United Nations
Economic Commission for Africa

ECA POLICY BRIEF

Fiscal policy for increased revenue generation and financing of sustainable development in Africa

I. Introduction

During the past two decades, African countries have made notable progress in mobilizing domestic resources to finance their endeavours to achieve the Sustainable Development Goals of the United Nations 2030 Agenda for Sustainable Development. Despite the fiscal reforms that many of them have undertaken since 2000, government revenue remains low (21.4 per cent of gross domestic product (GDP)), compared with the continent's potential and the financial resources needed to achieve their national development aspirations. Africa has an average tax revenue to GDP below 16 per cent, which is lower than global norms, but efficient and effective domestic resource mobilization could increase fiscal space and resolve a substantial portion of this financing shortfall.

The incremental financing needs for Africa to achieve the Sustainable Development Goals are huge, with estimates ranging from $614 billion to $638 billion annually from 2015 to 2030. The annual financing needs are particularly high in low-income countries and lower-middle-income countries, at as much as $1.2 trillion (approximately 11 per cent of GDP) for the same period. To bridge this financing gap, African countries need to enhance domestic resource mobilization, which requires a sustained improvement in the efficiency and efficacy of fiscal policy.

This policy brief provides an assessment of the state of fiscal policy in Africa, identifying key areas through which Governments can strengthen revenue mobilization, and presents the associated policy recommendations.[1]

II. Fiscal policy stance and opportunities in Africa

African countries must scale up investment in science, technology and innovation to promote rapid and inclusive growth – a prerequisite for the effective implementation of the 2030 Agenda for Sustainable Development and the African Union's Agenda 2063.

Despite increasing diversification of the sources of growth, commodities remain a key driver of growth in Africa. Since the commodity price shocks of 2014, however, revenue streams have narrowed, which has led to higher debt levels, as countries increased borrowing to ease their fiscal pressures. Prior to 2014, the total government revenue to GDP ratio in Africa was higher in oil-exporting countries than in oil-importing countries. During the period 2014–2016, revenue declined in both groups, but they declined more in oil-exporting countries, falling by some 5 per cent of GDP.

Public debt dynamics call for the adoption of debt sustainability strategies and frameworks through improved and effective debt management strategies, underpinned by increased deepening of domestic

1 This policy brief draws extensively on the ***Economic Report on Africa 2019: Fiscal Policy for Financing Sustainable Development in Africa*** (United Nations publication, Sales No. E.19. II.K.2).

capital markets and reliance on local currency-denominated debt instruments.

African countries have the potential to increase their revenue by 12–20 per cent of GDP, through the adoption of a policy framework that could strengthen revenue mobilization. They have vast untapped potential to enhance the role of fiscal policy, as an anchor for macroeconomic stability and a key tool for achieving sustainable growth and development.

For African countries to increase their revenue, they need to rebuild their fiscal frameworks and implement countercyclical fiscal policies that can create fiscal space and avoid the adverse effects of macroeconomic instability. Fiscal policy should also be anchored to national medium-term strategies, to allow countries to leverage the full potential of government revenue to accelerate and sustain growth, underpinned by macroeconomic stability.

African countries should avoid joining the race to the bottom and lowering taxes to attract foreign investment: a 1 per cent increase in total investment leads to a loss of up to 20 per cent in tax revenue. In contrast, an effective fiscal policy would crowd-in investment that could have significant impacts on per capita GDP, and also speed up economic diversification and accelerate structural transformation.

Indirect taxes, including consumption taxes, account for more than 60 per cent of total tax revenue in Africa, and realigning fiscal instruments to capture the hard-to-reach sectors, such as the large informal sector, could increase the countries' revenue collection. Countries should reassess their tax incentives and remove those that do not serve the intended purpose, and limit the use of incentives to sectors where they could be more viable and appropriate.

One of the untapped sources of revenue that could expand fiscal space in a majority of African countries is non-tax revenue (including grants, property rents, fees and other miscellaneous sources), which could be significantly increased through improved efficiency in revenue collection. Political capture, however, has often been an impediment to non-tax revenue collection in Africa, especially for property rents. Tapping non-tax revenue sources can be strengthened by creating strong institutions with high levels of expertise, building new infrastructure and establishing effective coordination between central and local governments. These should be coupled with an improved tax administration through introducing e-taxation and by curbing tax evasion and avoidance, especially in the natural resources sector.

Information and communication technologies proliferate on the continent, which gives rise to enormous opportunities for efficient fiscal policy management. Reforming tax administration systems through digitization and other information technologies could play a significant role in that regard. This could improve compliance, lower administrative costs, and widen the tax base for African countries. Countries that have digitized their tax administration have increased compliance rates and saved on compliance costs, with substantial potential gains. For example, in Rwanda, the Government increased its revenue by 6 per cent of GDP through the introduction of e-taxation, while in South Africa, its e-taxation initiative reduced compliance costs by 22.2 per cent and lowered the time to comply with the value added tax by 21.8 per cent.

Eliminating base erosion and profit shifting, which are major sources of revenue leaks in most African countries, is estimated to boost tax revenue by 2.7 per cent of GDP. 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), the inclusion of fiscal stability clauses in contracts, and the lack of coordination and information-sharing among government agencies, are the main avenues of tax evasion and avoidance in a majority of countries, especially through the natural resources sector. Governments need to close these loopholes to thwart base erosion and profit shifting.

Furthermore, rising government debt and the vulnerability of fiscal policy have exposed Governments on the margins of solvency to debt difficulties, including debt-servicing challenges. Accordingly, rebalancing fiscal and debt policy frameworks will be important in maintaining stable revenue and expenditure flows in the economy, and sustaining policies that will help countries to achieve the Sustainable Development Goals and Agenda 2063 goals.

A comprehensive structural shift in fiscal policy that encompasses the adoption of appropriate fiscal policy, tax administration and tax policy, in addition to ensuring sustainable debt management, could benefit African countries by strengthening macroeconomic stability and enhancing sustainable development, as these have the potential to increase government revenue (see the figure).

III. Conclusion

In the light of the above discussion, the following recommendations are given:

a. The changes in global financial markets and the global economy mean that African countries need to look inward for financing, especially through prudent fiscal policy.

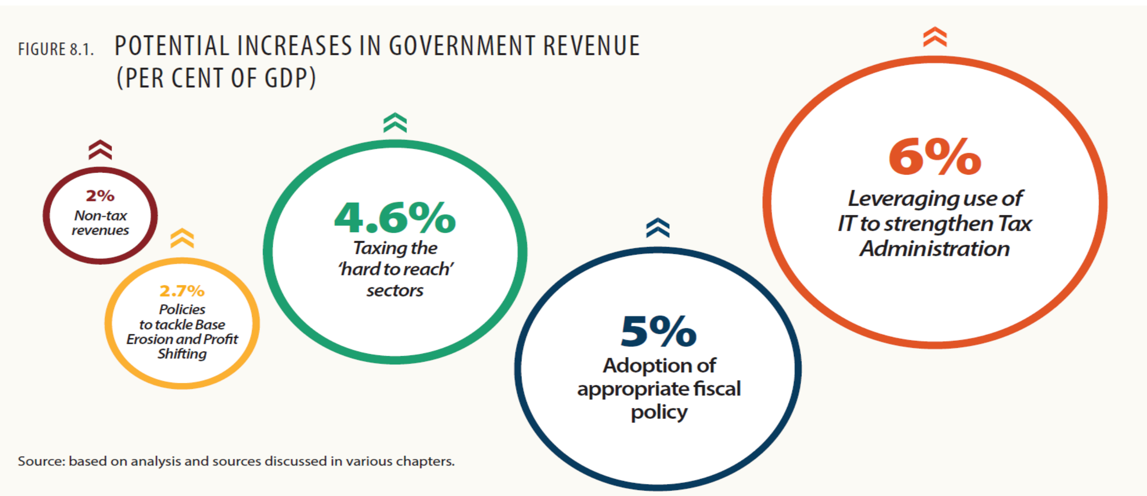
b. Countries should coordinate fiscal and monetary policy, which is vital because both tools must work together as stabilizers if they are to be effective in achieving the triple goals of growth, employment and stability.

c. Taxation and spending must take the business cycle into account. It will be imperative for countries to understand the sources of revenue and how they can ramp up their revenue collections to support development.

d. Countries will need to achieve a fine balance between raising revenue and incentivizing investment.

e. Countries should be made aware that fiscal policy has the potential to reduce social inequities by decreasing poverty and inequality. By advancing long-term growth and development, fiscal policy can help countries to achieve the goals set out in the 2030 Agenda for Sustainable Development and Agenda 2063.

Potential increases in government revenue (per cent of GDP)



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