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## **Money Talks: Africa at the G7**

### **Summary**

*At their forthcoming summit in Germany, G7 leaders will meet some of their African counterparts to discuss how they can support economic growth and sustainable development in Africa. The continent has enjoyed a recent economic boom, but countries across the continent remain blighted by poverty and inequality.*

*Africa is among the world's fastest-growing continents, but the rich world is reaping the rewards of this growth, as billions of dollars a year flow out of Africa. This is depriving it of vital revenue that could enable it to fund healthcare and education for all, and invest at scale in sustainable agriculture.*

*In 2010 alone, G7-based companies and investors cheated Africa out of an estimated \$US6bn through just one form of tax dodging – trade mispricing. This is equivalent to more than three times the amount needed to plug the funding gaps to deliver universal primary healthcare in the Ebola-affected countries of Sierra Leone, Liberia, Guinea and Guinea Bissau. At the same time, rich-country donors, including some G7 countries, continue to default on other vital income streams for Africa, as they break their promises on aid and on providing new and additional contributions to climate finance.*

*If G7 leaders are serious about supporting economic growth and sustainable development in Africa they must support ambitious and comprehensive reform of the global tax rules that allow multinational companies to dodge taxes and that fuel a 'race to the bottom' where governments offer ever more generous tax breaks to persuade companies to locate in their country. . These rules are letting multinational companies prosper, while bleeding Africa dry of vital revenue.*

*G7 governments must seize the opportunity to make ambitious commitments on tax and aid leading up to the UN Financing for Development Conference in Addis Ababa in July. They must recognize this period as critical in securing the changes that Africa needs to ensure long-term, sustainable, equitable growth.*

At their forthcoming summit in Germany, G7 leaders will meet some of their African counterparts to discuss how they can support economic growth and sustainable development in Africa. The continent has enjoyed a recent economic boom. In 2014, the IMF

estimated that Ethiopia was the world's fastest-growing economy at more than 10 percent. The Democratic Republic of Congo, Cote d'Ivoire, Mozambique, Tanzania and Rwanda all grew by 7 percent or above.<sup>1</sup> However, most African citizens are not able to prosper, as they should from this progress, since the benefits of growth are not 'trickling down' to the majority. Close ties between Africa's economic and political elites mean that too much of Africa's growth fails to reach the poorest people.

African governments have a central role in turning this situation around with a package of policy measures that set out a more equitable and sustainable path for their development. But any effort to drive forward a fairer, more sustainable agenda is being damaged by international development finance rules that are skewed in favour of rich governments and individual and commercial vested interests, in areas such as taxation, aid, private finance and climate change.

Without a fundamental change in approach, an international agreement on how to finance development for the future – including the Sustainable Development Goals (SDGs) for the next 15 years – will not help to achieve African development priorities or enable African people to escape poverty. The forthcoming UN Financing for Development Conference in Addis Ababa in July provides an opportunity for rich countries to support developing countries' agendas for their development by pledging to combat inequality and poverty and through proposing systemic change internationally in policy areas that affect public and private finance, such as taxation, aid and climate change. The G7 must use the summit as an opportunity to make ambitious commitments on tax and aid ahead of the UN Financing for Development Conference in Addis Ababa in July. They must recognize this period as critical to securing the change that Africa – and other developing countries – need to ensure long-term growth that is both equitable and sustainable.

## **Africa is 'rising', but remains blighted by inequality and poverty**

Over the past decade, Africa has been among the world's fastest-growing continents – its average annual growth rate was more than 5 percent.<sup>2</sup> Global demand for natural resources, and increased commodities exports and tourism, along with improvements in the region's regulatory framework and macroeconomic stability, are key factors accounting for this impressive growth.<sup>3</sup> Yet sub-Saharan Africa remains the poorest region in the world.

Forty percent of people in sub-Saharan Africa live in extreme poverty (on less than US\$1.25 per day); this is more than four times greater than the world average.<sup>4</sup> It is the region with the highest prevalence of people going hungry, and where – in contrast to global trends – the total number of people in hunger is still increasing.<sup>5</sup> Nor are future poverty trends positive for the region. The absolute number of people living in extreme poverty in sub-Saharan Africa is projected to increase by over 50 million between 2011 and 2030, to 470 million people.<sup>6</sup> Women are hit hardest. In sub-Saharan Africa, they earn on average 30 percent less than men,<sup>7</sup> and continue to have limited access to productive resources, such as land, water and credit, and to services including healthcare, education and agricultural training and support for small-scale farmers.

High levels of inequality across Africa are slowing poverty-reduction efforts. Six African countries (South Africa, Namibia, Botswana, Zambia, Central African Republic and Lesotho) are among the top 10 most unequal countries in the world (as measured by their gini coefficients). In these six countries, the richest 10 percent of the population accounts for, on average, almost half of the combined total income, while the poorest 10 percent earn just one percent.<sup>8</sup> Worse still, much of the income of the richest is leaving the continent's economies. The African elite have a higher level of capital flight relative to GDP than their equivalents in other parts of the world, and keep a larger proportion of their wealth abroad.<sup>9</sup>

## **Rich world gaining most from Africa's progress**

Billions of dollars a year flow out of Africa because of the transfer of profits by foreign investors, debt repayments and illicit financial flows (commercial transactions, tax evasion, criminal activities (money laundering, and drug, arms and human trafficking), bribery, corruption and abuse of office).<sup>10</sup> Illicit financial flows alone make Africa a 'net creditor' to the world;<sup>11</sup> a sharp contrast to its image as a region that only sucks in aid money.

The common assumption that Africa loses money primarily because of bribery and corruption needs to be re-assessed. Tax avoidance tricks are allowing multinational companies to move considerable amounts of money out of Africa. A recent report by the High Level Panel on Illicit Financial Flows, led by former South African President Thabo Mbeki, found that in 2010 alone, multinational companies were responsible for around US\$40bn<sup>12</sup> leaving the continent as a result of trade mispricing (where companies deliberately over-price imports or under-price exports between subsidiaries of the same company to evade taxes, avoid customs duties, or launder money).<sup>13</sup> G7-based companies and investors<sup>14</sup> were responsible for as much as US\$20bn in taxable flows leaving the continent through deliberate mispricing. This amounts to around US\$6bn in revenue lost to national treasuries through multinational companies cheating the system.<sup>15</sup> This is just one of the many tricks multinational companies use to manipulate the accounts to escape paying their fair share of taxes and avoid making a long-term productive investment into the continent.

## **Africa is being bled dry**

Outflows of capital from African countries because of trade mispricing have a real impact on government revenues, as the tax due on these sums is not paid. Further negative effects include the lost opportunity of that money being invested within the African continent. To put the scale of this US\$6bn loss in tax revenue into perspective, it is equivalent to more than three times the amount needed to plug the funding gaps to deliver universal primary healthcare in the Ebola-affected countries of Sierra Leone, Liberia, Guinea and Guinea Bissau.<sup>16</sup> Such investments could improve and even save millions of lives.

Many multinational companies operating in Africa take advantage of these loopholes to reduce their tax bills, while also negotiating tax exemptions from governments engaged in a race to the bottom to attract foreign investment. By using tricks like trade mispricing, multinational companies constrain the ability of African governments to tackle inequality. The loss of legitimate tax revenues to African governments is starving them of vital public finance to fill financing gaps, and to invest in the future SDGs. It is clear that the international tax system, which enables and almost incentivizes multinational companies to avoid tax, is in desperate need of wholesale reform and Africa is suffering the worst consequences of a fragmented and secretive system.

## **Fair systems of taxation within African countries**

By reducing by 50 percent their 'tax gap' (the difference between expected total revenue and what is actually collected), African countries could raise an additional US\$112bn per year by 2020, equivalent to four percent of the continent's GDP.<sup>17</sup> Rwanda provides one success story of a country strongly increasing its tax revenue, while adopting a more progressive approach to taxation.<sup>18</sup> Domestic revenue rose from nine percent of GDP in 1998 to 14.7 percent in 2005, and the costs of tax collection were also reduced. This achievement was attributed to strengthening administration and improvements in accountability among all stakeholders. It was also supported by foreign aid. Unfortunately, globally no more than 0.1 percent of total official development assistance (ODA) is channelled into reforming or modernizing tax administrations, public financial management or tax collection.<sup>19</sup>

However, efforts to raise the tax-to-GDP ratio must be treated with caution. Governments must avoid the temptation to rapidly increase revenue from regressive forms of taxation, or

to prioritize the efficiency of the tax system over its progressiveness. Already tax systems in developing countries tend to be some of the most regressive in the world, with taxes more often penalizing the poor. For example, indirect taxes such as value-added tax (VAT), which fall disproportionately on poor people, make up on average 67 percent of tax revenues in sub-Saharan Africa.<sup>20</sup> A regressive tax system can offset part of the positive redistributive impact of social investment.

### The high price of corporate tax abuse in Nigeria

Corporate tax abuses, including royalty fraud in the extractive industry and other forms of illicit activity, led to Nigeria accounting for the largest share of total illicit financial flows from Africa (30.5 percent), worth up to 12 percent of Nigeria's GDP.<sup>21</sup> Domestically, the country exercises a regressive approach to taxation that reinforces uneven wealth distribution, with poor people paying disproportionately more in tax than the wealthy. To meet tax revenue gaps, state authorities charge a variety of indirect taxes, the burden of which often falls on street vendors and small and medium enterprises (SMEs), further squeezing already low incomes.

For example, Charles Ogbu is a 46-year-old owner of a fish-smoking business in Ossissa, Delta State. A father of four, his small business is undermined by multiple taxes, even as the source of his fish is threatened by the effects of climate change. Charles explains:

***'Every four days – that is, on Nkwor market day – I must pay different taxes to the local government, the market authority, the development levy, security and even tax on the motorbike that I use to transport my fish. Sometimes local government people will introduce one payment, print papers, and say the money will go to Asaba, the state capital. We are tired but there is nobody to speak for us. The water where I get my fish is drying up and covered with weeds. Canoes cannot navigate easily.'***

Former Finance Minister Ngozi Okonjo-Iweala acknowledges that 75 percent of registered businesses do not pay taxes.<sup>22</sup> While taxes should not necessarily be increased, revenue collection from income, corporate taxes and VAT must be improved. The government must reconsider its systems, which exert significant tax pressure on petty traders, market vendors (mostly women) and SMEs, while allowing big businesses and multinationals to get away with tax abuse.

Corporate income tax is enormously important to developing countries. It comprises a significant share of total tax receipts – around 16 percent on average – in low-income and lower middle-income countries, compared to an average of 6 percent in high income economies.<sup>23</sup> Taxing companies, particularly successful multinational companies, is one of the most progressive forms of taxation. All companies must pay their fair share of taxes, according to their means. They should not be allowed to escape their obligations to the societies in which they operate and where they generate their profits.

## International tax systems favour corporate tax dodgers<sup>24</sup>

It is clear that developing countries can make great strides towards more progressive and effective taxation and spending through action within their own borders, but their efforts to increase taxation will be ultimately hampered by an unfair international tax system that favours corporate tax avoidance. The potential tax revenue loss for African countries due to trade mispricing by multinational companies discussed above is just one small part of the full picture of the potential revenue that developing countries lose because of corporate tax avoidance.

Companies can take advantage of a myriad of loopholes in the international tax system that enable them to minimize corporate tax contributions by making taxable profits 'disappear' on paper. They can artificially attribute the ownership of assets or the locations of transactions to paper subsidiaries in secret jurisdictions with zero or low nominal tax rates, known as 'tax havens'.<sup>25</sup>

Estimates of how much tax revenue developing countries lose because of corporate tax avoidance schemes are hard to come by because of a lack of available data and opaque corporate reporting. Estimates that look at Africa in particular are almost non-existent. A recent report from UNCTAD found that developing countries lose around US\$100bn in tax revenues each year as a result of corporate tax avoidance schemes that route investments through tax havens.<sup>26</sup> This US\$100bn does not include the full set of tax avoidance schemes used by multinational companies nor does it include the estimated US\$138bn per year that developing countries lose because they give away generous tax incentives to multinational companies.<sup>27</sup> The overall impact of the broken international tax system on the tax revenue base of developing countries is likely to run into the hundreds of billions of dollars.

Multinational companies, investors and tax havens (or 'profit havens') cannot be allowed to prosper so unequally off the backs of, and at the expense of, the countries where they derive their economic value. The G20 has recognized that the international corporate tax system is outdated and requires reform. Led by the OECD, the Base Erosion and Profit Shifting (BEPS) Action Plan<sup>28</sup> is due for completion at the end of this year.

Unfortunately, the BEPS project is set to apply a plaster to a gaping wound. One of its stated outcomes is to deliver reforms of international tax rules that would ensure multinational companies can be taxed: 'where economic activities take place and where value is created'. But the BEPS project is set to fortify a system that results in higher tax revenues in the richer countries where multinational companies are 'resident', with no new revenue in the countries that provide the 'source' of the profits. This is because the OECD has ruled out negotiations on the fairer allocation of tax rights (known as the source vs. residence principle<sup>29</sup>) in favour of the status quo. Another critical flaw in the BEPS project is that two-thirds of the world's governments have no formal role in the negotiating process. One tax administrator remarked following an African regional consultation on the BEPS proposals that '*It's like coming to a dinner table, hoping to partake of the meal, only to end up on the menu.*'<sup>30</sup>

The BEPS project is also too narrow in scope, and concentrates too heavily on rich-country interests. For example, the agribusiness, telecommunications and extractives sectors are central to developing economies, yet the BEPS Action Plan gives them scant attention. Many developing countries rely heavily on extractive industries for public revenues, but these industries are often heavily under-taxed because of tax exemptions or profit-shifting practices.

#### **Great gains for South Africa's mining giants, but huge losses in government revenue**

In 2012, more than R300bn (US\$29.1bn) or close to 10 percent of GDP left South Africa in the form of illicit financial flows. Among the worst offenders were the countries' mining giants who used a variety of dubious accounting practices to sidestep paying taxes. This has led to the South African treasury losing out on US\$359m a year.<sup>31</sup>

Meanwhile, poor mining communities are going without vital public services that these taxes could help pay for. Ermelo is an old mining town close to Johannesburg. The town is in a state of decay with residents suffering high levels of unemployment and often lacking basic services such as water and electricity. In addition, water pollution caused by mining operations is affecting crop production and many families are now struggling to feed themselves as they cannot afford to buy food to make up for loss of crops.

Mine workers in Welkom, a gold mining town in Free State, are suffering from debilitating respiratory diseases such as tuberculosis or silicosis because of a lack of adequate protection in the mines yet struggle to access healthcare services.<sup>32</sup>

Regrettably, no international process is currently underway to tackle the issue of discretionary tax incentives. In their need to attract foreign direct investment (FDI), many developing countries offer generous tax breaks, without real evidence of any strong pay-offs in development terms.<sup>33</sup> Often, they accept unfair conditions imposed by powerful multinational companies when negotiating contracts, out of fear that companies will take their business elsewhere. For example, in Sierra Leone, a country with high economic inequality, tax breaks in 2012 amounted to an astonishing 59 percent of the entire government budget, more than eight times the health budget and seven times the education budget.<sup>34</sup> If Ethiopia could capture just 10 percent of the money it loses each year through tax exemptions, it could enrol 1.4 million more children in school.<sup>35</sup>

Some governments do try to resist such pressure from multinationals, as the following example illustrates.

#### **The Nigerien government and mining company Areva**

Niger is in the unenviable position of being ranked lowest on the UN Human Development Index, with 60 percent of its population living on less than US\$1 a day. This is despite the fact that Niger is also the world's fourth-largest uranium producer; the country has received very little in return for the exploitation of its valuable natural resource. Uranium represents almost 50 percent of Niger's exports, but only accounts for around five percent of the country's budget.

Areva, a French company, which is 86 percent state-controlled<sup>36</sup> and a leader in global nuclear energy, has been mining uranium in Niger for more than 40 years. During this time it has negotiated a number of tax privileges, such as exemptions from duties, VAT and fuel taxes, and a deal to exclude a portion of its profits from taxation.

In May 2014, Areva and the Nigerien government successfully negotiated a new general agreement. This now recognizes a new mining royalty rate, which is due to rise progressively from 5.5 percent to 12 percent, depending on market prices and the company's performance. By way of comparison, a royalty rate in Canada, for example, could typically be around 12 percent. But because today's uranium prices are low, the company will still pay low marginal tax rates and the higher tax rate will remain theoretical for now.

The Nigerien government announced that it signed mining conventions in October 2014; however, these have not been publicly disclosed, despite there being a constitutional requirement to do so. It is therefore not possible to assess the details of the agreement between Areva and the government. The government did want to apply a new convention that would remove exemptions on duties and VAT. However, Areva has negotiated to hold on to its VAT exemption and defer tax payments to a later date, thereby reducing its tax bill.<sup>37</sup>

The global revision of the mining code needs to tackle this issue and find a fairer way to calculate extractive companies' contributions.

Meanwhile, Niger's national budget is around US\$2.7bn. The country desperately needs additional revenue to sustain and improve basic services, such as education and free access to healthcare (which is under threat), and to invest in sustainable smallholder agriculture to address the threat to lives and livelihoods caused by recurring food crises. Official aid currently accounts for 40 percent of Niger's budget. Just by removing Areva's exemption on VAT, the country could earn as much as US\$20m a year. In 2013, US\$20m represented 5.6 percent of Niger's education budget,<sup>38</sup> and could pay for more than 200,000 children to go to primary school.<sup>39</sup>

In 2014, finance ministers of low-income francophone countries expressed a united view about how the international tax system hampers their ability to collect sufficient tax revenue:

*'The global tax system is stacked in favour of paying taxes in the headquarter countries of transnational companies, rather than in the countries where raw materials are produced. Low income countries need help to eliminate exemptions; renegotiate bilateral tax and investment treaties; and resist a "race to the bottom" through harmful competition to reduce*

*direct taxes. The cause of the problems in the international tax system is the lack of decision-making power for low income countries in global tax discussions.*<sup>40</sup>

The time has come for the creation of an **intergovernmental tax body that includes all countries as equal members and that has the mandate and resources to reform international corporate taxation to prevent tax evasion and avoidance and harmful tax competition, and to ensure tax cooperation between governments.**

As Oxfam International's Executive Director Winnie Byanyima said recently, *'It's absurd that there are international organizations for trade, health and football, but not for tax.'*

This would build on and complement current reform initiatives, such as the G20 and OECD BEPS Action Plan, as well as efforts to improve the automatic exchange of information between tax authorities, and public country reporting by companies to improve transparency and enable all countries to benefit from the international tax system more fairly.

The WEF-Africa Addis Conference offers a crucial step on the road to improving international cooperation on tax and an important opportunity to build momentum. Tax must be at the top of the agenda in Addis. African governments, like all governments, must commit to action on raising more revenue through progressive taxation and spending, and improved transparency and accountability. But international tax reform is essential for African governments to tap their tax-raising potential and bring more equity to the tax system.

## **Deliver aid promises**

In an analysis of how the Millennium Development Goals (MDGs) are being financed across a broad range of developing countries, Oxfam and Development Finance International found that government revenue currently funds 77 percent of spending on the MDGs.<sup>41</sup> National public finance has been found to be more stable, aligned with government priorities, balanced between investment and recurrent, and easy to implement than donor-funded spending. This underscores the importance of the need to mobilize domestic resources. Even with increases in domestic revenue collection, the needs are enormous, and alone will not in itself be sufficient. Other sources of new and additional international public finance are needed. Over the last decade, financial flows beyond aid have grown by significant degrees. Aid no longer dominates the development finance portfolio as it once did. Private finance, such as FDI and remittances, has come to make up the largest aggregate share of resources flowing to developing countries. But, aid remains a vital flow of concessional public finance to more than a fifth of the world's countries. Aid is still larger than any other external resource flow in 43 countries – most of them in sub-Saharan Africa – which are home to over 220 million people living on less than US\$1.25 a day,<sup>42</sup> and where over 20 percent of the population is going hungry.

Ultimately, the goal is for aid to work itself out of a job. To make this happen, aid must first catalyse other forms of development finance and help sustain it. The vast majority of extremely poor people live in countries where tax systems are weak and raise minimal public revenues domestically. Aid should support increasing domestic revenue collection to increase self-reliance. Second, aid needs to advance the rights of citizens. More aid should be used to improve public accountability and to support citizen's efforts to hold their governments to account. Development is the product of a compact between active citizens and effective states. Aid most often fails when it tries to substitute for this relationship, rather than supporting and strengthening it. Finally, aid needs to do a better job of sustainably supporting people to raise themselves out of poverty. Donors remain reluctant to fully invest in the success of local development institutions and leadership to sustain development independent of aid.

### **Mozambique's aid success story**

Along with taxation, aid investments directly contributed to Mozambique's national plan to tackle poverty and inequality by encouraging increased national spending in social sectors.

Just 20 years ago, Mozambique was the poorest country in the world. It has since doubled its spending on healthcare. This investment in more trained health workers and new health centres across the country is providing people with direct access to medicines. In the past decade, this has helped to reduce the number of children in Mozambique who die before their fifth birthday by 20 percent.<sup>43</sup>

Mozambique's response to disaster risk reduction has also been a success. In 2000, Mozambique was battered by cyclones and floods that killed 800 people, displaced half a million and left more than a million people without income. Since then, with the support of aid, the government has prioritized disaster management, developing a nationwide master-plan that includes early warning systems and community mobilization, which could save many lives and protect livelihoods.<sup>44</sup>

International aid plays a role in saving millions of lives and alleviates poverty and inequality. But rich country donors continue to break their aid promises, many by a considerable margin. If all OECD donors actually delivered on their 40-year-old commitment to reach the international aid target of 0.7 percent of gross national income (GNI), this could raise an additional US\$250bn a year, bring their total aid contribution to just short of US\$400bn per year.<sup>45</sup> This year, the OECD announced that donors' average net aid stood at just 0.29 percent of GNI. Just five countries (Denmark, Luxembourg, Norway, Sweden and the UK) met the 0.7 percent GNI target for ODA in 2014. Of the G7 group, the UK, Germany and the US did increase their aid. Fifteen donor countries reduced their aid budgets, including four G7 countries: France, Canada, Japan and Italy. The biggest declines in aid were from Australia, Canada, France, Japan, Poland, Portugal and Spain. Aid to Least Developed Countries (LDCs) dropped by eight percent in 2014,<sup>46</sup> and only five donors (Denmark, Ireland, Luxembourg, Norway and Sweden) hit the target of 0.2 percent to the poorest countries. In terms of the geographical distribution of international aid, donor countries spent just 0.09 percent of their collective GNI on aid to LDCs,<sup>47</sup> the majority of which are in sub-Saharan Africa.

Emerging-economy donors and other new providers cannot be expected to fill financing gaps either. While the levels of South-South cooperation have increased over the past 15 years, with this accounting for US\$16.1bn–US\$19bn of aid in 2011,<sup>48</sup> it is still only equivalent to one-eighth of total aid from OECD donors. Traditional donors cannot shirk their promises to pay their full share of concessional public finance and expect developing-country governments – with large populations of people living in poverty – to meet the shortfall.

Shocks, crises and uncertainty undermine the impact of development efforts and investments, and entrench inequality. Concessional aid continues to be needed more than ever to allow countries to respond to and recover from shocks and crises. The recent outbreak of Ebola in West Africa and the earthquake in Nepal have shown how quickly development gains can be rolled back, and how the poorest people suffer more, and for longer. While disasters can hit anywhere, they have the greatest impact on the poorest countries and on the poorest people within them.<sup>49</sup>

## **Public spending to fight poverty and inequality, and to build resilience**

It's not just more international and public finance that is vital; equally important is how it is spent. A greater proportion of domestic public finance and aid – both humanitarian and development – must be used to prevent, mitigate for and reduce risk, to build resilience and strengthen public services for all. Public investment in health, education, agriculture, and



water and sanitation is essential to fight poverty and inequality. Public investment that provides added-value when climate-proofing is integral to development programmes: investments that take account of a changing climate will help safeguard sustainability at local and global levels. International public finance, however, should not be double-counted against new and additional climate finance targets.

To increase the development effectiveness of all forms of public (and private) finance, action is needed at the Addis Conference to accelerate progress toward meeting existing development effectiveness standards, such as the Busan Partnership for Effective Development Cooperation, which include commitments towards government ownership, transparency and accountability for all development actors.<sup>50</sup> Of paramount importance is that African governments have ownership over (and are accountable for) their development agendas. There needs to be a focus on *how* international public finance and domestic public spending is allocated and targeted, as this has a definitive influence on inequality and poverty outcomes. Spending within countries, across sectors or across social groups (gender, age, ethnicity etc.) is also crucial in this respect. Research by the Association of Women in Development (AWID) in 2010 revealed that the median budget for 740 women's organizations from around the world was a miserly US\$20,000.<sup>51</sup> Meaningful systemic change towards gender equality and women's rights can only happen with significant resources.

Most developing countries are spending, on average, only 38 percent of their spending budgets on the MDG sectors.<sup>52</sup> It is essential that Africa governments are held to account for spending targets in key sectors, such as health, education and agriculture, in line with African Union commitments. For example, the Ebola-affected countries in West Africa historically allocated inadequate levels of government spending on healthcare, compared with the Abuja target of spending 15 percent of the public budget on health. Only Liberia has reached this target and even then it is well below the figure of \$86 per capita per year, which is the most recent estimate of the minimum public spending needed to achieve universal primary healthcare.<sup>53</sup> Only ten African countries have consistently met the Maputo commitment to spend at least 10 percent of their budgets on agriculture,<sup>54</sup> despite the reaffirmation of the target by African Union leaders last year in Malabo.<sup>55</sup> This can, however, be challenging when debt service costs, which are increasing sharply, are 'crowding out' spending in other areas, such as on health and education. Additionally, large proportions of budgets are spent on essential large-scale infrastructure.<sup>56</sup>

Global funds for health and education have been critically important in helping to fill these gaps, provided they are aligned with national plans, but in the long-term countries must finance these priorities from their own budgets. The Global Partnership for Education is a strong model of international cooperation which prioritizes country ownership and sustainability by providing grants to finance high-quality national education plans. This approach deserves much greater financial support from the global community, and efforts must not be fragmented by the creation of a separate global fund for education. While the Global Fund to Fight AIDS, Tuberculosis and Malaria has provided an effective response to these diseases, such a model would not be appropriate for delivering comprehensive health systems. Instead, direct investment in national health plans should be prioritized to ensure country ownership and support for national priorities and planning, as well as avoiding donors' coordination challenges at a country levels.

## **Align private finance to guarantee sustainable and equitable development and poverty reduction**

To mobilize the massive resources required to meet the sustainable development challenge head on, private finance is an inevitable part of the effort since considerable levels of investment are required for large-scale infrastructure projects, such as roads, railways, power and telecommunications. But private finance must play a positive role in development by creating job opportunities, enabling people to learn new skills, and generate the wages communities desperately need to prosper. Private finance and the private sector cannot also substitute for public finance.

FDI plays an important role in the development process by stimulating the private sector, but there is an urgent need to improve the transparency and quality of FDI, and to regulate and direct overall flows to priority areas in line with national priorities. Developing countries must have the necessary policy space and flexibility to drive and regulate private financial flows and activities towards growth with equity and decent employment. Until now, evidence has shown that FDI hardly reaches least developed countries and micro, small and medium enterprises (MSMEs), which provide the majority of employment and GDP in developing countries.<sup>57</sup>

The role of financial instruments created to mobilize private investment, such as public private partnerships and blended finance for development, are consistently over-emphasized by donors and governments. There must be guarantees in future partnerships that the role of private providers in development is positive and sustainable, and does not entail any conflict with the public interest. Too often private finance is mobilised in murky, unaccountable ways, leading to hidden public and user debt burdens and environmental, social and human rights abuses. There is rapidly growing evidence, including from many European countries, which shows that long-term contractual arrangements in which the private sector is tasked with the delivery of a public service or an asset are a very expensive and risky method of financing. If they fail, public-private partnerships (PPPs) can end up 'privatising benefits while socialising losses', when the public sector has to rescue or bail-out a failing private service provider.<sup>58</sup> Oxfam research into 'mega-PPPs' in agriculture similarly found them likely to skew the benefits of investments towards the privileged and powerful, while leaving the risks to fall to the poorest and most vulnerable.<sup>59</sup> Despite this, there has been a rapid expansion of aid being used in partnership with private sector investment without the required level of debate on the strong accountability and mechanisms needed to ensure that the aid is stimulating the private sector's contributions to sustainable development. By 2015, the amount of aid flowing to the private sector is expected to exceed US\$100bn, which is equivalent to almost two-thirds of ODA.

Private finance cannot, and should not, substitute the role of governments in their obligation to safeguard human rights and provide basic services and agriculture extension. Good-quality public health and education services that are free at the point-of-use and available to all can be powerful equalizers, enhancing the economic prospects of the majority while protecting those who are most vulnerable from impoverishment. Addressing funding gaps at a national level through strengthened and fairer taxation, and aid as required, is imperative for universal public service provision.

However, many developing country governments and donors are supporting the private sector as partners in development in areas such as health, education, agriculture, and water and sanitation.

The UK's Department for International Development (DfID) was recently criticized, for example, for its partnerships with the private sector. The UK's Independent Commission for Aid Impact (ICAI) said DfID 'must work with businesses which want to invest in developing countries in such a way as to maximize benefits for the poor'.<sup>60</sup> To give another example, the World Bank Group's (WBG) International Finance Corporation (IFC) is investing large sums in high-end, urban private hospitals, private insurance providers and other private health actors through its Health in Africa initiative.<sup>61</sup>

Private health and education services benefit the richest first and foremost, leaving people in poverty behind. When healthcare is sold through the private sector for example, quality care and medicines are often available only to those who can afford them, while poor people may be forced to rely on low-quality medicines or unqualified care. At the same time, prioritising the private sector can see public services eroded as financial and human resources are diverted from the public to the private system. Oxfam found that a new PPP hospital in Lesotho was costing at least three times the amount of the old public hospital it was built to replace, amounting to 51 percent of the total health budget for the entire country.<sup>62</sup> In a submission led by the International Chamber of Commerce (ICC) responding to the draft negotiating text for the Addis Summit, the ICC pushed the insertion of new language to

promote 'blended finance' (public and private) and a bigger role for private finance, including 'using limited public finance to mobilize private'.<sup>63</sup>

Meanwhile the IFC's lending to financial intermediaries, such as banks, private equity and hedge funds, for projects from the energy to agri-business sectors now outstrips the WBG's lending to health by 50 percent and is three times higher than its lending to education, with disastrous consequences for people suffering from land rights and other human rights abuses.<sup>64</sup>

There is an urgent need to work towards stable and binding rules and standards, which are conducive to achieving national development priorities and to ensuring that businesses adhere to the UN Guiding Principles on Business and Human Rights, and respect international social and environmental safeguards. Specifically, clear criteria should be applied when donors and governments are deciding on private sector partners and evaluating potential deals. Criterion should be based on financial sustainability, accountability, and a strong governance framework including independent oversight, and transparent monitoring and reporting. Compliance with development effectiveness principles and robust environmental and social safeguards is also critical. There should also be equity in risk, benefit sharing, and influence over project design between governments, donors and private investors. Finally each project should be assessed against whether it maximizes benefits for sustainable development, as well as ensure interventions do no harm.

## **Climate change adds a huge burden on developing countries**

For many developing countries climate change already presents huge additional costs that were not taken into account when aid targets were set. Conservative top-down models, which tend to grossly underestimate adaptation costs, suggest that following current trends of global greenhouse gas emissions, sub-Saharan African countries will face total costs for climate change adaptation and from residual damage from climate change impacts of between 0.5 and 1 percent of GDP by 2025, over 2 percent of GDP by the 2050s and over 6 percent by the end of the century.<sup>65</sup>

The G7 countries themselves bare a major part of the responsibility for the emissions driving these impacts. Coal-fired power stations in G7 countries alone emit twice as much fossil fuel as the entire African continent. They will cost Africa more than \$40bn per year by the 2080s, and approximately twice as much per year by the end of the century. This is three times what the G7 countries contribute to Africa in ODA.

In the face of such costs, the domestic finance that African governments are already spending on adaptation alone (without taking into account the costs to mitigate climate change) is significant and growing. Oxfam estimates that sub-Saharan African countries are already spending around US\$5bn of their own resources on climate change adaptation – for many countries far more than the amount they have received in international climate finance. For example, Tanzania spends approximately three times more on adaptation each year from its own budget than it received from international climate finance in the three years of the 'Fast Start Finance' period (2010–12); Ethiopia spends approximately double each year what it has received in the same three year period.<sup>66</sup>

This year governments are negotiating a new international climate change agreement for the post-2020 period, due to be finalized in Paris in December 2015. In the face of spiralling domestic costs and flat-lining public international climate finance flows, the Africa Group of negotiators have proposed a new long-term goal for adaptation that would ensure that international adaptation finance targets are set based on the collective mitigation ambition of the new agreement. With adaptation having received only a minor fraction – less than a fifth – of international climate finance flows in recent years, it is vital that the Africa Group's proposal is agreed in Paris to ensure a significant increase in international public support for adaptation in the years ahead.

It is also vital to ensure that donor countries – who are increasingly double counting contributions to aid as climate finance – do not simply rob existing aid budgets to pay for new spending on climate adaptation. The UN Financing for Development Conference in Addis Ababa must recognize that climate change brings an additional burden to developing countries. Climate finance for mitigation and climate resilience – including funding to increase food security in the face of climate change – should be provided on top of resources provided to meet existing aid commitments (such as the 0.7 percent GNI target), and the diversion of existing aid to climate finance should be stopped immediately.

However, recognizing that climate finance can qualify as development aid if it is provided as grants or concessional loans, and that adaptation measures are often similar in nature to well-designed development programmes, an interim agreement could be struck in Addis: where climate finance qualifies as ODA, it should be part of a rising overall aid budget, which increases at least at the same rate that climate finance increases. This would be a first step towards ending the diversion of existing aid to climate finance, and making the provision of climate finance additional to existing aid promises. Agreement at the Addis Conference on this point would signify an important trust-building measure, helping to unlock the standoff in the climate finance negotiations ahead of this year's UNFCCC meeting in Paris.

Additionally, Addis is the right place to secure commitment to a high-level political process to release new sources of finance – such as fair carbon pricing on bunker fuels, financial transactions taxes and other innovative sources – which could secure predictable and scalable funding for the Green Climate Fund, in addition to existing government budget contributions.

## Conclusion

African governments are in desperate need of new and additional public finance not only to fill financing gaps in their budgets, but also to invest more in the future SDGs. African governments have a central role in turning this situation around with a package of policy measures that delivers a more equitable and sustainable path for their development. But their efforts are hampered by international finance policies that are skewed in favour of rich countries and individual and commercial vested interests. This has resulted in the African continent hemorrhaging billions of dollars in taxable financial resources. These potential tax losses could have been invested in reducing inequality and poverty. At the same time, rich-country donors continue to default on another vital income stream for Africa, as they break their promises on aid and on providing new and additional contributions to climate finance. The G7 must do more to reform unfair tax rules so they benefit all countries, particularly poorer countries. They must also deliver on aid promises and commitments to provide new and additional finance for countries to mitigate and adapt to climate change.

### **Oxfam is calling for the following steps to be taken to ensure that financing for development is fair for all:**

- Governments must arrive in Addis ready to make ambitious commitments – it is the culmination of the biggest year for development for 15 years. This requires the **highest level of political participation**, with Heads of State and Government, and no less than Finance Ministers, attending.
- Governments must finish the job of clamping down on tax dodging by multinational companies through the **creation of an intergovernmental body for cooperation in tax matters that includes all countries**, developed and developing, on an equal footing in decision making; and broaden the scope of future tax negotiations to include issues that ensure developing countries get their fair share of corporate tax revenues.
- Acknowledging most donors' failure to fulfil past aid promises, governments must **re-commit to 0.7 percent ODA/GNI, backed with targets that have tangible, verifiable timetables**, with a rising allocation of total share to the poorest and most vulnerable countries reaching 50 percent within the next five years.

- Recognize that **climate finance for mitigation and adaptation must be fully additional** to resources provided to meet existing development finance targets, and commit as a first step that where climate finance qualifies as ODA is should be part of a rising overall aid budget, which increases at least at the same rate that climate finance increases.
- Private finance must **guarantee sustainable and equitable development and poverty reduction**. It must not be seen as a substitute for filling the gaps in public provision and financing, and must demonstrate strong transparency and accountability.
- Increases in **international concessional aid and national public spending must be targeted at reducing economic and social inequalities and poverty**, with more spending on public services, women and other disadvantaged groups, sustainable agriculture and small-scale food production, and citizens' efforts to hold governments to account.

# Notes

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- <sup>12</sup> AU/ECA Conference of Ministers of Finance, Planning and Economic Development (2011) 'Illicit Financial Flow: Report of the High Level Panel on Illicit Financial Flows from Africa', pg 105, <http://www.uneca.org/publications/illicit-financial-flows>. According to the report, the amount could be even higher.
- <sup>13</sup> Trade mispricing involves either under or over-declaring the true value of goods and services moved between subsidiaries of the same multinational company, mainly to reduce artificially the tax bill by declaring loss in countries with high taxation and profits in countries with low taxation). While deliberate transfer mispricing in theory constitutes unlawful tax *evasion*, in practice current tax rules allow companies to set the prices of many company-specific goods and services more or less arbitrarily, making them nearly impossible for developing country tax authorities to challenge. It is estimated the by the OECD that 60 percent of all world trade is intra-firm trade and therefore possibly at risk of trade mispricing.

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- <sup>14</sup> Calculated on the basis that the cumulative percentage of world stocks from the seven countries in 2013 was 52 percent. Fifty-two percent of \$40bn flowing out due to trade mispricing amounts to approximately \$20bn attributed to G7 country based multinational companies and investors. Source: Data on Outward Foreign Direct Investment from the G7 countries was obtained from UNCTAD, <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx>
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- <sup>24</sup> See C. Godfrey (2014) 'Business Among Friends: Why corporate tax dodgers are not yet losing sleep over global tax reform', Oxford: Oxfam, <http://oxf.am/chP>
- <sup>25</sup> Tax havens are jurisdictions or territories which have intentionally adopted fiscal and legal frameworks allowing non-residents (physical person or legal entity) to minimize the amount of taxes they should pay where they perform a substantial economic activity. They usually fulfil several of the following criteria (to be applied in a combined way): (i) they grant fiscal advantages to non-resident individuals or legal entities only, without requiring that substantial economic activity be made in the country or dependency; (ii) they provide a significantly lower effective level of taxation, including zero taxation for natural or legal persons; (iii) they have adopted laws or administrative practices that prevent the automatic exchange of information for tax purposes with other governments; or (iv) they have adopted legislative, legal or administrative provisions that allow the non-disclosure of the corporate structure of legal entities (including trusts, charities, foundations etc.) or the ownership of assets or rights.

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- <sup>29</sup> A company's headquarters is often tax-resident in one place and registered in another.
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- <sup>31</sup> Open Society Initiative for South Africa (OSISA), Third World Network Africa, Tax Justice Network Africa, Action Aid International, Christian Aid (2009) 'Breaking the Curse: How Transparent Taxation and Fair Taxes can Turn Africa's Mineral Wealth into Development', <http://www.christianaid.org.uk/Images/breaking-the-curse.pdf>
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