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A race to the bottom?

Effects of Tax competition on African countries

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Structure

- Introduction: Should nation-states Compete?
- Structures and dimensions of tax competition in Africa
- Impacts of harmful Tax competition
- Case study: The East African experience
- Policy recommendations

Introduction

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Should Nation States Compete?

- Theory on tax competition among national states (horizontal/Vertical Tax competition) is contested
- The dominating doctrine is that competition between national states is desirable because it leads to an efficient allocation of public goods
- Part of the neo liberal Ideology encouraged by IFI e.g the World bank though their Doing business index
- It is argued increased competition among national states will increase efficiency and create a conducive environment that encourages investments and job creation

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Rationale for Tax Incentives:

Attract FDI which will in turn:

- Create Jobs
- Facilitate forward and backward linkages to domestic economy
- Enable technology transfer
- encourage investment in specific under-served sectors/areas
- Generate revenue through PAYE

Faultlines

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- Policies that are a result of external pressure undermines the social contract and fiscal self-determination of national states
- Competition between states cannot be healthy since there is no international regulatory framework to ensure fairness
- Competition between national states encourages beggar thy neighbor policies, and treaty shopping that undermine tax bases of weaker countries
- State unlike Companies failure is not an option

Tax Competition

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Structures& Dimensions:

1. Corrosive global financial system that is behind the establishment of Tax havens offering specific tax instruments (Trusts/ Foundations) to attract mobile capital.
2. Tax and investment policies that limits or undermines cross border taxation: Outdated Double Tax agreements:
3. Continuous reduction of corporate tax rates over time- Shift leading to skewed tax burden on income tax and consumption tax as opposed to taxation of mobile capital and increasing the tax gap.
4. Tax incentives contributing to ever increasing gap between statutory and effective tax rates; Encourages rent seeking

Impacts

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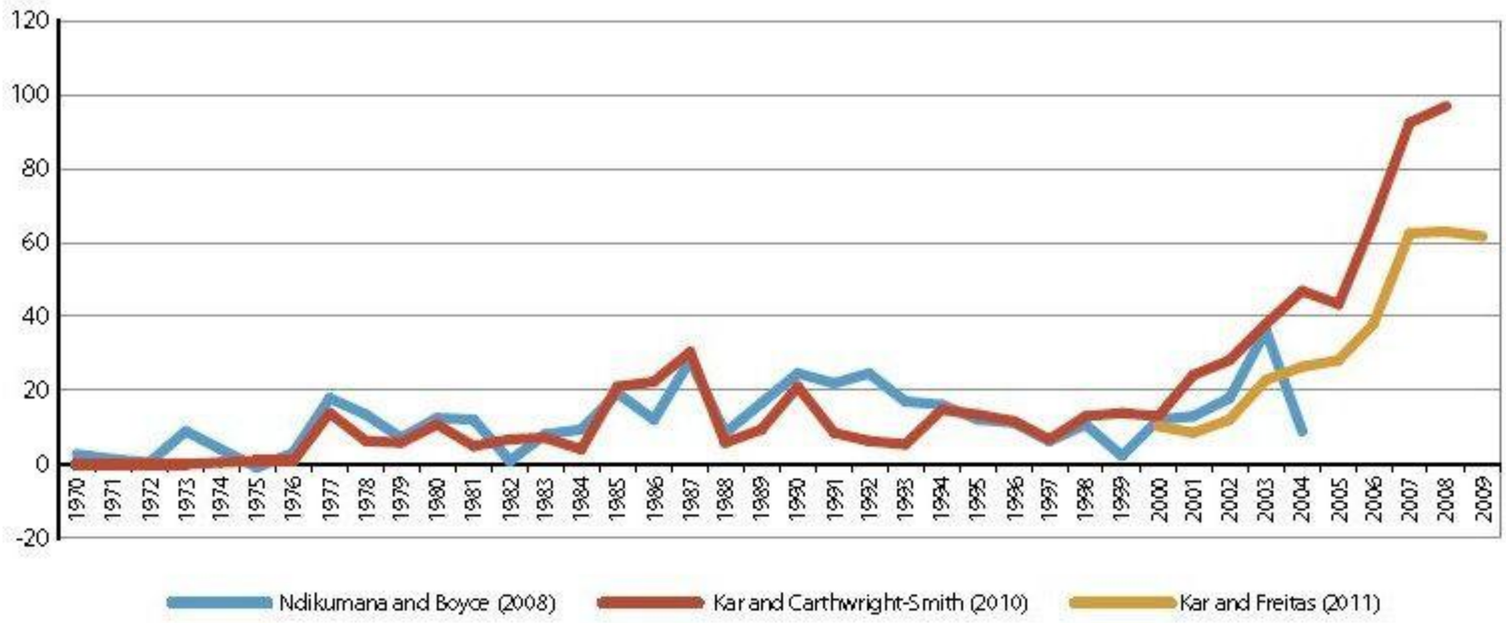
Illicit Financial Flows From Africa

: Illicit financial flows from Africa over the 1970-2009 period, $ billion



Source: ECA, 2012a

Impacts

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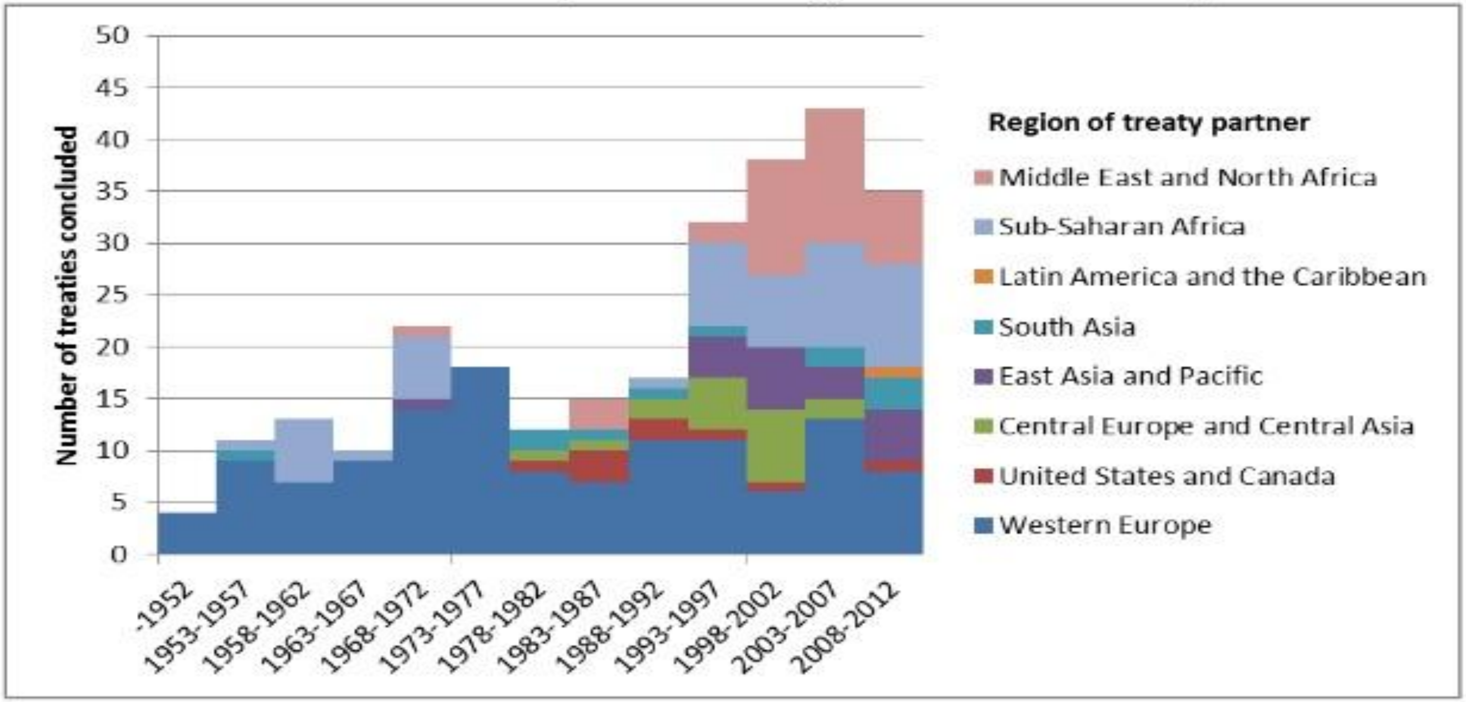
Tax treaties concluded by sub-Saharan countries (excluding South Africa)



Impacts

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Double Taxation Agreements

Status	2012 Inter-African treaties/ protocols	2012 Intra-African treaties/ protocols	2012 Total	2013 Inter-African treaties/ protocols	2013 Intra-African treaties/ protocols	2013 Total
(Re-)negotiations	19	4	23	40	8	23
Concluded (initialled or signed)	14	10	24	21	8	24
Entered into force	20	4	24	12	1	24
Terminated	1	0	1	4	0	1

Impacts

- Reduction of Corporate Tax

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Impacts

Tax Incentives

- Distorts resource allocation
- Complicates administration & creates opportunity for corruption
- Broad economic features far more important to investors
- Even where used successfully, not cost-effective
- ‘Race to the bottom’

East Africa Case Study

Types of Incentives

- CIT holidays
  - Unnecessary, tax avoidance, prone to abuse:
- Indirect (partial or full exemption from indirect taxes on inputs)
  - Export-oriented industries
  - Highly prone to abuse, unnecessary
- EPZs/SEZs
  - Attract labour-intensive industries, and promote exports, zero taxes
  - Leakage onto domestic markets, questionable results
- Cost recovery schemes: accelerated depreciation
  - Allow investors to realise their costs in purchasing depreciable assets faster

EPZ Incentives

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- a 10-year corporate income tax holiday, followed by a 25% rate (compared to the standard 30%) for the next 10 years
- a 10 year exemption from all withholding taxes
- exemption from import duties on machinery, raw materials, and inputs;
- exemption from stamp duty and VAT on raw materials, machinery and other inputs

Estimate Revenue Loss

Study shows that **$2.8 billion is lost each year** due to tax incentives in the four East Africa Community (EAC) members Kenya, Uganda, Tanzania and Rwanda.

Impact

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Tax Incentives

- **Kenya** loses as much as US$ 1.1 billion a year. This would amount to around 3.1% of GDP
- **Tanzania** lost as much as US$ 1.23 billion in 2008 – amounting to 6% of GDP
- **Uganda** loses as much as 2% of GDP per year, amounting to around US$ 272 million in 2009/10
- **Rwanda** US$ 156 million in 2008 and (US$ 234 million) in 2009. These were the equivalent of 3.6% of GDP in 2008 and 4.7% of GDP in 2009

FDI Flows (*in US$ Millions*)

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	2006	2007	2008	2009	2010
Kenya	51	729	96	141	133
Tanzania	597	647	679	645	700
Uganda	644	792	729	816	849

Source: UNCTAD , World Investment Report 2011,

Development foregone

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- In Tanzania, if the revenue losses of USD 266mill in 2008/09–2009/10 were spent on education and health, the education budget would increase by a fifth and the health budget by two-fifths.
- In Kenya, the government's entire health budget in 2010-11 was USD 461. Yet the government spent more than twice this amount on providing tax incentives .
- Uganda's revenue losses from tax incentives and exemptions – at 2% of GDP, as measured by AfDB – amounted to nearly twice the entire health budget in 2008/09.
- In Rwanda, revenue losses from tax exemptions would be sufficient to more than double spending on health or nearly double that on education.

Problems with Tax Incentives

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- result in a loss of current and future tax revenue
- create differences in effective tax rates and thus distortions between activities that are subsidised and those that are not
- could require large administrative resources
- could result in rent-seeking and other undesirable activities
- be a particularly ineffective way of promoting investment.
- could attract mainly footloose firms
- can be outside the budget and non-transparent.

Policy Recommendations

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- Global regulatory Framework to ensure level playing field
- Coordination and Harmonization at sub regional level to address race to the bottom

- Renegotiation of outdated Tax Agreements to tackle double non-taxation
- Tax Expenditure Analysis (at least annually)

End

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Thank You!!

Asante Sana,

Danke Schoen

Merci

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