring the business cycle. The Report finds that countries that adopt a countercyclical fiscal policy could increase government revenue by 5 per cent of GDP.

## CORPORATE TAX REDUCTIONS OFFER LITTLE INCENTIVE FOR INVESTMENTS

For African countries, lowering taxes does not significantly influence investment. The Report finds that to achieve a 1 percent increase in total investment, governments could lose up to 20 per cent in tax revenue. African countries should thus avoid joining the race to the bottom and lowering taxes to attract foreign investment, since the gains will be much smaller than the revenue loss.

In contrast, fiscal policy is vital for "crowding in" private investment in Africa, which has a significant effect on real GDP per capita. In the long run a 1 per cent increase in private investment could boost GDP per capita by up to 1.6 per cent.

Fiscal policy can speed up economic diversification and accelerate structural transformation in Africa, since government consumption has the second largest impact on manufacturing value added. In light of that knowledge, governments need to revisit their spending plans so that they boost domestic demand for manufactured products. Full implementation of the African Continental Free Trade Agreement will also increase investment in Africa.

## INDIRECT TAXES HAVE BEEN THE MAIN SOURCE OF TAX REVENUE

African economies have large informal sectors, which for the most part function outside the tax net. It is difficult to identify economic agents in the informal sector and ensure that they are appropriately taxed. Consequently, to reach them, governments rely mainly on indirect taxes such as consumption taxes, which generate more than 60 per cent of tax revenue. Realigning fiscal instruments to capture the large informal economy could increase revenue collection.

Taxing hard to reach sectors, improving governance in revenue collection and bolstering accountability would greatly reduce inefficiencies and mobilize up to $99 billion a year over the next five years.

## IMPROVING THE EFFICIENCY OF REVENUE COLLECTION COULD GREATLY INCREASE NON-TAX REVENUE

Non-tax revenue is another untapped source of revenue that could expand fiscal space in a majority of African countries. Sources of non-tax revenue include grants, property rents, fees and other miscellaneous sources. However, political capture is often an impediment to non-tax revenue collection, especially for property rents. Improving governance frameworks and actively monitoring non-tax revenue could increase revenue by as much as 2 per cent of GDP.

## LEVERAGING THE USE OF INFORMATION TECHNOLOGY COULD TIGHTEN COMPLIANCE AND LOWER ADMINISTRATIVE COSTS

Tax administration reforms have been among the most successful fiscal reforms in Africa over the last two decades. Setting up semi-autonomous tax authorities, mainly in Anglophone countries, and leveraging the use of information technology have improved compliance, lowered the costs of compliance and tax collection and widened the tax base. The potential gains are substantial. Rwanda increased revenue by 6 per cent of GDP by introducing e-taxation, while in South Africa e-taxation reduced compliance costs by 22.4 per cent and lowered the time to comply with the value-added tax by 21.8 per cent.

### BASE EROSION AND PROFIT SHIFTING ARE MAJOR SOURCES OF REVENUE LEAKS

Eliminating base erosion and profit shifting could boost tax revenue in Africa by an estimated 2.7 per cent of GDP. The main avenues of tax evasion and avoidance in the natural resources sector in Africa highlighted in the Report are the use of non-strategic tax incentives, loopholes in double-taxation agreements, difficulties in applying the arm's length principle effectively in regulating intra-company transactions, inclusion of fiscal stability clauses in contracts and a lack of coordination and information sharing among government agencies.

The Report also examines the relationship between fiscal policy and debt sustainability in Africa. It disaggregates external and domestic debt by instrument, creditors and debtors and assesses governments' cash-flow constraints, unsustainable debt levels and factors influencing fiscal sustainability and debt management.

The rise in government debt and in the vulnerability of fiscal policy in Africa has exposed governments on the margins of solvency to debt difficulties, including debt servicing challenges. Rebalancing fiscal and policy frameworks will be important for maintaining stable revenue and spending flows in the economy and sustaining policies for achieving the SDGs.

Finally, the Report highlights major gaps in fiscal data that limit analysis of country experiences and comparisons across countries and regions. It calls on African countries to address these gaps and improve access to data.

## KEY POLICY RECOMMENDATIONS

The Report argues that **African countries can increase government revenue by 12–20 per cent of GDP** by adopting a policy framework to strengthen revenue mobilization in six key areas:

- **Fiscal policy options.** Anchoring fiscal policy to national medium-term financing strategies could allow African countries to leverage the full potential of all government revenue—tax and non-tax—for accelerated and sustained growth underpinned by macroeconomic stability.

  To safeguard macroeconomic stability, countries must align fiscal policy with the business cycle, improving revenue mobilization and reducing spending to curb supply-side pressures, while lowering taxes and increasing spending when economic activity slows.

- **Tax policy options.** African governments must widen the tax base by bringing hard to tax sectors into the tax net, including agriculture, the informal economy, the digital economy and the natural resources sector. Countries must reassess tax incentives and drop those that do not serve the intended purpose. Limiting the use of tax incentives in the agricultural and natural resources sectors could stem tax leakages and enhance revenue collection.

- **Non-tax revenue options.** Investing in better data collection methods and implementation could strengthen monitoring of non-tax revenue collection and non-reporting. Non-tax revenue collection can be enhanced by establishing strong institutions with high levels of expertise, building new infrastructure and establishing effective coordination between central and local governments.

- **Tax administration options.** Reforming tax administration systems through digitization and

other information technologies could increase revenue mobilization. Countries that have digitized their tax administration have increased compliance rates and saved on compliance costs. The rollout of digital technologies needs to be accompanied by capacity building for policy makers and tax collectors on how to take advantage of data generated through digitization for more efficient assessments.

- **Policy options for the natural resources sector.** African countries should strengthen their oversight of the natural resources sector. They could consider a more equitable and less administratively challenging approach to assessing what share of multinational corporations' profits to tax (for example, based on the share of sales or other variables), or they could base taxes on variables that are harder to manipulate than corporate income. At the same time, governments need to close loopholes to thwart base erosion and profit shifting.

- **Debt policy options.** The new dynamics of public debt in Africa call for adapting debt sustainability strategies and frameworks to current debt portfolios. That includes improving revenue mobilization to enhance debt servicing and reduce long-term borrowing. The Report calls for better debt management strategies underpinned by increased deepening of domestic capital markets and reliance on local currency–denominated debt instruments.

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