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Poor African Countries Into
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by Johnathan Rickman

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Is Tax Policy The Key to Lifting Poor African Countries Into Global Marketplace?

by Johnathan Rickman

Are African countries shooting themselves in the foot by imposing tax policies that just don't make sense for their economies? Are international lending organizations, such as the International Monetary Fund and the World Bank, doing African countries a disservice by dangling enticing loans in front of them with the requirement that they adopt potentially poor tax policy strategies? Some analysts say yes; others say no. Nevertheless, as the years go by, living conditions remain dismal throughout much of Africa. Half of Africa's population lives on less than one US dollar a day, more than half the population has no access to safe drinking water, and more than 2 million infants die annually before reaching their first birthday, according to United Nations figures.

Some analysts say better tax system administration and further integration into the global marketplace is the best means necessary for lifting poor African countries out of poverty. Despite varying viewpoints, most observers would agree that sub-Saharan Africa is one area of the globe that requires a reconfiguration of its fiscal strategy.

Global Integration or Internal Development?

Total trade between the United States and sub-Saharan Africa, including imports and exports, decreased dramatically during 2002, according to the most recent figures. Bilateral trading amounted to only US \$24 billion, about 15 percent less than the previous year. Those figures, published jointly by Africa Action and Foreign Policy in Focus in their "Africa Policy Outlook 2004" report, reveal a dramatic

decline in trade that the two groups say is largely the result of the global economic downturn.¹

Still, the overall share of African trade, investment, and rate of business activity is generally very low compared to most regions, according to Seth Terkper, an IMF tax expert. What sub-Saharan Africa should do to alleviate poverty is introduce more stable macroeconomic policies and fiscal management, engage in more trade, and open more of its markets. Those moves would improve Africa's position in the global marketplace, he said.

Patrick Bond, a South African professor at the University of the Witwatersrand in Johannesburg, said most African countries are already "massively" integrated into world financial and trade circuits. "Its trade-to-GDP ratio is much higher than [that of] any other continent," Bond said. But globalization doesn't work for Africa. "The correlation between trade liberalization and rising inequality is indisputable," he said.

Although foreign direct investment has been limited largely to extraction and eco-despoilation industries in corruption-ridden societies such as in Nigeria and Angola, as well as to controversial, post-apartheid privatizations in South Africa, trade liberalization makes it very difficult for countries to raise funds through customs; the funds they do generate

¹"Africa Policy Outlook 2004" by Salih Booker and Ann-Louise Colgan, January 2004. © Copyright 2003.

are disproportionately sucked out in foreign debt repayments, Bond said.

Recent World Bank figures show that from 1980 to 2000, sub-Saharan Africa's total foreign debt rose from US \$60 billion to US \$206 billion, with the ratio of debt to gross domestic product rising from 23 percent to 66 percent. Africa now repays more than it receives, Bond said. In 1980 loan inflows of US \$9.6 billion were higher than the debt repayment outflow of US \$3.2 billion; and by 2000, only US \$3.2 billion came in, with US \$9.8 billion repaid, leaving a net financial flows deficit of US \$6.2 billion, he said.²

"African leaders should forget about attracting foreign investment and concentrate on making business easy to conduct at the level of their own people," said Jude Wanniski, a political economist and founder and chair of Polyconomics Inc. If African leaders would simply pretend to be alone in the world and face their problems without outsiders, they would more easily see that they have been smothering the energies of their own people and discouraging outside investment, he said.

In his editorial "The IMF enslavement of Black Africa," Wanniski called on policymakers to find ways to help encourage poor African countries to expand their economies internally "in ways that don't require handouts from American special interests or American taxpayers."³ A new direction is needed, Wanniski said. "[In economies where tax rates are confiscatory at the lowest level of production,] it makes no sense for financial intermediaries to facilitate domestic trade between willing producers, because the government will snatch such a high percentage of the exchanges of goods and services," he said.

Income Tax Thresholds

Corporate and individual income tax rates alone rarely reflect a complete image of a country's fiscal structure, but they often reflect the success or failure of a country's ability to achieve growth and boost development — especially in sub-Saharan Africa, where VAT was recently introduced and where the bulk of taxes currently come from indirect taxes on imports.

The thresholds at which income tax rates are encountered in sub-Saharan Africa are "ridiculously low" and prevent economic growth from occurring, Wanniski said. "In most cases the rates could be left alone and the thresholds increased tenfold." Africa

also would do well to eliminate all capital gains taxation, he said.

In Zambia, the top income tax rate is 30 percent and it is imposed upon annual income that exceeds US \$488. Its VAT rate is 17.5 percent, Wanniski said. In comparison, Botswana's top income tax rate is 25 percent and it's encountered at US \$18,500. "Botswana grows, Zambia stagnates, case is closed," Wanniski said.

Zambian Finance Minister Peter Magande acknowledged during the week of 15 December 2003 that his country was bankrupt and would have to raise taxes if no financial assistance was forthcoming. (For prior coverage, see *Tax Notes Int'l*, 22 Dec. 2003, p. 1090, 2003 WTD 242-7, or *Doc 2003-26549* (1 original page).)

But one cannot make a simple comparison between Zambia and Botswana, Terkper said. For example, he said, a good deal of Botswana's prosperity is tied to its diamond mines, which account for about a third of that nation's GDP, while Zambia only has copper mines that have only recently been privatized. Botswana also has sought to implement policies aimed at diversifying the economy by promoting growth in competitive manufacturing and service industries. (For prior coverage, see 2003 WTD 105-13 or *Doc 2003-13358* (16 original pages).)

Terkper recommended making periodical adjustments of the thresholds and brackets against inflation, but he agreed that high individual income tax thresholds make tax systems easier to administer. He also said the economic welfare of poor African families and peasant farmers could be greatly enhanced by simply adding value to the local products. Instead of just extracting and trading raw minerals, Terkper said processing or otherwise adding value to those products before their sale would make local businesses more profitable.

Aside from widening the tax base, sub-Saharan countries would significantly improve their economic performance if they would exempt basic food items from consumption taxes, better manage medium- and large-size taxpayers, exempt small businesses from VAT, maintain a VAT registration threshold of between US \$30,000 and US \$50,000 relative to local currencies, and set high individual income tax thresholds, Terkper said.

Corporate taxes are probably not the best pro-poor tax policy instrument other than to provide the obvious incentives for attracting overseas investors, said Terkper. However, sub-Saharan African countries should be careful of what incentives they give to potential investors, as some incentives could lead to "a race to the bottom" and an erosion of the tax base, he said.

²World Bank (2002), *Global Finance Tables*, Washington.

³"The IMF Enslavement of Black Africa" by Jude Wanniski.

There is a lack of buoyancy in sub-Saharan tax systems as well as a lack of resources, organization, and effective leadership in the administration of those systems, Terkper said. “[Such poor tax structures likely] impede African countries’ economic business development.” Struggling African countries must work to improve compliance while making their

tax systems and policies more business-friendly, more efficient, and more resilient, he said. And it’s vital that African governments spend their tax revenues on the proper areas, such as healthcare and education, he said. ♦

♦ *Johnathan Rickman, Tax Analysts.*
E-mail: jrickman@tax.org