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Towards a Framework for Assessing and Reporting Tax Expenditures in Africa

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ideas for a prosperous Africa
Ideas to Action

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Context

- In the current context of narrowed fiscal space, African governments face:
  - Immense pressure to ensure robust economic growth and raise sufficient revenue to finance country priorities.
  - Tension between the need to grow domestic revenues while trying to attract investment (especially FDI) through offering tax incentives.
- Tax incentives cost governments money in terms of lost revenues. Their Cost are referred to **as tax expenditures**, which was the focus of the ECA-EGRII report.
- **The main objectives of EGRII**:
  - Equipping tax officials and practitioners with tools to define, cost and report on tax expenditures and implement potential reforms for enhanced DRM.
  - Assessing the governance of tax expenditure in Africa and provide guidance for effective governance framework for tax expenditures.

Methodology

- The approach used in EGR II entailed the following:
  - Technical preparation of the methodology for measurement of tax expenditures, including definition of benchmark systems for the two selected tax types - the CIT and VAT;
  - Collection of data in 10 selected countries across four sub-regions of the continent (Eastern North, Southern, and West Africa); and
  - Estimation of relevant tax expenditures, as deviations of tax provisions from the benchmarks.
- National consultants were recruited to work with selected countries' revenue authorities under the regular oversight of the ECA-ATAF technical team to:
  - Define benchmarks (to establish a reference tax system against which deviations were compared)
  - Catalogue tax expenditure provisions, collect relevant data,, carry out relevant estimation using the revenue-forgone approach and producing country reports.

Key findings-Governance gaps

- Significant number of Tax expenditures provided under arbitrary and discretionary circumstances outside the country’s tax laws- potential tax revenue leakages.

- High prevalence of tax incentives not backed by costs-benefits analyses.

- Significant gaps in frequency of collection and public reporting of tax expenditures,

- Insufficient skilled human resource and financial resources, as well as institutional frameworks to facilitate regular monitoring, evaluation and reporting on tax expenditures.

Key findings-magnitudes of TEs

Country	Total Number of TEs (CIT &VAT)	Total number of TEs with cost estimated	TEs with cost estimated (% of Total TEs)	VAT-related TE		CIT-related TE	
				As a % of Total revenue	As a % of GDP	As a % of Total revenue	As a % of GDP
Benin	97	59	61%	11.70%	1.30%	1.60%	0.01%
Burkina Faso	131	109	83%	1.48%	0.23%	2.46%	0.39%
Ghana	32	24	75%	3.77%	0.52%	1.91%	0.26%
Kenya	5,225	5,223	100%	20.90%	2.69%	4.04%	0.52%
Mauritius	121	106	88%	27.45%	6.21%	7.26%	1.64%
Morocco	130	86	66%	0.13%	0.03%	1.67%	0.32%
South Africa	68	15	22%	5.43%	1.19%	0.26%	0.06%
Tanzania	181	79	44%	6.11%	0.86%	0.02%	0.00%
Uganda	102	27	26%	3.46%	0.45%	1.47%	0.19%
Zambia	66	38	58%	68.70%	13.50%	7.78%	1.53%

Key findings-TEs relative to key spending categories

	Education expenditures	Total imports bill	Total Interest payments	Total Govt cash payments
Mauritius	Almost double the education expenditures	18%	More than 3 times of total interest payments	More than 1/4
Morocco	1/3rd	4%	More than 60%	6%
Sooth Africa	1/4	6%	1/3	Almost 50%
Tunisia	1/4	6%	Not available	Not available
Uganda	40%	3%	1/3	5%
Zambia	More than 4 times	Almost 50%	Almost double	Almost 60%
Ghana	1/5	4%	12%	4%
Kenya	Almost 3/4	Almost 1/5	Almost 90%	Almost 1/4
Burkina Faso	Almost 1/4	2%	Almost 50%	4%
Benin	Almost 1/2	5%	Not available	Not available
Tanzania	Almost 1/4	6%	Not available	Not available

Towards a framework for effective governance of TEs in Africa

Function	Procedure
Organization of TE by host government agency	• Establish a central tax expenditure unit • Identify and articulate need • Define purpose (clear objectives and intended outcomes) • Specify the target tax base • Estimate duration • Require clearance by head of agency
Design of TEs	• Analyze evidence base to support design decisions • Clearly spell out smart objectives and outcomes • Appraise options, including cost of tax expenditures • Submit to head of unit and ministry of finance • Include in finance bill and present to parliament
Oversight and enactment of TE provisions	• Fiscal officials to present finance bill • Parliament to deliberate on tax policy • Scrutinize tax expenditures for cost, value for money, governance arrangements and sunset provisions • Decide tax expenditure • Enact tax expenditure law
Administration and monitoring	• Host agency ensures the costs and benefits are monitored, assessed and reported annually in line with a budget cycle • Manage the process for executing expenditure • Assess the risks, manage and mitigate • Report to the tax expenditure unit
Evaluation and feedback	• Deploy the system to evaluate the costs and benefits • Compile feedback of evaluation • Share and engage with host agency to inform changes and knowledge base for design of future tax expenditures • Prepare brief for parliament (as part of finance bill)

Key conclusions

- Only TEs under CIT and VAT were identified and analyzed in ten African countries. Also, only a small portion of TEs were costed due to data constraints.
- Therefore, the real total cost of tax expenditures is larger than what is reported under EGRII.
- TEs being provided under arbitrary and discretionary practices outside the country's tax laws and central administration system are susceptible to corruption and leakages of public revenues.
- Lack of centralization in the governance of TEs results in ineffective analyses, reporting, oversight and scrutiny of total tax expenditures.
- Tax expenditures are not subjected to the same budgetary control procedures as direct budgetary spending.
- Data availability and institutional capacity need significant improvements.

Selected recommendations

- Strengthen data landscape for regular TEs analysis and reporting.
- TEs provision and reporting should be made part of regular budget reporting, similar to the direct budget spending programmes.
- African countries should revisit their tax incentives policies, including:
  - ❖ Careful assessment of the cost (where possible-benefits) of different tax incentives provisions,
  - ❖ Establishing transparent and robust framework for TE provision, and effective monitoring and reporting of TEs and their respective policy objectives.
  - ❖ Sound legislative and regulatory framework surrounding the management of TEs.

The governance structure for TE should entail:

- The Ministry of Finance as the overseer of the overall governance of TEs,
- Engagement of the legislature and representation from other ministries, government agencies and departments concerned with TEs through a well coordinated multi-agency steering committee.

Thank you