Missed Opportunity: how could funds lost to tax incentives in Africa be used to fill the education finance gap?

Policy Brief

August 2017

Introduction

How much revenue do African governments lose from providing tax incentives, such as giving companies tax holidays and exemptions on paying taxes on import duties and value added tax? And if these precious national budget resources were set aside to fund quality, public education instead, how much greater could education spending be?

These questions are pressing today, as in sub-Saharan Africa alone, 34 million of children (including 18.6 million girls) aged 6 to 11 are out of school.[1] Millions more, receive poor quality education, with low quality of teaching, poor sanitation facilities, unsafe environments and inadequate classroom equipment, making for poor learning outcomes.[2]

Meanwhile, many of our African governments are failing to invest enough in education to ensure quality schooling for all children and are yet to meet targets they committed to internationally, of allocating 6% of GDP and 20% of total public expenditure to education. Governments need to urgently increase the size and effectiveness of their education budgets.

We believe much of the resources are already available to do this. Our research suggests that:

Governments in sub-Saharan Africa may be losing an estimated US$38.6 billion a year, or 2.4% of their GDP, to tax incentives. This is equivalent to nearly half (47%) of their current education spending. Having a much clearer pro-poor policy for granting incentives and using some of these resources to fundeducation could provide a much-needed and significant boost to education budgets across Africa.

Research findings

ActionAid Malawi, Action Mozambique and ActionAid Tanzania have led a project that analysed data from government and IMF sources for a number of sub-Saharan countries to establish how much revenue is lost as a result of granting tax incentives.

Eleven countries provided such estimates (see Table1 below), which vary from estimated tax losses of 0.1% of GDP in Sierra Leone to 7.3% in Senegal, with the average rate being 2.42%.

Sub-Saharan Africa's GDP is estimated by the World Bank as being at US$1.60 trillion in 2015.[3] Using the average of 2.42% as a proxy for revenue losses to tax incentives in all sub-Saharan countries, we estimate that **African countries could be losing US$38.6 billion annually as a result of tax incentives.**

We also examined governments' current education spending using UNESCO figures and found that the **average revenue loss to tax incentives is the equivalent of 47% of current levels of education spending** - meaning that sub-Saharan African states may lose the equivalent of nearly half their spending on education to tax incentives. This must change – our governments need to use all available resources to invest in our nations' education if we are to ensure all children, especially girls are able to access and complete a free, quality public education.

Why invest more in girls' education?

Despite significant achievements in girls' access to education with many countries achieving gender parity in primary school enrolment across the world, in 2014, 38% of African countries and 31% of low income countries had not yet achieved this goal.[4] According to UIS data, girls are more likely to remain excluded from education and in Sub-Saharan Africa 9 million girls are expected never to attend school compared to 6 million boys.[5]

Access to free, quality public education is a fundamental right of all children and one that States are legally bound to respect. Research also shows that investing in girls' education in particular also makes sound economic sense and enhances not only girls' empowerment, health and wellbeing but also the health and wellbeing of wider society.[6] However, a recent consultation by the UN Girls' Education Initiative concluded that: *'Lack of political will remains a critical obstacle to investment and action to advance girls' education' noting that 'global momentum around girls' education has not sufficiently translated into increased national budgets and donor aid for education targeting girls' education and gender equality.'*[7]

Tax expenditure and harmful tax incentives

The figures presented in Table 1 are for all tax incentives provided by governments. The most common tax incentives granted include exemptions on VAT and import duty, and corporate income tax incentives, which often benefit foreign investors. Neither governments nor the IMF tend to distinguish in their estimates between those tax incentives given to corporations (foreign or domestic) and those given to others, such as consumers. Incentives granted to corporations are especially harmful - taking more from the national budget than they return in other benefits such as job creation. And all tax forsaken to various incentives and exemptions, is too often simply a waste of potential revenues - unless focused on helping poor people or strategically promoting local business development.

What are tax incentives?

Tax incentives are a reduction in tax bills offered by a government. Tax incentives are a form of public spending, reducing our national budget to spend on other things.

Some reduction in tax bills, such as VAT, can be vital for people living in poverty, such as VAT exemptions on staple foods like flour, or essential equipment like hoes and fertiliser for small-holder farmers. ActionAid supports pro-poor incentives, especially where it helps women living in poverty and reduced gender inequality.

However, corporate tax incentives are often given to multinational companies. They can include reduced corporate tax rates, tax holidays, special economic zones, and reduced tax on goods brought into country.

Corporate tax incentives are given by government in the assumption that it attracts more foreign direct investment. However, many business surveys have found that tax incentives effectiveness is highly doubtful. Foreign companies are more attracted by other factors such as infrastructure and rule of law, which government needs to tax to create. Those investors that are attracted by tax incentives most often only stay for a very short time.

Currently many governments are giving corporate tax incentives in an untargeted, untransparent way without parliamentary oversight, for unnecessarily long time periods.

Our governments are also competing against our neighbours to offer corporate tax incentives. The logical end-result of us continuing to undercut each other is that no country collects any corporate tax, and we all end up at the bottom.

Table 1: Government/IMF estimates on revenue losses from tax incentives, and UNESCO estimates on education spending

Country	Amount of tax incentives	Education expenditure (Latest UNESCO figures for education spending as % of GDP, unless otherwise stated)	Tax revenue losses due to tax incentives as % of education spending (in latest available year)
Burkina Faso	Government, 2014[8]: FCFA 144 billion (US$287 million[9]) in 2013, amounting to around 2.3% of GDP. However, this figure was calculated on just a fraction of incentives provided. Other estimate: perhaps 5% of GDP.[10]	4.5% (2013) 4.5% (2014) 3.9% (2015)[11]	59% (using the government figure)
Cameroon	IMF, 2015[12]: 'more than' 1% of GDP. This would amount to around FCFA 168 billion[13] (US$272 million[14]) in 2015.	3.0% (2012) 3.0% (2013)[15]	33%
Cote D'Ivoire	IMF, 2016[16]: 1% of GDP (amounting to around FCFA 204 billion or US$346 million)	4.7% (2013) 4.7% (2014) 5.0% (2015)[17]	20%
Democratic Republic of Congo	IMF, 2015[18]: 1.0% of GDP. This would amount to around US$359 million (CDF 332 billion) in 2014.	2.2% (2013)[19]	45%
Ethiopia	IMF, 2015[20]: 3% of GDP in 2010. This would amount to US$1.85 billion in 2015.[21]	5.6% (2012) 4.5% (2013)[22]	66%
Ghana	Government, 2015[23]: 1.8% of GDP average for 2013-15. This would amount to around US$724 million in 2015.[24] IMF, 2015[25]: 'Perhaps 6% of GDP'. This would amount to around GC 6,806 million or US$2.27 billion in 2014.	6.2% (2014)[26]	29% (using the government figure)
Mozambique	IMF, 2016[27]: 4% of GDP in 2013 and 3.3% in 2014. This would amount to around US$640 million (MT 19.3 billion) in 2013 and US$561 million (MT 17.6 billion) in 2014.[28]	6.0% (2012) 6.5% (2013)[29]	51%
Niger	IMF, 2016[30]: FCFA 80 billion in 2014 (1.7% of GDP) and FCFA 150 billion in 2015 (4.5% of GDP) for tax and customs revenues. This would amount to around US$167 million in 2014 and $253 million in 2015.[31]	4.3% (2012) 4.9% (2013) 6.7% (2014)[32]	67%
Senegal	IMF, 2016[33]: FCFA 534 billion (US$1.1 billion[34]) in 2013, or 7.3% of GDP.	7.2% (2013) 7.2% (2014)[35]	101%
Sierra Leone	IMF, 2016[36]: 0.1% of GDP, amounting to Le 25 billion (US$3.5 million).	2.8% (2012) 2.4% (2013) 2.7% (2014)[37]	Around 4%
Tanzania	Government, 2015[38]: 1.5% of GDP ($790 million).	3.5% (2014)[39]	43%
Averages	***2.42% of GDP***	***4.7% of GDP***	***47%***

These findings are consistent with data for other countries which are less complete than for the 11 above. For example:

- A 2017 IMF report[40] notes that **Nigeria** loses 0.8% of GDP just from corporate income tax incentives. This would amount to US$3.3 billion.[41] In addition, the government loses revenue from import duty exemptions, amounting to around US$327 million a year.[42]
- In 2010 the African Development Bank estimated that in **Uganda** 2010 losses from tax incentives were 'at least 2%' of GDP.[43] This would have amounted to around UShs 690 billion (US$272 million) in 2009/10.[44]
- In a 2012 report[45], the IMF noted that a combination of improvements in **Zambia**'s tax administration, the introduction of new taxes and a reduction in tax incentives would together increase Zambian government revenues by 4% of GDP.

What are African Governments already doing to address this problem?

- Heads of State committed to the recommendations of the African Union and Economic Commission for Africa's High Level Panel report on Illicit Financial Flows, as one of the strategies towards increasing domestic resource mobilization across the continent and support the realization of Agenda 2063 in a sustainable and independent manner.
- The **Tanzanian** government has remained committed to and deserves praise for reducing tax incentives (e.g. by introducing a new law in 2015 to reduce VAT exemptions). Yet more needs to be done as the country continues to offer numerous incentives, especially within its Export Processing Zones and Special Economic Zones, and to oil and gas investors.

What does ActionAid recommend?

We support our Governments in Africa to carry through commitments made at the African Union by:

1. Urgently reducing tax incentives, especially corporate tax incentives to attract foreign direct investment, where these are not proven to provide economic or social benefits to the country, especially to the poor.
2. Ensure tax incentives are only provided following thorough cost-benefit analysis, including an assessment of impact on the poor and vulnerable groups. Such analysis should be subject to public debate, scrutiny and parliamentary oversight.
3. Allocate 20% of any extra resources generated from a reduction of tax incentives to key social investments which help to deliver human and women's right obligations, including education (especially for girls).
4. Create a public policy framework for granting tax incentives that is based on clear rules that are transparently applied and subject to public and parliamentary scrutiny.
5. Provide annual tax expenditure statements which quantify the costs of tax incentives as a component of the national budget.
6. Coordinate incentives at the level of regional economic communities to develop common standards and prevent a "race to the bottom".

Friends, Mozambique
PHOTO: ACTIONAID

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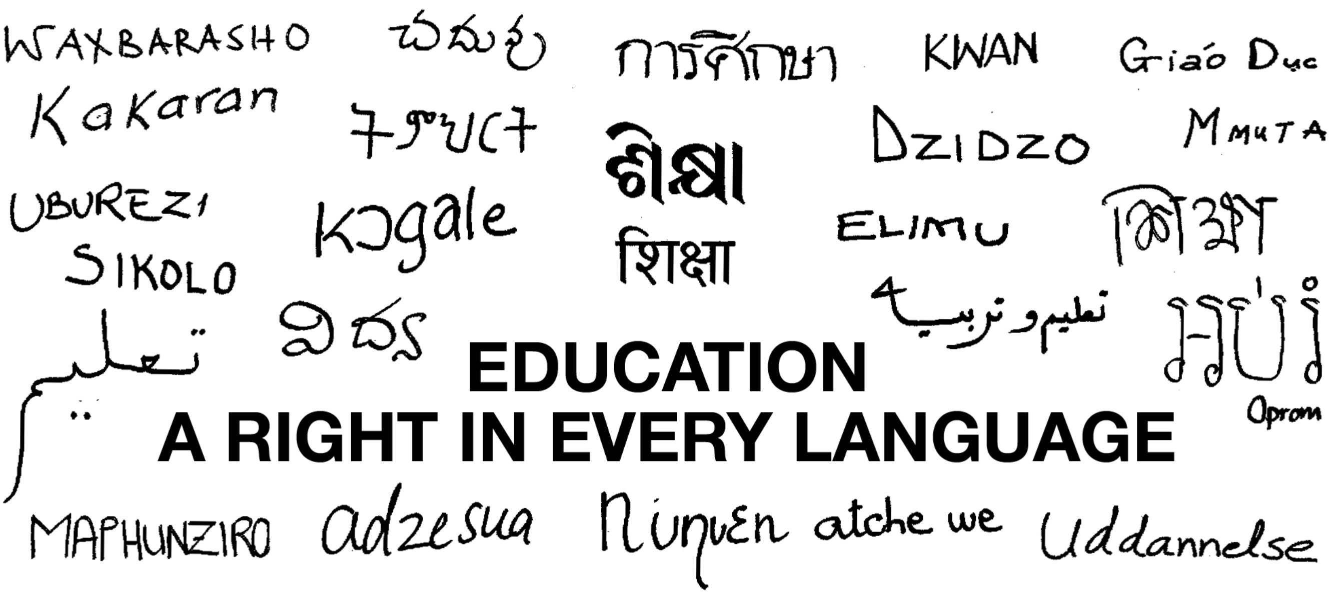

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August 2017