Why a SADC BIG funded predominantly from taxing extractives should be seriously considered!

"For each $1 developing nations receive in foreign aid, $10 in illicit money flows abroad—facilitated by secrecy in the global financial system. Beyond bleeding the world's poorest economies, this propels crime, corruption, and tax evasion globally." –
Global Financial Integrity

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Fundamentally, fiscal policy shapes the environment in which trade, investment and development take place. Central to the current economic development agenda, taxation should provide the stable flow of revenue to finance numerous development priorities both physical and socioeconomic, such as strengthening physical infrastructure or social protection measures, among others.

In Africa, a significant share of the tax revenue increase stems from natural resource taxes, while non-resource-related revenue has increased by less than 1% of GDP over 25 years.[1] During 2008-2011, there was an increase in share of resources tax to total tax collection from 35% (2000-04) to 40%; and in 2011 resource taxes accounted for half the increase in tax collection.[2] Despite the revenue increases, a major challenge for African countries is finding the optimal balance between a tax regime that is sufficiently business and investment friendly, but which can still leverage enough revenue for public service delivery to address the legal and developmental obligations to the people.

With increasing recognition and pressure for the need for Africa to reduce its dependence on external financial aid and mobilise its own revenue streams to finance its own development, the perception exists that government revenue from mining in many African countries is not fully optimised. This is as a result of overgenerous fiscal incentives, corruption, lack of transparency that has gone unchecked and most importantly commercial tax evasion through trade mispricing which is estimated to account for 60-65% of the global total of illicit financial flows[3]. In Africa, conservative estimate put a figure of over US$ 854 billion having been siphoned out of Africa since the 1970s and more specifically in Southern Africa between 2000 – 2008, estimates are US$ 117 billion[4], enough to not only wipe the region's external debt but also potentially leave some for poverty reduction and economic growth.

"I have made revenue collection a frontline institution because it is the one which can emancipate us from begging. If we can get about 22 per cent of GDP we should not need to disturb anybody asking for aid; instead of coming here to bother you, give me this, give me this, I shall come here to greet you, to trade with you."

President Yoweri Museveni of Uganda, that currently collects around 11 per cent of its GDP in tax.

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[1] Pfister, M. 2009. *Taxation for investment and development: an overview of policy challenges in Africa*. Background paper for the Ministerial Meeting and Expert Roundtable of the NEPAD-OECD Africa Investment Initiative, 11-12 November 2009. http://www.oecd.org/investment/investmentfordevelopment/43966821.pdf

[2] Figures provided by Chiminya J (Tax Justice Network Nairobi) during a presentation at the SADC BIG Key Experts meeting organised by SPII, 29 August 2013.

[3] Kar, D. Cartwright-Smith, D. 2010. *Illicit Financial Flows from Africa: Hidden Resource for Development*, Global Financial Integrity, Center for International Policy. [online]: http://www.gfintegrity.org/report/briefing-paper-illicit-flows-from-africa/

[4] ibid

With this in mind, calls have been made for more tax policy reforms and to achieve an optimal tax mix, African policymakers are challenged by the need to balance the following imperatives:[5]

- mobilising domestic resources and broadening the tax base to secure steady revenue streams for development financing and diversifying the revenue source
- fighting tax evasion, spurred by tax havens, regulatory weaknesses, and some corporate practices
- improving the investment climate for enterprise development, largely shaped by the tax regime
- promoting good governance, underpinned by effective taxation that promotes the accountability of governments to citizens and the investment community.

Need for caution and serious considerations for alternative and complementary financing

Indeed a SADC BIG will benefit from such reforms and greater mobilisation of revenue from the extractives. However, while there is reasonable justification to fund a SADC BIG solely through proceeds from taxes on extractives, it is also necessary to acknowledge that reliance on just one revenue source – i.e. only from extractives – may spell the doom of SADC BIG finances and it is therefore imperative to consider alternative and complementary financing sources. Amongst the sources of potential revenue for consideration, there is:

Capital Gains Tax (CGT)

For SADC, this is a potential revenue source that is worth considering, especially where CGT is absent. This is so mainly because the absence of a capital gains tax creates incentives for wealthy individuals to create schemes that convert other forms of income into artificial capital gains. This is both economically inefficient and costly in terms of foregone income tax revenue. In the South African context, preliminary analysis prior to the introduction of a CGT in 2001 indicated that a CGT had the potential to increase total revenue by between R5 billion to R10 billion[6] (enough to fund the South Africa's estimated annual universal BIG cost at US$15/ month per individual), including both direct CGT plus indirect revenue effects resulting from eliminating inefficient tax arbitrage.

Carbon tax

SADC currently provides a safe haven for carbon-intensive companies, with historically low electricity prices based on large-scale, cheap coal and hydroelectricity. In many ways, not taxing something is equivalent to subsidising it. A tax on carbon would be a way to tax a form of 'rent' (or excess profit) that currently goes to carbon-intensive users. A carbon tax would also represent an additional source of revenue, not previously budgeted for. The extent of carbon tax revenues could be significant. If a tax covers 400Mt CO_2 of a country's

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[5] Ibid.

[6] Samson, M. Babson, O. Haarmann, C. Haarmann, D. Khathi, G. Mac Quene, K. van Niekerk, I. 2001. *The Fiscal Impact of a Basic Income Grant in South Africa,* paper submitted to the Committee of Inquiry for Comprehensive Social Security, EPRI

overall annual emissions at a rate of US$7.5/tonne of CO_2, annual revenues would amount to US$3 billion.[7]

Carbon banking

Another way for SADC countries to raise revenue is by trading on the carbon market. Carbon finance is a new branch of environmental finance that explores the financial implications of living in a carbon-constrained world in which emissions of carbon dioxide and other greenhouse gases (GHGs) carry a price.

Increase in sin taxes

In an effort to promote a healthy lifestyle, to reduce smoking and alcohol abuse among others, countries globally have been increasing excise taxes on tobacco and alcoholic products – commonly known as 'sin taxes'. Cognisant of the fact that the trend of increasing taxes on such products will be with us for a while, channelling this additional revenue to a pool of funds specifically aimed at social protection can go a long way in complementing other revenue sources.

These and other considerations are worth serious exploration. However, what is critical and needs immediate action from our governments in SADC is to:[8]

- plug illicit flows of income from extractives (US$64 billion leaving Africa annually[9])
- reform extractives concessions and abolish harmful tax incentives
- scale up transparency in managing foreign direct investment
- end tax evasion
- end secretive mining deals; and
- demonstrate political will to promote nationalisation processes where applicable.

Tell us what you think?

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[7] Infrastructure Dialogues, 2012. [online]: http://www.infrastructuredialogues.co.za/wp-content/uploads/2012/10/Sovereign-Wealth-Fund-discussion-paper.pdf

[8] Except taken from the Communiqué from the 9th People's Summit, 17 August 2013. http://www.safpi.org/news/article/2013/reclaiming-sadc-people-s-development-9th-people-s-summit-communique.

[9] GFI report,, ibid pg 1