Journal of African Economies, 2023, **32**, i3–i8
https://doi.org/10.1093/jae/ejac056
Supplement Paper

OXFORD

Plenary Theme: COVID-19 and Public Finance in Africa: Challenges and Opportunities

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1. Introduction

Public finance plays an important role in the process of economic development. It is concerned with the capacity of governments to mobilise resources primarily for building institutions to promote security, competition and market development, as well as for redistributive purposes. Stylised facts indicate the capacity of governments to mobilise tax and economic development evolve together (Besely and Presson, 2014; Slemrod, 2019). Typically, countries mobilise more taxes per dollar of GDP as they become richer and vice versa (Besely and Presson, 2014). For the sample of African countries, the same pattern is observed where relatively poorer countries tend to mobilise lower taxes as a share of GDP compared with high-income countries. Figure 1 uses four country groupings to categorise African countries and tax mobilisation, which in tandem tend to be highly correlated with income groupings[1]. Broadly speaking, the factors that tend to affect capacity of governments to mobilise taxes fall into two categories. One is the structure of the economy, which is dependent on the stages of economic development, and the other is the institutional arrangements shaped by history and political economy. However, both factors feed each other to a degree (Besely and Presson, 2014; Slemrod, 2019).

In many low-income countries, the prevalence of a large informal sector with limited product processing capabilities and market organisation pose a challenge to governments to institute an efficient tax mobilisation scheme. Normally, this situation resolves in the process of economic development as has been witnessed by the experience of today's developed countries. Structural transformation, however, is not self-evident, and its pace and depth often are determined by institutions and incentive structures they give rise to. Informality hence may remain the default position for longer periods than is necessary. As a result, most

[1] Figure 1 and Figure 2 are based on data compiled by UNWIDER (https://www.wider.unu.edu/project/government-revenue-dataset) which is one of the most comprehensive and comparable on public finance to date and reports for 39 Sub-Saharan African countries for the period covering 1980–2018.

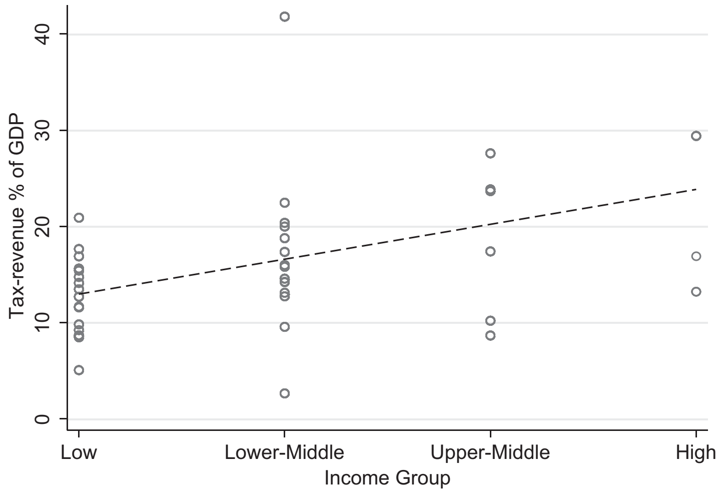

Figure 1. Tax revenue as a share of GDP for selected African countries by income group (1980–2018)

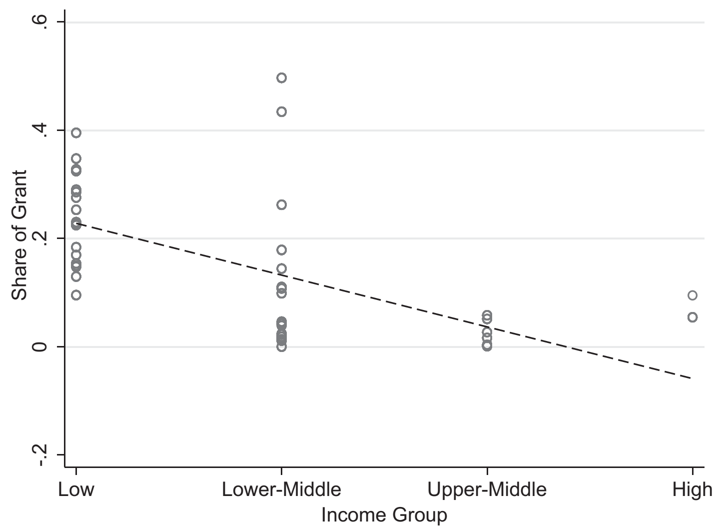

Figure 2. Share of grants in total tax revenue for selected African countries by income group (1980–2018)

economic activities escape the tax net and, in the process, create the political economy conditions resistant to transform into a modern, competitive, and formal economy with well-defined property rights, rule of law and adherence to competition. Many countries in Africa hence mobilise much lower tax than warranted by their potential in the economy and citizens generally consider governments to be corrupt, hence do not feel compelled to pay taxes (Boly *et al*., 2019). This has led many governments in poor countries to rely mainly on grants, loans, and other sources of revenue to finance their budget and experience chronic structural deficits that compromise macroeconomic stability (Figure 2).

The arrival of COVID-19 on the scene exposed the underlying weaknesses in public finance in many African countries. Deficits soared as governments lost significant revenue, introduced tax-reliefs and provided subsidies for necessities. Some estimates suggest that in 2020, the overall fiscal deficit as a share of GDP could rise by at least 4.3 and 3.2 percentage points for Africa and Sub-Saharan Africa (SSA), respectively, which is the largest deterioration in a single year for over two decades and the macroeconomic consequences of such large deficit cannot be overemphasised[2]. On the expenditure side, there is general perception among experts that African governments tend to be less efficient and equitable in the provision of public services leading to significant resource wastage and economic distortions[3]. The current situation hence may provide an important opportunity to better understand the notion of fiscal space and evaluating its magnitude to guide policy makers in times of severe shocks such as this[4]. The pandemic also provided a unique opportunity for governments and citizens to appreciate and recognise the importance of having a strong health care system, including its financing, and the need for comprehensive social protection programs.

A Memorial Lecture to commemorate Professor Benno Ndulu and three papers presented in June 2021 Biannual focused on the following issues:

- Despite previous setbacks and recurrent shocks, is there a reason to be optimistic about the future of African economies? If so what is the source of that optimism?
- What lessons do we draw from the COVID-19 emergency in terms of public finance? Based on what is known so far about the impact of COVID-19 on government budget, how likely is the impact of the shock to persist in the midterm to long run? How has the COVID-19 pandemic shock shaped the notion of fiscal space and attendant reforms?
- Many African countries have already introduced reforms about tax administration, tax rates and public finance management. Does the COVID-19 offer an opportunity to expedite their implementations? How do African countries fare in leveraging digital technologies for tax mobilisation?
- Citizen participation is a crucial part of tax compliance and efficient public resources management. What lessons has the COVID-19 brought forward that could shape the management of public finance going forward? How can governments improve tax compliance by citizens? What is the role of ICT digital finance in this regard?
- In the face of rising deficits, debt situation is likely to get worse. How can reforms in public finance management help in tackling future debt burdens? What is the scope for instituting an effective social protection program in Africa?

2. Africa's latent assets

The Memorial Lecture delivered by Soeren Henn and James Robinson develop a conceptual framework to assess the latent assets found in African societies that could potentially be helpful in building a prosperous and dynamic society. They focused on three attributes of African societies that crystalise innovation, robust institutions and dynamic economy. The first is the high mobility observed in African societies underpinned by premium given to talent and competence. Second, African societies exhibit strong aversion to authoritarian rules due to exposure to frequent abuses of power, which is essential for building strong institutions. Finally, African societies consist of a high proportion of people who speak multiple languages as compared with other regions of the world, which is an indicator of tolerance of others and essential for an increasingly globalised economy.

2 See https://www.afdb.org/en/documents/african-economic-outlook-2020-supplement

3 See recent report of the African Development Bank, 'African Economic Outlook, 2020'

4 See an interesting recent blog that discusses on understanding and quantifying fiscal space for purposes of policy: Vikram Haksar, Marialuz Moreno-Badia, Catherine Pattillo and Murtaza Syed, https://blogs.imf.org/2018/06/27/economic-preparedness-the-need-for-fiscal-space/

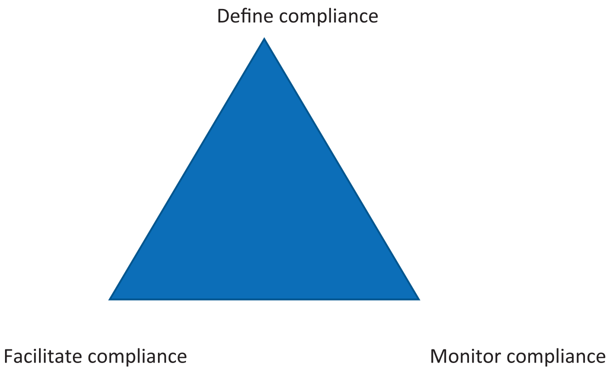

Figure 3. Three Pathways of Technology Enabling Compliance.

3. The promise and limitations of information technology for tax mobilisation

Okunogbe and Santoro, in their paper, reinforce the need for governments of Sub-Saharan Africa (SSA) to adopt technology in tax mobilisation. Limited person-to-person interaction service delivery in tax revenue collection stagnated during the restrictions of movement and lockdowns in some of the SSA countries. With the reduced compliance in tax remittance, the revenue stress was evident. Although the adoption of technology in tax mobilisation is still in its infancy stage in most of the SSA economies, the long-term benefit outweighs the cost.

With their lens on Africa, the authors argue that technology adoption in LMICs is much lower than in high-income countries. Even if that is the case, there is untapped potential that can be harnessed to change the status quo. For instance, success stories in adoption of technology in Africa include mobile phones and electronic payment systems. On average, in the developing world, the taxpayers were likely to have in-person meeting with tax officials at least 3.2 times compared to developed nations where it was 2.1 meetings. They noted that by adopting technology bureaucratic red tapes, which are likely to lead to economic rents and tax distortion, is likely to be avoided. In their discussion, the point of concern arose on the seamless adoption of the new technology given that most citizens in Africa are used to the in-person interactions and manual tax returns. Okunogbe and Santoro, in their paper, explore how the African countries and other lower middle-income countries can enhance their tax mobilisation using the recent technological advancements. The methodology of the paper is based on desk review of literature on the role of technology in tax administration.

The first part of literature analysis discusses the conceptual framework on the role of technology in tax administration. This is summarised in Figure 3.

The first pathway, 'define compliance', refers to the extent at which the tax administration can identify and create a new tax base through adoption of technology. The second pathway, 'facilitate compliance', relates to reduction in tax compliance costs borne disproportionately by the small taxpayers. The cost reduces due to less time taken during the e-tax transactions. In the final pathway, 'monitor compliance', technology enhances the monitoring and enforcement compliance. This can be through automation and cross-checks of self-reported tax liability. The second part of the paper discusses the bottlenecks that are likely to inhibit full realisation of benefits of adopting technology in tax mobilisation. The bottlenecks include inadequate infrastructure and internet connectivity; users and tax officials avoiding using the technology; high adoption costs; no clear organisation strategy to adopt the technology; and no functional legal system to enable enforcement of the tax law.

In conclusion, the authors recognised the value of technology in enhancing service delivery through reduction of tax transaction costs, monitoring and enforcement. The use of technology by the tax official is pivotal. Wider approach is needed in adoption of technology in terms institutional strategy. Lastly, the successful working of tax technology is dependent on the efficiency of the regulatory environment.

4. Tax aversion and the social contract in Africa

Robinson, in his paper, argues that a larger part of African population prefers lower taxation and minimal public goods provision from the government. With evidence that Africa has the lowest tax yield relative to GDP compared to higher income countries (Moore *et al.*, 2018), coupled with inadequate basic public goods, he observes that it is more socially desirable to increase the taxes to facilitate provision of the same. On the supply side, the mistrust on tax income utilisation acts as a hindrance to efficient tax collections, while on the demand side it is the lack of capacity to raise revenues and absorption. Robinson proposes that low tax revenues are low due to 'tax aversion' rather than weak capacity or its evasion. He hypothesises that even if states were efficient in tax mobilisation and absorption the citizenry may not be willingly wanting to pay for it. Historical evidence indicates that there was resistance to pay taxes, with evidence from anti-tax struggles in Sierra Leone and Southern Nigeria (Falola and Paddock, 2011; Matera *et al.*, 2011). The behavioural tendencies of anti-tax struggles in the colonial period have shaped the psyche of the African states on how they perceive taxation and hence tax aversion.

Using Afrobarometer data, Robinson argues that level of taxation is limited by social contract. On tax aversion hypothesis, the evidence from Sierra Leone asserts that government should tax less, even on the premise that public good provision is very poor. Why such responses? The belief that taxes can be misappropriated as 7% and 5% of the respondent believed that state leadership and civil service were not corrupt respectively. On Allocation of tax revenue to public service, 83% believed that government was doing badly. The evidence further alludes that Sierra Leone citizen would rather pay lower taxes for lower public service good provision rather than the alternative. About 41% of Sierra Leone preferred lower taxes and lower services. Another evidence from Botswana indicated that 395 of Botswana citizen also preferred lower taxes and lower services relative to higher taxes and higher services.

On social contract hypothesis, he developed several arguments depicting both colonial and post-colonial governance models. In the colonial period, the first argument is that, historically, African political societies were smaller and did not have bureaucratic centralised states relative to those of European and Asian political societies. Secondly, Africans are skeptics when it comes to authority, as such they developed mechanisms and institutions that hinder centralised power arrangements. Thirdly, they set up hybrid solutions thus merging both small communities and the bureaucratic states. Robinson reiterates that the pre-colonial social contracts have permeated the post-colonial social contracts. He uses the case study of Sierra Leone Cipher State to depict continuity of traditional and modern time social contracts. Another example given in the paper is the Mobutu State (Democratic Republic of Congo), which tried to develop centralised polities realising segmentary states. Formation of large-scale bureaucratic states proved to be an uphill task for most of the leadership. In Botswana State, there is a mixture of traditional rulers and the bureaucracy. He notes that Botswana is a good example of tax aversion in Africa.

What are the fiscal implications? Robinson argues that to understand the difficulty in raising taxes in Africa, 'corruption' and 'state capacity' cannot be the main arguments; although they are important by comprehending the legitimate political order perception in Africa. He observes that the experience of public good provision is uncorrelated with the thought of whether the state has the right to levy taxation for the same. He further argues that tax mobilisation is rather a political problem than a technical one.

In conclusion, Robinson relates the taxation levels in Africa and absence of fiscal states as a pivotal outcome of historical social contracts. The fact that the political structure of Africa is different from those of Eurasia, it has created fragmented legitimacy of government authority in tax mobilisation and absorption.

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