TAX REVENUE:
THE SUSTAINABLE ALTERNATIVE TO EDUCATION FINANCING

1. Introduction

The 2011 General Assembly for the Global Campaign for Education (GCE)held in Paris, France, called for increased domestic financing for education[1] . This resolution emphasised increasing the share of national budgets allocated to expenditure on education, adopting just and progressive tax mechanisms, as well as challenging capital flight and intra-company flows which contribute to tax evasion.

This came in the wake of a concern on the progress towards achieving the Education for All (EFA) goals by 2015. With the year 2015 having already set in, most African countries riskmissing the EFA Goals by the end of 2015. Over 160 million adults are illiterate and about 30 million children remain out of school in Africa[2] .Recent studies have however shown that there is a funding gap in education of about US$11 billion due mainly to most African countries not allocating the six (6) percent of Gross Domestic Product or 20 percent of annual national budget required to achieve EFA goals.

[1] *http://www.globalmarch.org/General%20Assembly%20GCE*

[2] *African Union 2nd Decade Plan of Action, UNESCO GMR*

2. Context

A number of recent studies have identified the causes for these education financing shortfalls to include:

- lack of sufficient funding to finance education;
- Most donor agenciesand cooperating partners failing to honour their commitments to finance education especially due to the global financial crisis of 2008, as well as the Euro-zone crisis of 2010;
- The two crises above also impacted negatively on the liquidity of resource-rich African countries as it led to a decline in global ore prices and hence revenues earned from the resource rents in these countries. This resulted in the thinning of the fiscal spaces for most resource dependent African countries;
- Tax loopholes such as weak Double Tax Treaty (DTT) frameworks which result in revenue leakages and low tax revenue collections.
- Abuse of tax incentives

These global financial crisis has reduced the amount of resources that donor agencies and cooperating partners receive from their financiers, as the financiers have to deal with their own internal financial challenges caused by the crisis before they can extend aid to African countries. The trickle down effects of these criseshave also limited the capacity of African countries to provide essential social services for their citizens.

3. Trends in Education Financing in Africa

Statistics show that education financing in Africa has been a perpetual challenge for many decades. A typical example is the existence of temporal variations in Gross Enrolment ratios (GER) in primary education in Sub-Saharan Africa countries. This is illustrated in Table 1 below.

Table 1: Trends in Gross Enrolment Ratios in Sub-Saharan Africa

Year	1960	1980	1992	2000	2005
GER	40%	80%	72%	80%	97%

Source: World Bank 2008

From the above statistics, Sub Saharan Africa almost satisfied the 1961 Addis Ababa target on Universal Primary Education by 1980. However, the region failed to achieve this target mainly due to an unforeseen doubling of the population of children of school going age. The largely positive trends were a result of annual increases in

national budget allocations to education by an average of 2.3 percent between 1980 and 1999, which was however slightly below the population growth rate for the region. The mid-1970's economic crisis also had an influence on the afore-presented trends. The crisis led to a reduction in per-capita GDP by around 36 percent between 1970 and 1999, and led to most countries introducing school fees, an extra burden on the parents which they did not receive well, and derailed the progress towards achieving Universal Primary Education. However, a positive trend was later realized due to more prioritization of education and hence increases in budget allocations to education of around 9.2 percent annually, and the abolishing of school fees in most countries. According to the World Bank:

"This was necessitated by improvements in regional growth rates between 2000 and 2005 from 2.1% (1980-1999) to 4.8 percent (2000-2005); resumed growth in foreign financing of education and increased share of GDP to education"[3] .

In Sub-Saharan Africa, about thirty-two (32) million children of school going age were out of school in 2010, mainly due to lack of resources[4] . However, even though pledges had been made by cooperating partners, not all commitments were being honoured and Africa still faces a great shortfall in pledges honoured, to the tune of US$18 billion[5] . The UNESCO report estimates funding gap to achieve Education for All in low income countries at US$16 billion annually[6] . However, it also postulates that low income countries could increase spending on basic education by around 0.7 percent of GDP.

Most African countries are however facing serious challenges to finance education in order to achieve the Education for All goals by 2015. This is mainly due to declining and uncertainty in foreign aid to finance education from cooperating partners, as well as the limited capacity of national governments to provide the requisite financing. Whilst other studies are postulating that sources of additional financing will tend to be found outside the national tax systems, TJN-A instead asserts that the key and sustainable alternative source of revenue to finance education for the attainment of the Education for All goals in Sub Saharan African countries, is domestic tax revenue mobilisation.

4. Why Use Tax as an Alternative?

Given the uncertainty in foreign aid financing education in Africa, and some cooperating partners not honouring their pledges to finance education on the continent, it is worth recognizing the importance of focusing on taxation as the potential alternative because tax is one of the most sustainable sources of domestically mobilized resources to finance development. Tax plays four key main roles in an economy, which can be summarized as the 4 R's of taxation, that is:

- Revenue Mobilisation;
- Redistribution;

[3] *World Bank, 2008*

[4] *UNESCO, 2010*

[5] *Unesdoc.unesco.org/images/0018/001865/0018652SE.pdf*

[6] *UNESCO, 2010*

- Representation; and
- Re-pricing.

Re-pricing entails the use of taxes to ensure that market prices better reflect social costs and benefits. In this instance, taxation is used as a measure to control or deter the consumption of economic 'bads' and assist in moulding the consumption behavior of economic agents. By so doing, the design of the tax system may contribute to the achievement of social benefits by making it costly to engage in socially harmful behaviour. When used in this way, taxes enhance economic efficiency by encouraging economic agents to take into account the social costs of their decisions and activities.

Representation entails that taxation has the potential to shape relationships between the state and the society in significant and distinctive ways. It can be used as a tool for state-building. Taxation for state development requires understanding of tax as a system that needs to be administratively effective, economically efficient, and politically equitable[7]. Taxation assists in creating a social contract between government and citizens – the tax payers, and in democratic states, it gives the citizens some bargaining power to hold government accountable on how tax is raised and how the raised revenues are spent, thereby enhancing good governance.

Redistribution entails the role of taxation in enhancing equity in an economy. By equity, it implies both vertical – whereby economic agents with higher incomes contribute more to the fiscus in tax and is mostly achieved under progressive tax structures – and horizontal – where economic agents with the same level of income are taxed at the same rate. However, the provision of tax incentives and over-reliance on Value Added Tax (VAT) and other regressive taxes adversely affects this function of taxes.

Revenue mobilisation entails how taxation is used to finance government activities. Taxation enables government to generate revenues to fund essential goods and services. It is more predictable and sustainable than aid and debt. With improved tax revenues, citizens can press governments to increase spending on basic services like education and health, among others.

In this brief, the main focus is on revenue generation role of taxation, with the intention of determining where there is potential to raise more revenue for African countries to be able to finance education in pursuit of the education for all goals by 2015 and the post EFA 2015 education for all objectives.

5. Findings on Government Policy

5.1. Sierra Leone

The central government tax system in Sierra Leone is administered by the National Revenue Authority (NRA), which was set up under the National Revenue Authority Act of 2002. Since the creation of the NRA, tax

[7] *Moore, 2007*

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revenue generation has improved markedly from around 6 percent of the country's Gross Domestic Product (GDP) at the time of the peace settlement in 1999 to an average of around 13 percent of GDP in 2012.

The tax ratio for Sierra Leone has been hovering around 12 percent since 2009, and as of 2012, it was at 13 percent. This has been explained by the performance of the main tax types. Income tax, comprised of both corporate income tax (CIT) and personal income tax (PIT), has been the most dominant tax type since 2011, as the prominence of customs and excise tax has been on the decline. The main taxes in Sierra Leone are income tax, goods and services tax (GST), customs and excise tax, as well as mining royalties. These taxes' individual percentage contribution as a ratio of GDP as at the year 2012 amounted to 5 percent, 3 percent, 2-3 percent and 2 percent respectively[8] . The country is rich in mineral resources, but the contribution of the mining sector to the fiscus still remains low mainly due to excessive incentives offered to the sector.

Recent studies have shown that there are various loopholes in the tax system in Sierra Leone which is resulting in the country losing significant amounts of revenue. According to the 2013 Global Financial Integrity (GFI) report, Sierra Leone lost an average of fifty-three million United States Dollars (US$53 million) per year, which is about 1.78 percentof the country's GDP between 2001 and 2010. This translates into an annual tax revenue loss of around US$15.9 million.

5.2. Zambia

The tax system in Zambia is solely administered by the Zambia Revenue Authority.The ZRA was instituted as a result of a tax reform programme to redress the massive decline in revenues from around 30 percent of GDP in the 1970s to around 13 percent of GDP in the early 1990s. However, since its institutionalization, enactment of the VAT Act, as well as improvements in policy measures for income, customs and excise, the Tax-to-GDP ratio has since improved greatly to above 18 percent.

The main types of taxes in Zambia are Income taxes, value added tax, customs and excise duties, withholding tax, mining royaltiesand presumptive tax for the informal sector among others. However, there are no Capital Gains Taxes, which are a very important tax type to redress inequality as well as raise more tax revenue, in Zambia.The highest tax rate in Zambia is 35%, which is the corporate tax rate, and also the highest tax bracket for Personal Income Tax. Although the Corporate Income tax is officially pegged at 35%, various sectors pay different rates due to incentives. Withholding taxes on dividend in Zambia are pegged at 15%, however, there is no withholding tax levied on dividends for companies engaged in the mining sector.

Inasmuch as Zambia has a well set-out fiscal system, it still cannot fully rely on its domestically generated resources to finance basic social service delivery.This is mainly due to various revenue leakages, which mainly

[8]Government of Sierra Leone Publications (2012, 2013)

come in two forms, licit revenue leakages (provisions in tax treaties and tax incentives viewed as protecting and enhancing foreign direct investment) and illicit revenue leakages.

Provisions in the tax treaties create a platform to attract investment from the contracting jurisdiction.However, at the same time they come with provisions to lower taxes levied on the would-be investors, thereby reducing the revenue receipts for the fiscus (e.g. The Zambia-Canada Tax Treaty, protects Canadian investors in the Zambian Mining sector and it has a clause stating that the companies will be taxed in the contracting state they are registered, which in this case is Canada, given that the Zambian operations are being conducted by a subsidiary to the Canadian parent. The tax treaty also stipulates that the withholding tax levied on the company is 15%, rather than 20% charged to other foreign taxpayers in Zambia, thus a loss in revenue to the fiscus). Moreover, tax treaties create a loophole that can be abused by the multi-national companies, thereby resulting in further losses in tax revenue for the fiscus. These loopholes come in the form of transfer pricing, treaty shopping and round tripping of investments among others.

Over and above these incentives given to attract investment in the critical industries, more incentives are discretionarily given to specific companies in mining and various players in other industries. Due to these tax incentives, the government is losing significant amounts of revenue, which could have been used to finance basic social service delivery. Other studies have found that Zambia on average loses about US$651 million annually, which translates to tax revenues of US$227.5 million per year. If 20% of that revenue is allocated to education, it entails an additional annual allocation of US$45.57 million and if that revenue is shared using the Zambian Sixth National Development Plan (2011-2015) financing projections, it entails, for example, 44 new ECCDE teachers per year, 20 Primary schools built per year, 3187 more university students funded (assuming it costs $400 per semester) annually and 39270 new lower to basic education students fully funded annually.

6. Overview of Sources of Revenue Leakages

The main sources of revenue leakages established in Zambia and Sierra Leone are:

- Corruption;
- Minerals Smuggling;
- Lack of a clear legislative framework to prevent money laundering;
- Some Provisions of tax treaties (e.g. the Zambia/Canada Tax Treaty);
- Tax incentives/waivers (e.g. Customs duty , GST waivers, corporate tax for some mining companies, levied at 30 percent instead of 37.5 percent and 15 year tax holidaysin Sierra Leone);
- Illicit financial manifested in, for example, trade mispricing; and
- Loopholes in tax systems such as weak DTT frameworks which are abused by, for example, treaty shopping and round tripping.

7. Conclusions

The main conclusions from the study are that sub Saharan African countries have a huge potential to increase their revenue profiles using taxation. Various loopholes that have been identified in Zambia and Sierra Leone, including tax incentives and losses through illicit financial flows, are a common characteristic in African countries. The study also found that if incentives are done away with, there will be a significant increase in finances for education towards the attainment of the Education for All objective.

8. Policy Recommendations

The key recommendations are that:

- The Education for All objective should be pursued beyond the expiry of the MDGs period (2015) and continue as part of the Sustainable Development Goals (SDG) since it is now very clear that Education for All in Africa will not be met by 2015 as envisaged earlier;
- Education financing should receive its fair share from the national budgets as education is paramount to Africa's development;
- There is need to review tax treaties so that source states, where real activities are happening have the taxing rights as opposed to the provisions of taxing rights being given to the jurisdiction with effective management;
- There is need to do away with most of the tax incentives, thereby unlocking more revenue to finance education and other key public services;
- There is need for CSOs and academia to conduct more extensive tax expenditure studies in African countries so as to determine the revenue losses and compel governments to rectify and harness those lost resources;
- African governments need to conduct cost-benefit analysis before issuing tax incentives to multinational companies.

Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the Global Alliance for Tax Justice. It is a network of 29 members in 16 African countries. Through its Nairobi Secretariat, TJN-A collaborates closely with these member organisations in tax justice activities at the national and regional level. TJN-A seeks to promote socially just and progressive taxation systems in Africa, advocating for pro-poor tax policies and the strengthening of tax systems to promote domestic resource mobilisation. TJN-A aims to challenge harmful tax policies and practices that favour the wealthy and aggravate and perpetuate inequality.

TJN-A engages in various activities that are aimed at promoting public awareness regarding tax issues in Africa.

TJN-A's vision is A new Africa in which tax justice prevails and ensures an equitable, inclusive and sustainable development which enables all its citizens to lead a dignified and fulfilled life. In line with the TJN-A mandate, the revised Mission is "To spearhead tax justice in Africa's development by enabling citizens and institutions to promote equitable tax systems through Research, Capacity Building, and Policy Influencing."