


# Consultations on Strengthening Africa's Voice and Participation in Global Taxation Reform Negotiations

 September 14th, 2023  Virtual meeting  2pm - 4:30pm (GMT)

Register here: <https://us02web.zoom.us/meeting/register/tZUodO6hqj8iH9Fq54ljBd6hRzN4AXoNh1OH#/registration>



## BACKGROUND AND CONTEXT



The United Nations (UN) is currently engaged in discussions on reforming the global taxation system. These discussions hold a significant importance for African countries as the continent seeks and argues for a fair and equitable international tax system. The current international tax system – a complex network of more than 3,000 bilateral double-taxation treaties based on the “arm’s length” and “permanent establishment” principles – is fundamentally unfair to African countries. It has resulted in a “race to the bottom” behavior, and tax avoidance and profit shifting practices by MNCs.

The Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development (FFD) of July 2015 establishes a global framework for financing sustainable development and introduces measures to revamp global finance practices. In addition, both Agenda 2063 and the SDGs underline the centrality of domestic resource mobilization to implement Africa’s priorities, and the need to mobilize resources from all funding mechanisms. In fact, the AU’s Agenda 2063 calls on member States “to take full responsibility for financing [their] own development.” But the continent faces significant hurdles in reaching this goal, not due to lack of resources, but because of its inability to fully mobilize its own resources. Yet the continent’s development needs are indisputable.

### The Urgent Needs for Resources to Finance Africa’s Development

The COVID-19 pandemic triggered the continent’s first recession in 25 years, with an estimated loss of output of \$115 billion and pushing 40 million additional people into extreme poverty, according to the World Bank. By the same token, the IMF has projected that Africa will face a post-recovery financing gap of \$345 billion representing the amount needed to cover countries’ emergency stimulus packages, jumpstart the economy, strengthen national health systems, and implement social safety net programs for the most vulnerable.

The scope of the development funding requirements in Africa are beyond the COVID-related challenges, however. Even prior to the COVID-19 pandemic, African countries faced tremendous challenge in mobilizing sufficient resources to finance its development priorities. Indeed, estimates have shown that the incremental financial needs in achieving the SDGs amounted to \$269 billion–\$279 billion per year in African low-income countries, and \$345 billion–\$359 billion per year in African middle-income countries, for a total gap of \$614 billion–\$638 billion per year (UNCTAD, 2016).

### Africa’s Debt Burden Restricts its Fiscal Space

Africa already faced a debt crisis even before COVID outbreak, having accumulated a total debt burden of \$547 billion prior to the pandemic. According to the Brookings Institute’s estimates, as of 2017, 19 African countries have exceeded the 60 percent debt-to-GDP threshold set by the African Monetary Co-operation Program (AMCP) for developing economies, while 24 countries have surpassed the 55 percent debt-to-GDP ratio suggested by the International Monetary Fund.

Furthermore, as described above, African countries have had to face severe budgetary pressures due to additional COVID-19 spending and have been forced to take on more loans as alternative forms of financing beyond ODA. And this, along with slowdown in economic activity and lockdowns, have led to worsening debt situation in Africa, severely restricting the continent's fiscal space. The implication is that debt management strategies, coupled with stronger fiscal policies will be necessary ingredients in the drive to further mobilize the resources that will be necessary for financing Africa's development priorities.

## **The Necessity of Enhancing Domestic Resource Mobilization**

Domestic resources remain at the core of overall resource mobilization strategy in Africa. They are more reliable (their relative variance is lower than that of ODA, ECA), and more adaptable to national priorities. The level of resources generated domestically is also more significant than those generated from international or foreign sources such as ODA, FDI or remittances. Over the 2011-2016 period for instance tax revenues averaged USD510 billion in Africa, compared to ODA, which generated an average of USD52.65 billion during the same period. Furthermore, the decline of Foreign Direct Investments (FDI) flows to Africa, its unequal and unevenly distributed streams to the continent has had limited impact in terms of source of development financing to the continent. In fact, FDI flows to Africa slumped to US\$42 billion in 2017, a 21% decline from 2016.

## **Illicit Financial Flows and its Damaging Impact on Domestic Resource Mobilization**

During the 2000-2015 period, net IFF between Africa and the rest of the world averaged USD73 billion per year from trade re-invoicing alone (ECA). Global Financial Integrity estimate that the amount of financial flows that left Africa by way of other channels averaged USD 26.7 billion per year over the period 2005-2014 (Spanjers and Salomon, 2017). Taken together, this amounts to \$100 billion annually, or 4 per cent of the continent's gross domestic product. Boyce and Ndikumana (2012) estimated that the capital stock of Africa would have expanded by more than 60 per cent without these flows, and GDP per capita would be up to 15 per cent higher.

Furthermore, the High-Level Panel in his report on IFF stated that given the well-known dependence of several African countries on significant amounts of ODA, the loss of resources through IFFs can only serve to deepen reliance on donors. Moreover, Cobham (2014) states that IFFs can generate environmental degradation, security concerns and conflicts over resources in Africa. In the same way as corruption, IFF also threaten and weaken the public institutions and the rule of law. IFF from African countries have also been shown to discourage value addition to the continent's natural resources. This is particularly harmful to the continent given the important role that value addition plays in providing sustained, inclusive growth (ECA, 2017a; ECA and African Union Commission, 2014).

## **What are African Countries' Interests in the Global Taxation Reform?**

According to the African Union (AU) "reforming international tax cooperation requires a relook at agenda setting, transparent process, governance, and inclusivity on the basis of equal contribution." This is true from a process perspective. However, we should further note that from a substantive point of view, the continent's primary concern in the global tax system reform has to do with increasing revenues available for government expenditure and investment in domestic economies. The continent also remains concerned about base erosion and profit shifting practices which are used for aggressive tax avoidance by multinational corporations to the detriment of its revenue mobilization efforts. And when it comes to the digital economy, Africa must continue to insist that taxation should be enabled where economic activity takes place.

## The OECD Inclusive Framework Solution

These BEPS (Base Erosion and Profit Shifting) behaviors are made possible by a combination of several factors: increased globalization, mismatches in different countries' tax laws, and ease of transfer of "intellectual property". The rise of corporate tax havens has also been a major factor in facilitating large corporations' ability to transfer profit to avoid taxation from the host country. The OECD Inclusive Framework (IF) process with its 2-Pillar solution is ostensibly designed to address the BEPS problem.

However, from an African perspective, the OECD solution has proved not to be inclusive in the way that it was designed and carried out. Representation and participation of African countries was limited. Only 23 African countries were part of the IF at the time the two-pillar solution was developed. Further, the demands and proposals of African countries and other developing countries have been largely ignored in the negotiations, resulting in countries such as Kenya, Nigeria, Pakistan, and Sri Lanka not endorsing the agreement. Furthermore, studies have since shown that African countries stand to lose revenue under the OECD solution rather than gain revenue.

## The UN Approach to Global Tax Reform: The UN FACTI Recommendations

In view of the preceding analysis, for African countries the UN global tax reform negotiations process may represent a preferred alternative to the OECD process. Contrary to the OECD setting, African member States stand a better chance of presenting a stronger voice, and a more realistic ability to influence the agenda setting in a UN process. Due to its far-ranging implications for countries' ability to achieve the SDGs and finance their development needs, the UN must recover its leadership role in multilateral reform processes, particularly the global tax reform process. With its focus on important normative notions such as inclusivity, participation, legitimacy, fairness, and international cooperation, the UN FACTI recommendations for instance, can well serve as a starting point for negotiations for African countries. The FACTI Report puts forth the proposition that while Pillar Two may represent a substantial change to the international tax architecture and includes a proposal to make MNEs subject to a minimum level of tax globally to address profit shifting and tax competition among jurisdictions, nonetheless the OECD proposal is filled with complexities, which may hinder the ability of countries to administer it. Article 12B on the other hand, adopted by the UN Model Tax Convention, would allow market jurisdictions greater taxing rights, as it offers two options for taxing income from such digital services, a gross and a net basis, with administrative guidance including on how net profits can be calculated. Article 12B could indeed provide a major step in providing a practical and simple approach that is well-adapted to developing countries' context.

These are some of the measures by which African negotiators should gauge whether any agreement reached would advance the cause of the continent as outlined above. In this regard, the present consultations aim to explore the options available to be considered by African negotiators during the UN global taxation negotiations process, as they weigh the costs and benefits to the continent of maintaining adherence to the OECD 2-pillar solution or fully participating in a multilateral process such as the UN negotiations that are based on inclusivity, participation, legitimacy, fairness, and international cooperation. It is expected that participants will further examine ways in which the hands of the African negotiators can be strengthened for Africa to speak with one voice and to have its interests and position fully integrated into the negotiations process.

## OVERALL OBJECTIVE OF THE CONSULTATIONS

The overall objective of these consultations is to present participants with analysis and recommendations on strategic options to support and strengthen the hands of African negotiators in the UN global taxation reform negotiations. The meeting further aims to solicit from stakeholders suggestions and proposals on how to make sure that Africa's voice and interests are effectively integrated and represented.

## SPECIFIC OBJECTIVES OF THE CONSULTATIONS

Specific objectives of the consultations include:

1. Increase understanding of the impacts of the OECD 2-pillar solution on African countries' resource mobilization abilities and development prospects;
2. Expand knowledge on how African governments can strengthen the position of the continent in the UN negotiations through partnerships and international cooperation by working in collaboration with such groups as the G-77, G-24, and within the framework of South-South cooperation.
3. Increase expertise on the role of taxes and tax policy in optimizing African countries' domestic resource mobilization capacities;
4. Gain insights from participants on strategic steps to take to ensure that the agreed-to recommendations are effectively integrated in the UN negotiations and fora.

## EXPECTED OUTCOME

As a result of these consultations, it is expected that the African negotiators in the UN global tax reform discussions will be better prepared, more aware, and better informed on the critical issues that imperatively need to be addressed in order for the continent's interests to be fully integrated and reflected in the outcomes of the negotiations. It is further hoped that these consultations will contribute towards the continent speaking with a strong voice and engaging in the process in a coordinated manner.

## DATE, FORMAT, AND EXPECTED PARTICIPANTS

The stakeholders' consultation will take place on **14 September 2023 at 2pm-4:30pm GMT**. The meeting will take place in a virtual format. It is expected that participants will include representatives of policy institutions, financial institutions, think tanks, academia, and civil society organizations whose work and interests intersect with the subject of this meeting.