tax justice network – Africa

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Regional Policy Round Table:
Harmful Tax Competition in East Africa: A Race to the Bottom?

Introduction

In the development discourse, the prevailing thinking has been that the only viable way of bridging the financing gap is through attracting Foreign Direct Investment ('FDI') or aid, rather than domestic resource mobilization, in order to finance economic and social development. To this end, the practice of governments subsidising foreign and domestic investment through the tax system in the belief that doing so will stimulate domestic enterprise, economic growth, and create jobs has proliferated. But the past 10 years of private sector-led economic growth and reliance on foreign aid have by and large failed to deliver on these promises, and particularly to generate sufficient revenue to meaningfully reduce poverty.

Recognising the sustainability of taxation as a source of development finance, attention has once again returned to how taxation (and innovative domestic resource mobilisation) can be used to unlock Africa's growth potential, lessen the continent's aid dependence, and enhance downward accountability. Part of this process has demanded a review of the practice referred to above: subsidising investment through the tax system. Subsidies that governments offer investors include lower corporate income tax rates (to nil in some instances), export processing zones, indirect tax incentives, and tax holidays. The costs to the economy of providing these are not only unknown in many countries (since very few systematically conduct tax expenditure analyses), but they also pose great risks of being abused (especially export processing zones and indirect incentives). Not only is it very difficult to attribute investor decisions solely to the provision of these subsidies, but studies have indicated that investors are far more influenced by a country's broader economic features.[1] Subsidies are also sometimes granted to compensate investors for having to conduct business in economically challenging circumstances (e.g. poor infrastructure). However it is always a better policy to instead address the underlying structural issues. The aggregate impact of countries in the same region with the same general economic features providing investors with the same range of incentives can quickly lead to harmful tax competition, or the 'race to the bottom,' that results in unnecessary net revenue loss for each country—revenue that could have been used to finance essential public goods and services.

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[1] See generally Zee et al. *Tax incentives for Business Investment: A Primer for Policy Makers in Developing Countries*. World Development, Vol. 30, No. 9 pp 1497–1516, 2002.

The issue of harmful tax competition and tax incentives generally, remains a polemical one. The wisdom of granting tax incentives has been increasingly questioned in development circles, not least by the IMF itself. Mauritius recently rationalised its scheme of tax incentives resulting in increased revenue generation. Kenya promised to follow suit with a view to removing 'obsolete incentives' before June 2011. It was expected that this process would generate over Ksh 60 billion per year. On the other hand, in his address to the African Free Zones Association (AFZA) in May 2011, Tanzania's Prime Minister Mizengo Pinda hailed the use of free economic zones as a means to step up economic growth, reduce poverty and unemployment, and achieve the Millennium Development Goals (MDGs). Also in May, Zanzibar's President Dr. Ali Shein announced the rejuvenation of export processing zones in Zanzibar as a means for Small and Medium Enterprises (SMEs) to benefit from the expanded market within the East African Community. Clearly, there remains a tension between the goals of using the tax system to subsidise and incentivise investment on the one hand, and broadening the tax base in order to generate much-needed revenue on the other.

Regional Policy Roundtable on Tax Competition in the East African Community

In this context, the Tax Justice Network-Africa (TJN-A) and Action Aid International Kenya (AAIK) commissioned studies in four of the East Africa Community (EAC) countries, with a view to understanding the rationale for and nature of tax incentives used by these governments, as well as contribute to the ongoing debate on the harmful aggregate consequences of tax competition and the tax harmonisation process in the EAC.

The TJN-A and the AAI now propose to hold a regional policy round table on **July 27th and 28th** in Nairobi in order to critically review the findings and recommendations of the final Rwanda country report, and the draft country and regional reports for Tanzania, Uganda, Kenya, and the EAC respectively. The policy roundtable will provide a platform for high-level discussion on the nature, impact, and means of alleviating harmful tax competition in East Africa, including through tax harmonisation and the proposed Code of Conduct against Harmful Tax Competition and the Model Agreement on Double Taxation Avoidance.

Invited participants will include regional and national policy makers, including members of the EAC Council of Ministers, EAC Secretariat, representatives from revenue authorities and relevant government ministries, as well as civil society actors, SME Associations, academics engaged in tax policy and administration, and private sector tax practitioners.

Objectives

The purpose of this Policy Roundtable is to:

- Critically consider the extent, nature, and impact of investment incentives in East Africa;
- To critically review the draft reports of the TJN-A and AAIK studies in Uganda, Kenya, and Tanzania on harmful tax competition in the region;
- Critically discuss emerging issues relating to the ongoing tax harmonisation process at the regional level; and
- Critically consider lessons learned and best practice from the region and elsewhere (for example the use of tax expenditure analysis, experience in contending with tax competition in other regional economic communities).

Expected Outcomes

The Policy Roundtable proposes to achieve the following outcomes:

- Shared analysis and understanding of the tax policy issues relating to tax incentives and the impact of harmful tax competition on the economic and social development of member states; and
- Develop innovative and politically feasible recommendations on how to contend with harmful tax competition and rationalise the use of tax incentives in order to further enhance the objectives of generating employment, increasing equality and meaningfully reduce poverty.

The **Tax Justice Network-Africa (TJN-A)** is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa. TJN-A advocates for pro-poor taxation and the strengthening of tax regimes in order to promote domestic resource mobilization. TJN-A aims to challenge harmful tax policies and practices that favour the wealthy and aggravate and perpetuate inequality.

Action Aid International (AAI) is a non-partisan, non-religious development organization that has been working in Kenya since 1972. Action Aid seeks to facilitate processes that eradicate poverty and ensure social justice through anti-poverty projects, local institutional capability building and public policy influencing. The organisation is primarily concerned with the promotion and defence of economic, social, cultural, civil and political human rights, and supports projects and programs that promote the interests of poor and marginalized people.