ERSA Research Brief

February 2019

Determinants of tax revenue performance in the Southern African Development Community (SADC)

By Michael Ade

African countries (including the Southern African Development Community (SADC) countries) have recently considered additional robust means of mobilising tax revenue in order to meet revenue targets and consistently provide for the developmental needs of its citizens. For instance, countries have been considering Domestic Resource Mobilisation (DRM) initiatives (as opposed to External Resource Mobilisation - ERM), via improved management of taxation and reduction of tax leakages, in line with the general agenda of enhanced fiscal policy coordination (African Economic Outlook (AEO) 2013). The argument is that DRM would lead to Africa achieving greater economic development, independence and better mobilisation of revenue. Enhanced mobilisation of revenue entails expanding the tax base in these countries by capturing in the tax net, activities not adequately taxed because of policy or administrative weaknesses. Efficient means of taxation could help improve the governments' revenue positions, reduce public sector borrowing requirement (PSBR), reduce dependency on aid and increase countries' ownership of their development agenda (including the UN's post-2015 development agenda or the Sustainable Development Goals - SDGs).

This paper investigates the determinants of tax revenue performance in the SADC from 1990 to 2010. The study ascertains the effectiveness of proffered determinants of tax revenue collected which is necessary for improved tax performance. The main determinants of tax revenue investigated are foreign direct investment (FDI), tax rates and tax policy hamonisation measure (TPHM). Furthermore, the effectiveness of other variables such as growth of domestic credit (DCR), government expenditure (GOV), export (EXPO) and inflation (INF) are equally investigated. After controlling for cross-sectional dependence (CSD) of the error term, endogeneity, contemporaneous correlation and individual effects; the results of the empirical analysis affirm the role of FDI towards revenue mobilisation in the SADC. The finding also partly answers the question on the effectiveness of tax incentive driven FDI towards better tax revenue collection in the SADC. However, the counter-argument against excessively using tax incentives to attract FDI is that the opportunity cost may be marginally higher than the tax revenue gained. The empirical results also highlight the role of taxation, providing empirical rationale to what have largely been anecdotal evidences on the effectiveness of tax rates and tax policy harmonisation (or enhanced tax policy coordination) towards tax revenue collection in the SADC. The results give credence to the use of the tax variables as instruments by policy makers towards reduction of tax competition and better revenue mobilisation.

This study improves on a small separate but related strand of literature which exclusively focuses on tax competition in the SADC. The findings help ascertain how differences in tax rates and tax policy affect investment, location and the amount of tax revenue collected. This is especially given the fact that FDI will flow to countries with better return on investment and high tax rates are detrimental to FDI inflows.

Generally, the empirical results are important in assisting policymakers in understanding the various determinants of tax revenue efforts in the SADC. The findings broadly suggest that the channels through which member countries can mobilise additional revenue to improve the budgetary positions are to a large extent already in place. The results also provide a basis for policy makers to understand what institutional and policy positioning is required to maximise revenue collection.