



# **NEXUS BETWEEN TAX, PUBLIC DEBT AND INEQUALITY IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY IN**

**SADC**

# ACKNOWLEDGEMENTS

The African Forum and Network on Debt and Development (AFRODAD), the organisation would like to recognise and appreciate the efforts made by Dr Nebson Mupunga, the researcher and Theophilus Jong Yungong the AFRODAD Head of Programmes who provided leadership in this study. We would also like to acknowledge Rangarirai Chikova and Michael Zuze for reviewing and editing the document. Lastly, we also appreciate the support from Moreblessings Chidaushe from Norwegian Church Aid – Southern Africa.



# TABLE OF CONTENTS

|     |  |    |
|-----|--|----|
| 00: | Executive Summary  | 1  |
| 01: | Introduction   | 4  |
| 02: | Tax And Debt Management in SADC                          | 6  |
| 03: | Nexus between Debts, Tax and Inequality in SADC          | 18 |
| 05: | Adequacy of Policies to address inequality in SADC       | 24 |
| 06: | Fiscal and Debt Management Policies to reduce inequality | 29 |
| 07: | Conclusion   | 33 |
| 08: | Reference  | 35 |



## TABLE OF FIGURES

|            |  |    |
|------------|--|----|
| Figure 1:  | Debt Management Challenges in SADC   Source: World Bank (2019)         | 6  |
| Figure 2:  | Trends in Total Revenue in Percent of GDP in SADC Economies            | 8  |
| Figure 3:  | Tax Revenue In Percent of GDP  | 9  |
| Figure 4:  | Composition of Tax Revenues as Percentage of GDP                       | 10 |
| Figure 5:  | Composition of Tax and Non-Tax Revenue                                 | 12 |
| Figure 6:  | Trends In Government Expenditure as a Percent of GDP                   | 13 |
| Figure 7:  | Social Expenditure and Interest Payments In SADC Countries             | 14 |
| Figure 8:  | Evolution of Public Debt for SADC Countries (2012-2019)                | 16 |
| Figure 9:  | SADC GDP Growth Rates (2007 to 2019)                                   | 17 |
| Figure 10: | Trends In Inequality In SADC Region In 207 Compared To 2019            | 19 |
| Figure 11: | Income Shares By Categories of Population                              | 20 |
| Figure 12: | Nexus Between Tax, Gini And Debt                                       | 21 |
| Figure 13: | Five years Average Fiscal Adjustments In SADC 2007-2019                | 22 |
| Figure 14: | Nexus between public debt to GDP ratio and Gini Index                  | 23 |
| Figure 15: | Trends and changes in Percapita Income.                                | 25 |
| Figure 16: | Per capita Incomes And Inequality                                      | 25 |
| Figure 17: | Social Protection Expenditure and Coverage for Older People (% of GDP) | 26 |
| Figure 18: | Poverty Headcount Ratio At \$1.90 A Day (2011 PPP) (% Of Population)   | 27 |
| Figure 19: | Progress on Shared Prosperity in SADC Countries                        | 27 |
| Figure 20: | Open Budget Index  | 31 |

## LIST OF TABLES

|          |                                     |    |
|----------|-------------------------------------|----|
| Table 1: | Tax Rates in SADC Countries         | 14 |
| Table 2: | Estimates of DSSI in SADC Countries | 18 |

# EXECUTIVE SUMMARY

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Inequality in SADC countries has remained high, with countries such as South Africa having extreme inequality compared to regional and global averages. Precisely, the SADC region is considered most unequal with countries such as Namibia, Comoros, South Africa, Angola, Botswana, Lesotho and Swaziland rated in the top ten of the most unequal countries in Africa (AfDB, 2012). The high levels of inequality have persisted despite successive growth rates and accompanying rise in domestic revenue mobilisation over the years. The low tax revenue amid high gross financing needs have also seen SADC countries accelerating borrowing from both domestic and external sources to finance development expenditure. Consequently, public debt has been rising in SADC economies, posing the risk of accumulating debt to unsustainable levels, with costly debt service obligations that could crowd out social expenditure.

The rapid pace of debt accumulation has seen an increasing number of SADC countries' debt distress ratings deteriorating from low and moderate to high risk and in-debt distress rating. These countries include, Zambia, DRC, and Mozambique. The situation has been compounded by the Covid-19 pandemic which reduced growth rates, hence tax capacity and debt carrying capacity of SADC countries. Although the G20 debt service suspension initiative (DSSI)

has alleviated debt service pressure under Covid-19 and protecting social expenditure for participating SADC countries, the initiative merely postpones the debt burden which will affect social expenditure in the future. Against this backdrop, this study sought to understand the nexus between tax, debt and inequality in the SADC region. The study traces the evolution and trends in tax, debt and inequality with a view to understand the underlying factors. The study also draws conclusions and insights from surveys and papers written by the IMF, World Bank, ILO, Oxfam, United Nations and views of Civil Society Organisations (CSOs) on fiscal policy, debt and inequality in developing countries, including the SADC region.

The study noted that SADC countries have, generally maintained their tax capacities as evidenced by relatively stable tax to GDP ratios, thus potentially guaranteeing financing of the social sectors. The coverage of social protection though remaining fairly sustained, has not significantly translated into inequality reduction as evidenced by a slightly reduction in the GINI index from averages of 55 in 2010 to 54 in 2019. The study also noted that the fiscal space created by new borrowing opportunities and moderate increase in tax revenues have enabled SADC countries to increase expenditure from averages

of 23 percent of GDP in 2006 to averages of 27 percent in 2019. The efforts made by SADC countries in enhancing domestic resource mobilisation supplemented by domestic and external borrowing have also resulted in gradual reduction in poverty levels as measured by GDP per capita. Interestingly, an increasing number of SADC countries have been upgraded by the World Bank from lower income category to lower middle income status since 2012. The recently upgraded countries include, Zambia, Zimbabwe and Tanzania. The study also noted that countries with better institutions as measured by the World Bank's Open Budget Index (OBI) have higher tax capacity compared with countries that have a lower OBI. This, notwithstanding, the subdued economic growth rates in recent years have compromised efforts by SADC countries to create adequate employment necessary to reduce inequality. Average economic growth rates reduced from 5.1 percent between 2006 and 2012 to about 3.3 percent for the period 2013 to 2019. The subdued growth rates have compromised SADC countries' tax capacity and debt carrying capacity and, in the process, translating into lower revenues and difficulties in settling external debt obligations or doing so at unrealistically high levels at the expense of social protection.

The study also noted that about 55 percent of total income in SADC countries is held by the top 20 percent and 35 percent by the highest 10 percent, while the bottom 20 percent hold 6 percent of income on average. This dichotomy calls for increased progressivity of the tax system to accelerate shared prosperity and redistribute the proceeds to social sectors. SADC countries also need to sustain efforts to grow their economies in order to enhance tax capacity, debt carrying capacity and boost domestic revenues for financing social expenditure and other developmental needs, while maintaining debt sustainability. Accordingly, the study recommends the following measures to boost tax and debt carrying capacity and help finance social protection schemes for reducing inequality:

- i. **Introduce wealth tax which can take the form of expanded coverage of property tax in view of the growing values of properties in urban cities. Property is generally a symbolism of wealth and increases its value as cities grow, thus, offering substantial unearned income to the owners. The additional revenue from property tax can assist in debt service as well as boosting social expenditure, thereby assist in reducing inequality and maintaining debt sustainability.**
- ii. **Reduce tax exemptions for VAT and tax holidays for foreign companies to boost tax revenue for re-distribution to social sectors and foster equality between domestic and foreign entities. Increased tax revenue also enhances debt carrying capacity which is necessary for alleviating debt servicing pressure and the risk of crowding out social expenditure.**
- iii. **Increase the depth and coverage of electronic transaction tax in view of the increased use of emerging electronic payment streams, including mobile money. This tax will also assist member countries to tap into the informal sector which largely remained outside the income tax bracket. Similarly, technology can be leveraged to enhance the efficiency of tax collection by modernizing and streamlining tax collection processes, reducing compliance costs and closing leakages.**
- iv. **Increase the progressivity of tax structure by making sure that the high income households and firms are taxed more than the poor. This entail increasing the income tax rates for high income agents to around 40 percent which is the highest for countries such as South Africa. This should be accompanied by efforts aimed at improving targeting spending on poor families, the elderly, the marginalised and the unemployed to reduce inequality.**
- v. **Expand level and coverage of social expenditure particularly in education and health for the poor and remote households to break the cycle of intergenerational poverty and inequality. This measure needs to be accompanied by appropriate labour policies that provide opportunities for employment in public entities to skilled personnel in remote and poor households.**



vi. **Improving institutions, particularly, transparency on tax, budget and borrowing is critical to boost the country tax capacity and the redistributive role of fiscal policy. Transparency is enhanced through increased disclosure and publication of key public sector statistics. Moreover, provision of timely and sound data is critical for sound debt and tax administration.**

Overall, boosting economic growth and taking measures to ensure inclusivity is fundamental in expanding the tax base, reducing debt burden and ultimately poverty, unemployment and inequality. Improving tax capacity will boost the ability of countries to increase social expenditure on, health, education, infrastructure and other social spending necessary to reduce inequality. Increased tax capacity will also increase the debt carrying capacity, thus enabling SADC countries to underwrite more domestic and external borrowing for financing huge gross financing needs, while simultaneously safeguarding social expenditure and public debt sustainability.

Moreover, enhancing the distributive aspect of fiscal policy is critical to ensure that the rich or high-income households and firms are taxed more than the poor and resources channelled to social protection and social safety nets. Public borrowing and tax receipts must support inclusive growth that is job rich, skills enhanced and human development necessary to reduce inequality. Curbing of illicit financial flows, removal of tax holidays, reducing tax evasion and avoidance, improving capacity for revenue collecting agents is also important in improving tax capacity. In this regard, Civil Society Organisations (CSOs) and Labour unions have an important role to play in lobbying for improved budget transparency, effective debt management systems and fair distribution of income, including resource rents. Transparency in public debt management is critical to help SADC countries make prudent borrowing and investment decisions that will not hinder sustainable financing of social expenditure



# INTRODUCTION

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## 1.1 Background and Context

Countries in the Southern African Development Community (SADC) continue to make concerted efforts to improve their economies through various financing mechanisms aimed at enhancing growth, development and ultimately reduce poverty. The pursuit for attainment of these objectives have over the years seen SADC countries using a combination of domestically generated resources in the form of taxation and borrowed funds from both domestic and external sources to finance development. These efforts have resulted in significant improvement in the income status of SADC member states as depicted by rising per capita levels from averages of US\$1750 in year 2000 to US\$4187 in 2019 (IMF 2020). Consequently, an increasing number of SADC member states have been upgraded by the World Bank from low income (LICs) category to lower middle income category and or from lower middle income to upper middle income.

According to the World Bank classification of countries by income status, there were only 5 out of 15 SADC countries that were still classified in the LIC category in 2019, compared to 9 in 2010 (World Bank, 2019). The recently upgraded

countries include, Zimbabwe, Zambia and Tanzania, with, Malawi, Mozambique, Comoros and DRC still to be upgraded. The rise in per capita income has, however, not been accompanied by a concomitant increase in the overall quality of life and reduction in inequality as evidenced by slow progress in reduction in inequality and poverty headcount. The poor performances, in terms of reducing inequality, are not specific to resource-poor countries only, but also a feature of resource-rich countries such as the Congo, Angola and South Africa (AfDB, 2011).

More importantly, improved fiscal space following debt relief initiatives in some SADC countries have increased borrowing capacity from traditional and emerging creditors, including access to international capital markets. The debt relief freed substantial resources for financing social expenditure necessary to reduce inequality. Moreover, the increased borrowing space has in turn provided SADC countries with additional resources to finance development expenditure and to stimulate economic growth. The accompanying rising GDP has provided opportunities for SADC countries to raise their tax bases, since the quantum of tax revenue



critically depends on the size of the economy. However, the new borrowing has concomitantly increased public debt from an average of 39.2 percent in 2011 to 55 percent in 2019 (IMF, April 2020). As a result, 4 countries in the SADC region have been assessed by the IMF in their respective Article IV reports to be at high risk of or already in debt distress. These countries include Angola, Zimbabwe, Zambia, and Mozambique.

The rising public debt and accompanying debt service obligations have been compromising sustainable financing of social sectors, thus, heightening the already high levels of poverty and inequality. Moreover, despite, significant improvements in income per-capita, inequality has remained elevated, posing risks of social cohesion, political polarization, and subdued economic growth (IMF, 2017). Reducing poverty and inequality are central to the United Nations (UN)'s Sustainable Development Goals (SDGs) and the World Bank Group's twin goals for 2030 of ending extreme poverty and promoting shared prosperity in every country in a sustainable manner (World Bank 2019).

The high income inequality in SADC countries underscores the need for understanding the nexus between debt, tax and inequality which are emerging challenges. High inequality also compromises macroeconomic stability and economic growth, which are also key determinants of tax and debt carrying capacity. Against this backdrop, this paper discusses the nexus between tax, debt and inequality in SADC economies. Precisely, the paper assesses the trends in tax, debt and inequality and policies being pursued by SADC countries to address inequality and the adequacy of such policies. The paper also proffers recommendations and strategies for improved domestic resources mobilisation, mineral resources governance, prudent debt management and options for reforming tax policies to help achieve equitable income distribution objectives in a manner that is consistent with maintaining debt and fiscal sustainability.

## 1.2 Methodology

The study was conducted through desk review of existing empirical studies on tax, debt and inequality and a review of SADC countries tax and debt management policies. In view of the relative paucity of research on the nexus between tax, debt and inequality in the SADC region, this study attempts to provide, a broad picture of the nexus in these variables by combining insights drawn from studies done in sub-Saharan Africa. The study also draws heavily on reports and papers written by the IMF, World Bank, Oxfam, UN, OECD and International Labour Organisations (ILO) on poverty and inequality. The key secondary data for statistical inference were obtained from the IMF World Economic Outlook Database, World Bank Poverty and Inequality database, Oxfam Inequality Database, IMF longitudinal reports and database, World Development Indicators, World Bank Poverty and Inequality, World Bank social protection reports and OECD Public and Social Expenditure Reports and Database.

## 1.3 Structure of the paper

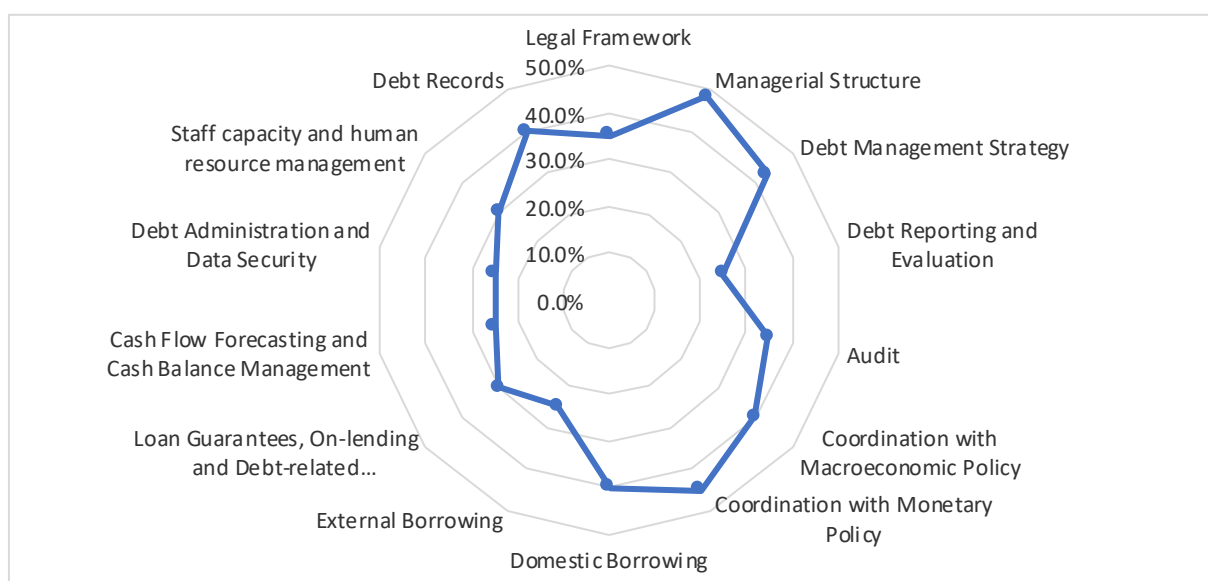
The structure of the paper is as follows. Section two discusses trends and challenges in tax, debt and inequality across SADC economies, including the nexus of these variables. Section three discusses trends in inequality in the SADC region, including the nexus between inequality, tax and debt. Section four discusses the policies being pursued by SADC countries to deal with inequality and an assessment of the adequacy of such policies. Section five discusses the options for fiscal policy reform to promote inclusive growth and fiscal redistributive goals necessary to reduce inequality. Finally, section six concludes the paper.

## TAX AND DEBT MANAGEMENT IN SADC

The Debt Management Performance Assessment (DeMPA) conducted by the World Bank by by end-2018 in low income and lower middle income countries, which also included selected SADC countries, noted weak debt management governance, such as suboptimal borrowing frameworks, insufficient audits and lack of operational risk management; partial debt

recording coverage; poor cash flow forecasting and management; and insufficient staff capacity in debt management offices, to adequately assess fiscal and debt risks and undertake debt sustainability analysis as major areas of public debt management concerns. The chart below summarises these challenges for selected SADC member countries.

**Figure 1: Debt Management Challenges in SADC | Source: World Bank (2019)**



As shown by the chart above, the areas which were rated poorly, have a score of less than 50%, reflecting a DeMPA score lower than C as per the World Bank category. The only area rated well on average is the managerial structure and to a lesser extent the coordination of debt management with monetary policy. The drying up of concessionary credit as countries incomes increases, have resulted in most SADC countries relying on non-concessionary borrowings, which have higher debt service requirements and expensive refinancing options. The resultant high debt service requirements from expensive loans pose the risk of crowding out social expenditure and in the process compromise efforts for reducing poverty and inequality. The debt carrying capacity has also been curtailed by the recent decline in economic growth across SADC countries as a result of climatic shocks, such as recurring droughts, cyclone Idai and the Covid-19 the pandemic.

The subdued economic growth curtailed tax revenues and foreign exchange earnings, which are the principal sources for debt service settlements and financing of social expenditure. Subdued revenue as a result of reduced tax base and higher debt service requirements also pose the risk of crowding out social expenditure and in the process compromise or reduce resources earmarked for social expenditure necessary to reduce poverty and inequality. The IMF revised the initial average economic growth rate for SADC countries from 3.1% in 2020 to about -3.1% (IMF, 2020). Compounding the vulnerabilities is that most countries have also witnessed sharp declines in remittances, foreign direct investment (FDI) and portfolio investments, which are also important sources of foreign currency earnings, from which countries settle external debt obligations. Declines in these variables critically affect the country's growth prospects, tax capacity and in the process reducing resources for financing social expenditure necessary for reducing inequality.

Moreover, the tax to GDP ratios have not been commensurate with the increasing huge financing needs for infrastructural development and to meet growing social needs. As a result, the pace of debt accumulation from both domestic and external sources has been rapid to finance the identified gross financing needs. The borrowing capacity has been aided by improved fiscal spaces as a result of debt relief, rising economic growth rates and availability of ample liquidity in advanced economies, searching for high returns in developing and emerging market economies following the 2008/09 global financial and economic crisis. These developments heightened the already precarious debt management situation in some SADC countries.

As such, economic shocks worsened the momentum that had already been entrenched in the SADC countries' debt stock (Prizzon, 2020). Although the borrowing has been accompanied by modest growth rates over the years, this has not resulted in a concomitant increase in tax revenues. The revenue to GDP ratios in SADC countries have remained low compared to ratios observed in advanced economies (EPS-PEAKS, 2019). The low tax to GDP ratio, amid increasing GDP dichotomy is also explained by the presence of a huge informal sector in SADC countries, which does not directly contribute to tax revenue. SADC countries just like other developing economies have a huge informal sector, which represents on average around 40-60% of their economies (Schneider, Buehn, & Montenegro, 2010). There is, however, significant heterogeneity in the size of informality ranging from a low of 20 to 25 percent in Comoros, Mauritius, South Africa and Namibia, 30-40 percent in Malawi, Zambia, Lesotho, DRC, Mozambique and Madagascar and to a high of between 50 to 65 percent in, Angola, Tanzania and Zimbabwe (IMF 2017).

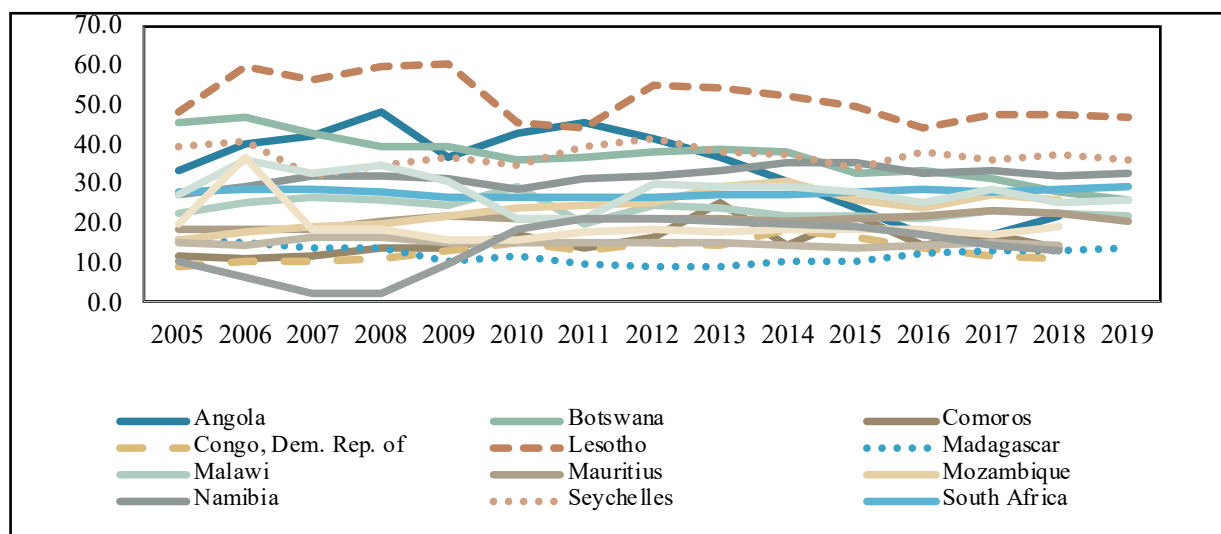
There is also dependence on a few taxpayers, often multinationals, that can exacerbate the revenue challenge by pursuing aggressive tax planning

to minimise their tax liability. Consequently, a combination of low government revenues and high debt service obligations reduced the capacity of SADC countries to sustainably support social sectors, thus compromising efforts to curtail inequality. Moreover, the region continued to be confronted with perennial challenges prevalent in both the developing and developed economies of tax evasion, tax avoidance, fraud and corruption, which deprive the fiscus of the much-needed revenue for social spending. In some cases, large companies abuse lack of capacity in revenue authorities to under declare taxes through transfer pricing. In addition, weak administration, poor governance and corruption tend to be associated with low revenue collections (IMF, 2011).

## Trends in Domestic Revenue Mobilisation in SADC

Total revenue as a percent of GDP in SADC countries has remained fairly stable, averaging 20 percent, compared to averages of 34 percent in advanced economies over the period 2007-2019 (OECD, 2019). The revenue to GDP ratios, however, vary substantially across SADC countries, with countries such as Lesotho, consistently recording a high revenue to GDP ratio above 40 percent, followed by Seychelles at 36 percent. At the bottom is Tanzania, DRC and Zimbabwe with revenue to GDP ratios of less than 15 percent. The size and level of government revenue is critically important because public spending and coverage of social transfers depend on the total amount of revenues mobilised. The chart below shows the trends in total revenue in SADC countries.

**Figure 2: Trends in Total Revenue in Percent of GDP in SADC Economies**

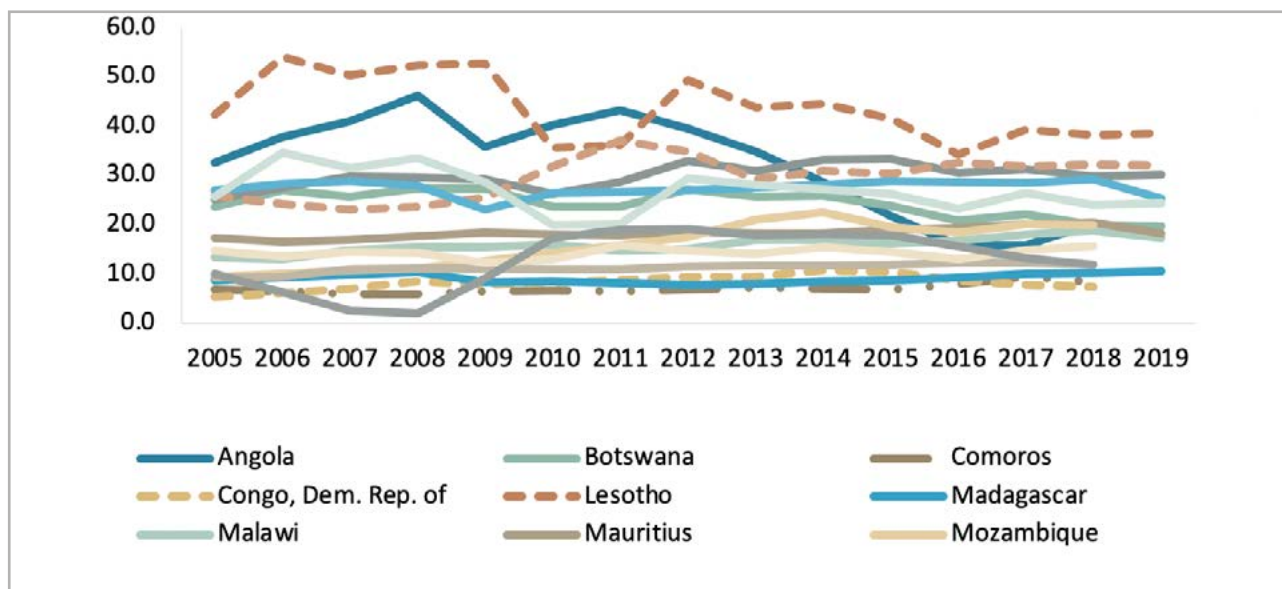


Source: OECD/ATAF/AUC (2019), *Revenue Statistics in Africa 2019*

The large proportion of revenue was comprised of tax revenue which contributed 20 percent of GDP on average. These ratios are consistent with estimates by the International Centre for Tax and Development (ICTD, 2019), which found that total

tax revenues account for more than 80% of total government revenue in about half of the countries in the world and more than 50% in almost every country. The graph below shows trends in tax revenue to GDP across SADC countries.



**Figure 3: Tax Revenue In Percent of GDP**

Source: OECD/ATAF/AUC (2019), *Revenue Statistics in Africa 2019*

From the graph above, it is apparent that Lesotho, Seychelles, South Africa and Namibia have relatively high tax-to-GDP ratios in comparison to other SADC countries. At the upper end are Lesotho, and Seychelles, which have a tax-to-GDP ratio above 30 percent, while at the lower end are DRC, Madagascar and Zimbabwe with tax revenue to GDP ratios of less than 15 percent. The relatively high share of tax revenue collected by the governments of Lesotho, Namibia, Seychelles and South Africa reflects the relatively wide range of taxes administered by these countries. The tax capacity in SADC countries is, however, constrained by structural

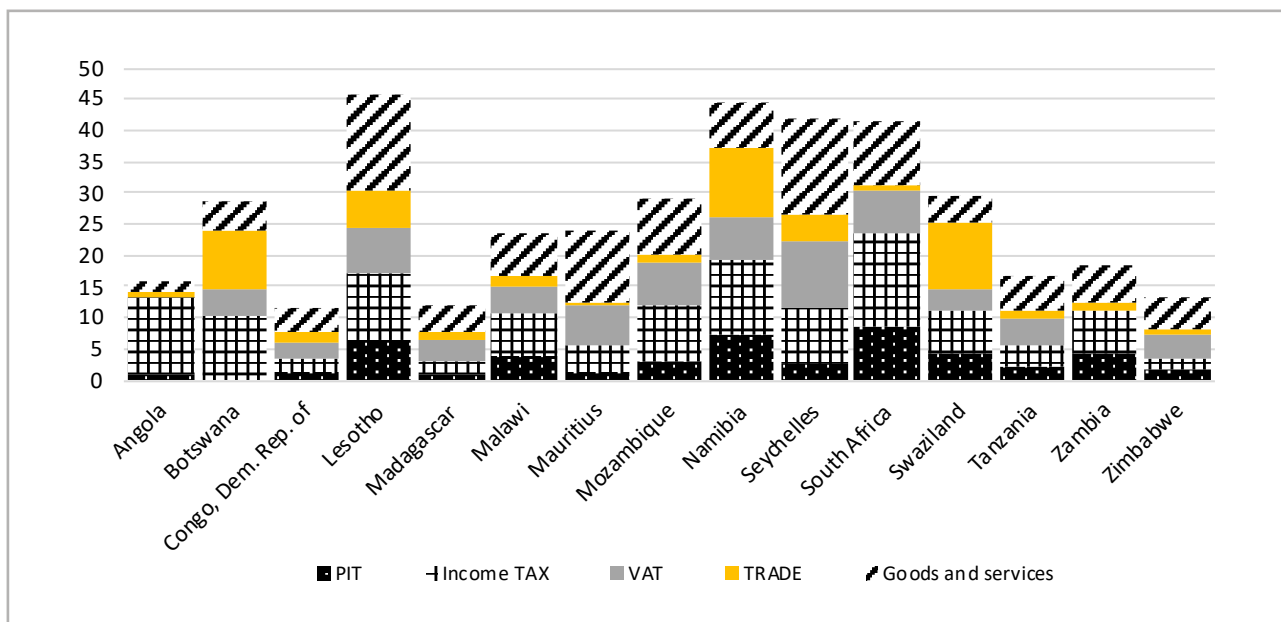
factors, notably the large size of the informal sector, illicit financial flows, opaque of the extractive sector, the low-level of taxable income and the dominance of the agricultural sector. In this regard, measures to formalise economies and diversify economic activity away from informal small-scale industries and subsistence agriculture, are needed to broaden the tax base and improve the tax capacity of SADC countries. Moreover, curbing of illicit financial flows, removal of tax holidays, reducing tax evasion and avoidance, improving capacity for revenue collecting agents are important in improving tax capacity.

## 2.1 Contributions of Various Tax Heads to National Fiscus

The tax structure, which generally, refers to the share of each tax in total tax revenues plays a critical role in the distributive role of fiscal policy in reducing inequality. The composition of tax as

a percentage of GDP is shown in the graph below. Figure4: Composition of Tax Revenues as Percentage of GDP is shown in the graph below.

**Figure 4:Composition of Tax Revenues as Percentage of GDP**



Source: OECD/ATAF/AUC(2019), Revenue Statistics in Africa 2019, <http://oe.cd/revenue-statistics-in-africa>

From the above graph, it is apparent that Seychelles had the highest VAT revenue ratio accounting for 6.7 percent of GDP, while Angola had the lowest of 2.3 percent of GDP. In terms of the tax rates, South Africa has the highest personal income tax at 45 percent, while Angola and Botswana have the minimum. The variation in tax structures across SADC countries

reflects different stages of development and administrative capacities. The redistributive role of taxation depends on the progressivity of income-related taxes, the taxation of capital income and wealth that are concentrated among the better off, and the design of indirect taxes. The tax rates are shown in the table below.

**Table 1:Tax Rates in SADC Countries**

|          | Personal Income Tax Rate | Corporate Tax Rates | VAT/Sales Tax Rates | Social tax Rates |
|----------|--------------------------|---------------------|---------------------|------------------|
| Angola   | 17                       | 30                  | 14                  | 11               |
| Botswana | 25                       | 22                  | 22                  |                  |
| Comoros  |                          |                     | 10                  |                  |
| Lesotho  | 30                       | 25                  | 17                  | 7                |

|              |      |    |      |    |
|--------------|------|----|------|----|
| Madagascar   | 20   | 20 | 20   | 19 |
| Mozambique   | 32   | 32 | 17   | 7  |
| Mauritius    | 15   | 15 | 15   |    |
| Malawi       | 30   | 30 | 16.5 |    |
| Namibia      | 37   | 32 | 15   |    |
| Eswatini     | 33   | 28 | 15   |    |
| Seychelles   | 15   | 33 | 15   |    |
| Tanzania     | 30   | 30 | 18   |    |
| South Africa | 45   | 28 | 15   | 2  |
| Zambia       | 37.5 | 35 | 16   | 10 |
| Zimbabwe     | 25.7 | 25 | 14.5 |    |
| DRC          | 35   | 18 | 9    |    |

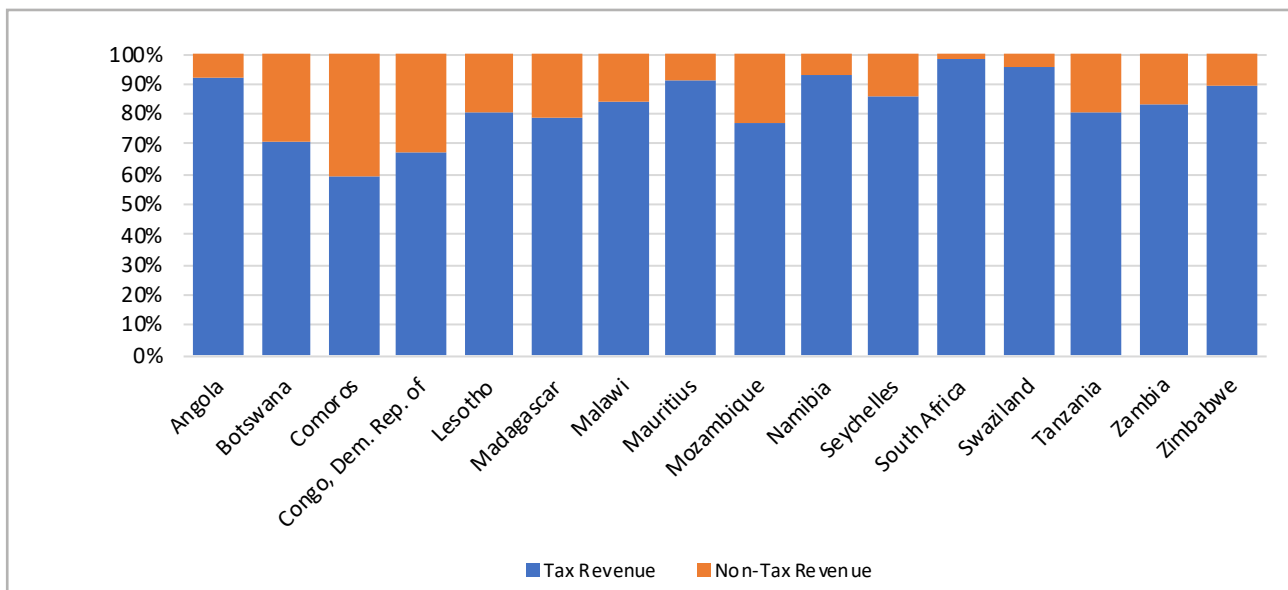
Source: *Trading Economics (2019)*

The chart above shows that most SADC countries have VAT tax rates averaging 15 percent except in DRC where it is less than 10 percent. However, indirect taxes, including VAT, are generally considered less effective in achieving redistributive goals than direct taxes. As a result, countries have a number of exemptions on VAT especially on basic commodities and extractive sectors. These exemptions, though critical in reducing burden for low income households, they deprive the fiscus of potential revenue that could be redistributed to address inequality as high-income earners inadvertently benefit from the exemptions. South Africa has the highest personal income tax rate of 45 percent while, Mauritius has the lowest at 15 percent. Corporate tax rates are higher in Zambia, Malawi, Namibia, Seychelles and Mozambique where there are above 30 percent. Ironically, these countries have also higher and growing levels of inequality. South Africa graduated tax bracket system was ranked highly by Oxfam in terms of tax progression, where it comes first among African countries, and third globally but poorly

on labour rights and minimum wages. However, inequality is high in South Africa and this is mainly explained by the areas where it scored poorly by Oxfam, notably, spending on education, social protection and labour market policies (Oxfam, 2019). Progressive income taxes also play an important redistributive function in some countries. The lower redistributive impact of fiscal policy in developing economies is also a key factor behind their high levels of inequality.

## 2.2 Non-Tax Revenue

The non-tax revenue, which refer to government revenue from various sources such as return on assets in the form of dividend and profits, interest, fees, fines and aid is generally low in SADC countries, except in Botswana and DRC. Non-tax revenue also plays a critical role as it can assist in financing social spending for fighting inequality. The chart below shows the composition of non-tax revenue in total revenue for SADC countries.

**Figure 5: Composition of Tax and Non-Tax Revenue**

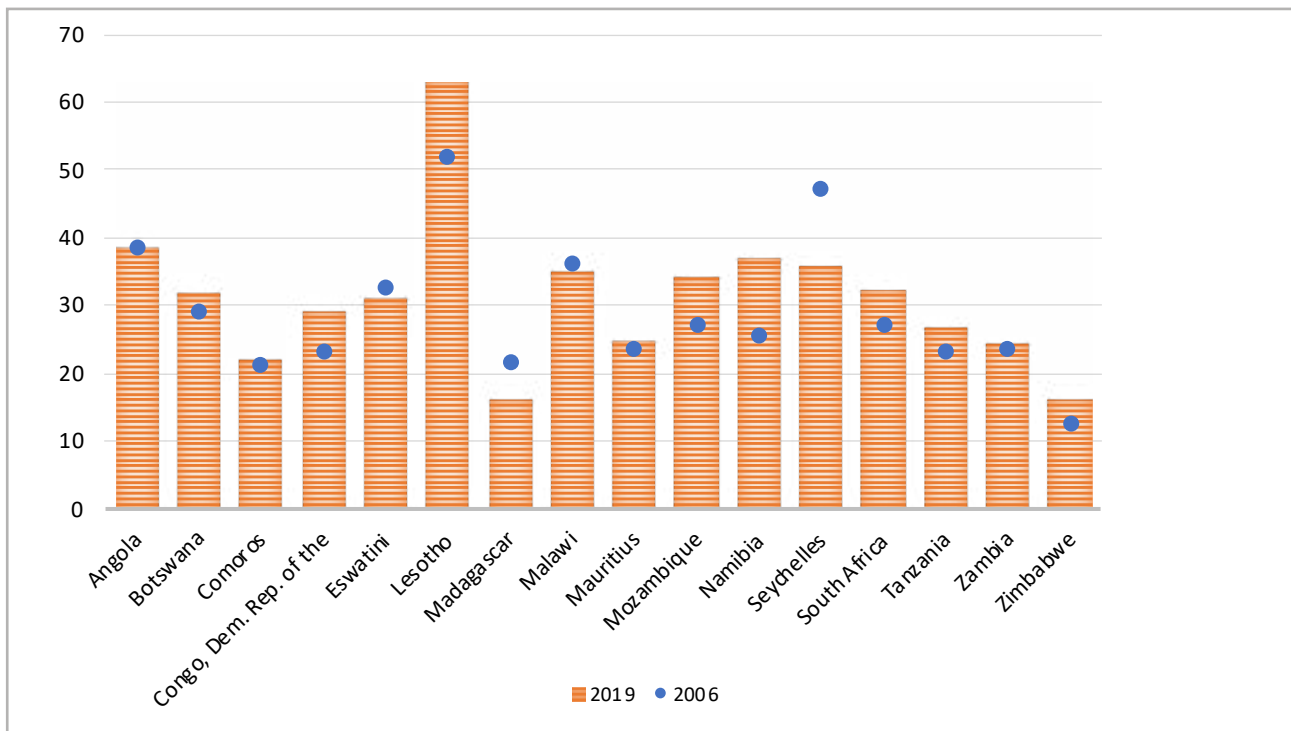
Source: IMF Longitudinal Dat

The above graph suggests that Botswana, Comoros, DRC and Mozambique have the highest share of non-tax revenue accounting for more than 30 percent of total revenue. The sources of non-tax revenue vary across SADC countries. Grants are the principal source of non-tax revenue in DRC, Madagascar and Malawi, which are still classified by the World Bank as low income countries which also qualify for grants. South Africa received its non-tax revenue mainly from rents, including real property income and royalties. Botswana, Lesotho, Eswatini and Namibia received a majority of their non-tax revenue from the Southern African Customs Union (SACU) revenue sharing agreement. Angola received most of the non-tax revenue from mineral resources. Generally, non-tax revenue is lower in SADC countries, despite these countries extensive reliance on extractive industries.

### 2.3 Trends in Public Expenditure

The borrowing opportunities created by debt relief initiatives and emerging sources of external financing, coupled with the general increase in the tax base since 2006 has created fiscal space to increase government expenditure. Consequently, total expenditure in SADC countries rose slightly from averages of 23.8 per cent in 2006 to averages of 27.6 per cent by 2019, driven by increases in both recurrent and capital spending. The graph below shows trends in Government expenditure.



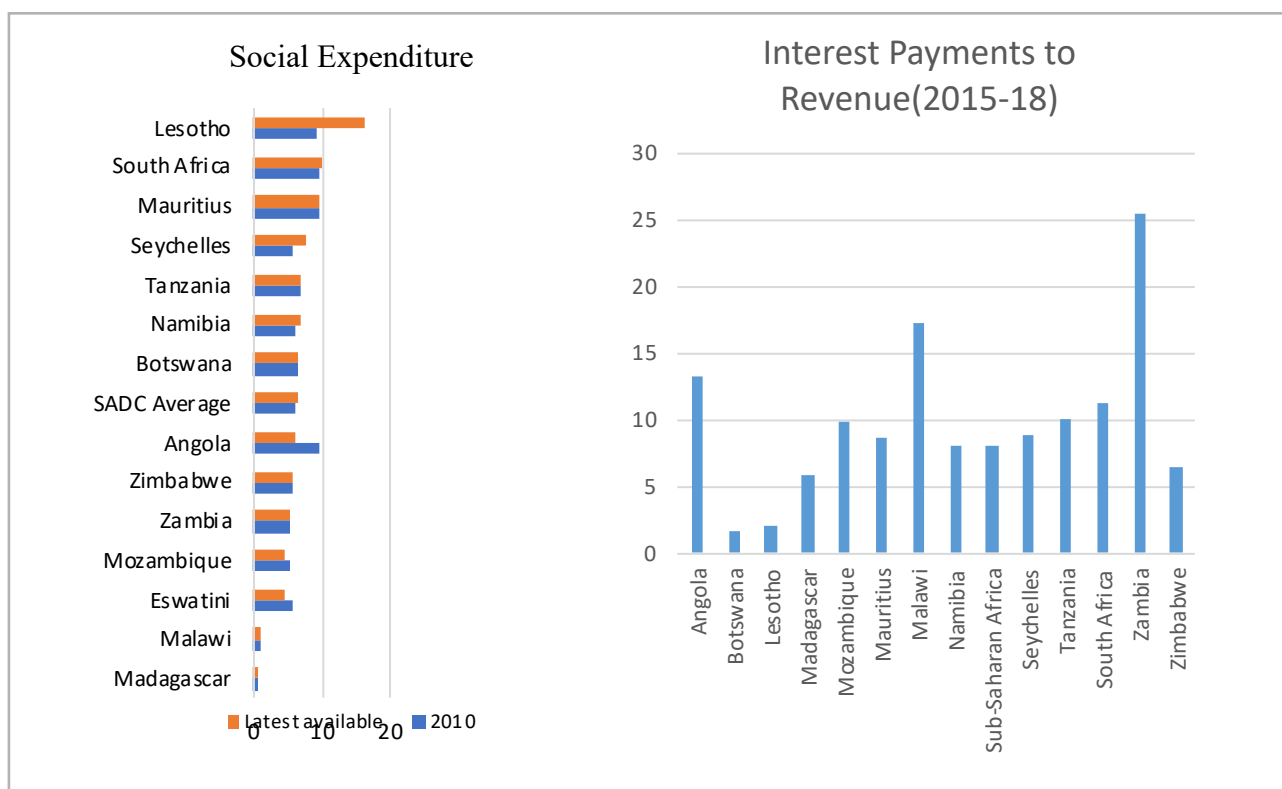
**Figure 6: Trends In Government Expenditure as a Percent of GDP**

Source: World Development Indicators (2019)

The above graph shows that Lesotho has the highest public expenditure to GDP, reflecting its higher revenue to GDP ratio. The graph also shows that the public expenditure to GDP ratio generally increased in 9 SADC countries between

2006 and 2019 except for Madagascar and Seychelles which reported declined. It remained static in Zambia, Comoros and Mauritius. Despite high expenditure levels, the proportion allocated to social expenditure has remained low in some countries as shown in figure below.

**Figure 7: Social Expenditure and Interest Payments In SADC Countries**



Source: World Development indicators 2020

The data shows that Lesotho, South Africa, and Mauritius, spend the largest proportion on social protection programmes, with a fiscal outlay of more than 10 percent. This reflects accelerated efforts, particular in South Africa to reduce the high levels of inequality. These countries also finance their social assistance spending through domestically generated revenues, while a number of SADC countries finance social assistance through international aid (Weigand & Grosh, 2008). SADC countries also rely on natural resource rents. However, these resource rents as a share of GDP appears to have a weak impact on inequality due to the enclave nature of this sector. As shown by the figure above, interest payments also take a sizable proportion of revenue, in excess of 20 percent of total revenue in countries such as Zambia. The high interest payments compromise sustainable financing of social expenditure and in the process affecting efforts for addressing inequality.

The capacity to spend was partially boosted by the lower external interest payments resulting debt relief enjoyed by some SADC countries, notably, Zambia, Malawi Tanzania and DRC. The DSSI, announced by the G20 on 15 April 2020 will also provide debt service relief to participating SADC countries. These funds are expected to alleviate pressure for social sector financing during Covid-19 pandemic. SADC had 9 participating countries under DSSI as at 15 September 2020. The participating countries are Angola, Comoros, DRC, Lesotho, Malawi, Madagascar, Mozambique, Tanzania and Zambia (The World Bank, 2020). The estimated size of debt service suspension for participating SADC countries is shown in the table below.

**Table 2: Estimates of DSSI in SADC Countries**

| Country    | Debt Relief | % of GDP | Risk of Debt Distress |
|------------|-------------|----------|-----------------------|
| Angola     | 2645.6      | 3.1      | Moderate              |
| Comoros    | 2.3         | 0.2      | Moderate              |
| DRC        | 104.4       | 0.2      | Moderate              |
| Lesotho    | 9.5         | 0.3      | Moderate              |
| Malawi     | 17.1        | 0.2      | High                  |
| Madagascar | 24          | 0.2      | Moderate              |
| Mozambique | 294         | 2.0      | In distress           |
| Tanzania   | 148.9       | 0.2      | low                   |
| Zambia     | 139.2       | 0.6      | High                  |

Source: The World Bank 2019: <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.W>

Civil Society Organisations across the globe have, however, expressed concern that the DSSI, merely postpones repayment pressure which would potentially affect social spending in the future. The DSSI, did not also provide the safety net to participating member countries. This phenomenon underscores the need for long-term approach to debt challenges facing developing economies including SADC countries.

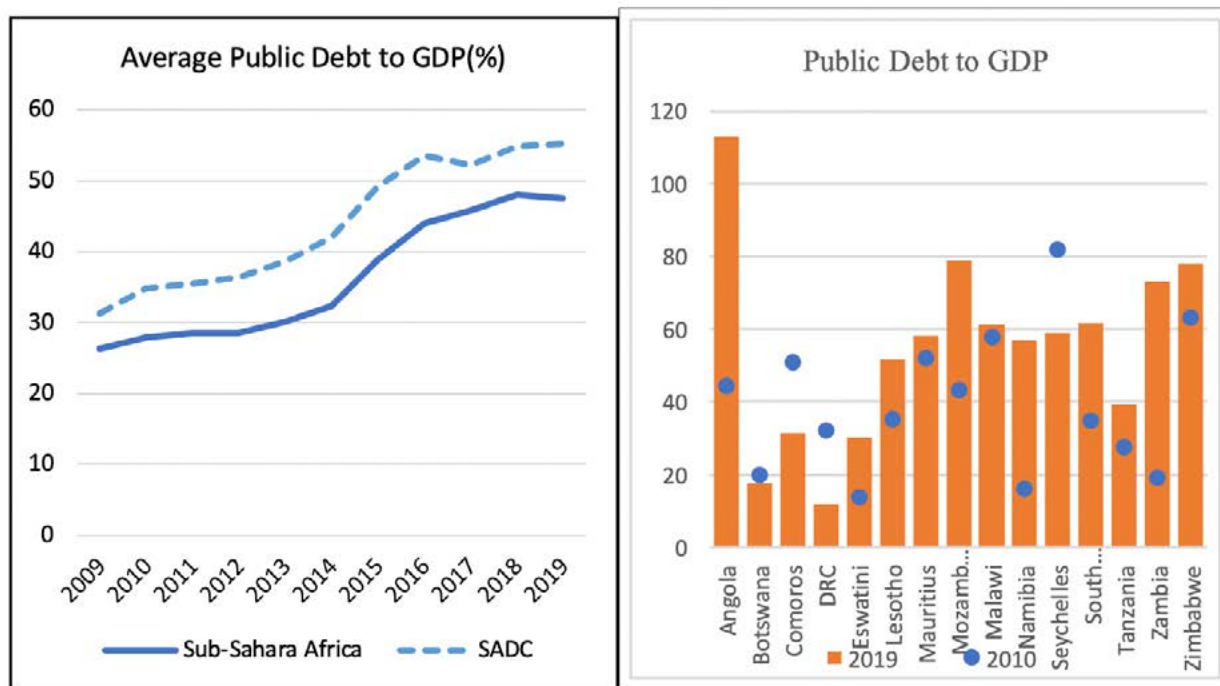
## 2.4 Evolution of Sovereign Debt in SADC

The insufficient domestic financial resources raised through taxation, amid high gross financing needs continues to compel SADC member states to rely on borrowed funds from both domestic and external sources to cover the financing needs. These financing needs are mainly for infrastructural development, which still lags behind other regions and also for stimulating economic growth. The change in composition of debt towards riskier sources of finance has also resulted in increased debt service costs, which

in some SADC countries such as South Africa, Angola and Zambia is now above 20 percent, thus, posing threats to debt sustainability, which could potentially crowd out social expenditure necessary for dealing with inequality (IMF, 2020). In Angola, debt service was expected to breach 100 percent of revenue in 2020 (IMF, 2020).

Consequently, the average public debt to GDP ratios for SADC countries which were on a declining trend partly due to multilateral debt relief initiatives in the early 2000s, increased significantly since 2012 from an average of 39.2 percent in 2011 to 55 percent in 2019 (IMF, 2020). There is, however, greater heterogeneity in public debt levels among the SADC countries, reflecting unique country financing needs, economic structure, debt management practices and various shocks affecting the countries as shown below.

**Figure 8: Evolution of Public Debt for SADC Countries (2012-2019)**

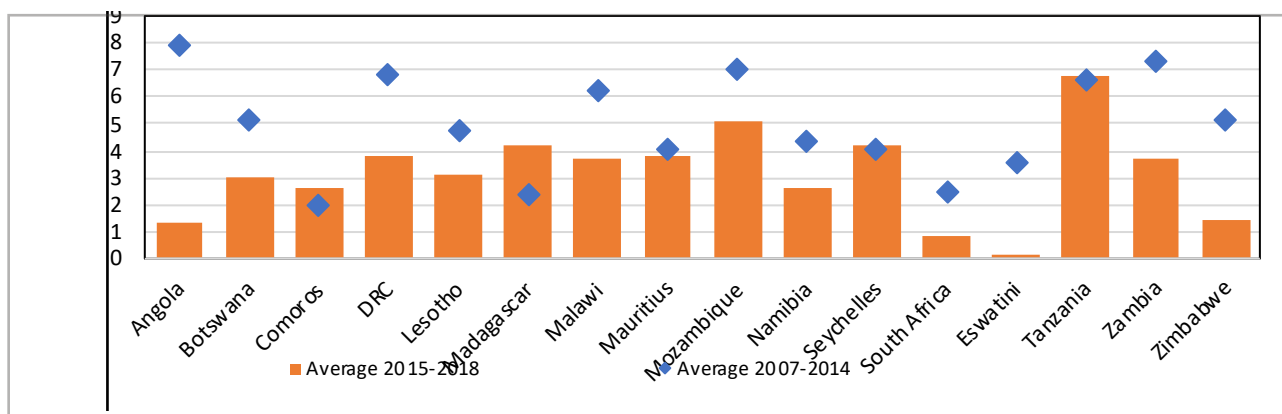


Source: World Economic Outlook Database (WEO), April 2020

As shown by the graphs above, the pace of public debt accumulation in SADC countries was rapid compared to averages for the sub-Saharan Africa. The significant changes in public debt were noted in Angola, Lesotho, Mozambique, Namibia, South Africa, Zambia and Zimbabwe. Comoros, Seychelles and DRC experienced a decline in their debt-to-GDP ratios. The rapid pace of debt accumulation has, however, not translated into higher growth rates and concomitant increases in tax revenues. As a result, respective debt carrying capacities of SADC countries as measured by GDP, exports and

government revenue have been compromised, thus, worsening debt sustainability challenges. The graph below shows the average growth performance for SADC countries for 2007-2014, compared to averages between 2015-2019.



**Figure 9: SADC GDP Growth Rates (2007 to 2019)**

The chart above shows that Tanzania has been recording growth rates averaging 6.6 percent since 2010 well above the SADC average of 3.3 percent during same period. However, the majority of SADC countries recorded significant declines in growth from 2015-19 compared to prior years. Consequently, in 2019, 5 SADC countries were either in high risk of debt distress (Zambia, Angola and Malawi) or debt already in debt distress (Zimbabwe, Mozambique). The debt sustainability outlook has further been exacerbated by the Covid-19 pandemic,

which created the need for increased public expenditures for health and stimulus packages to sustain economic activity. In addition to the increased pace of debt accumulation, the shift in the composition of public debt towards non-concessionary debt has also increased debt vulnerabilities. There has been a shift of the public and publicly guaranteed (PPG) external debt towards private creditors and non-Paris Club governments (World Bank, 2020).

## NEXUS BETWEEN DEBTS, TAX AND INEQUALITY IN SADC

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Inequality as measured by the commonly used Gini index has slightly declined in SADC countries over the years, except in Malawi and Seychelles where it increased (Figure 9). The IMF defined economic inequality in various forms, notably, income, which captures how individual or household incomes are distributed across the population at a point in time. Other dimensions include, lifetime inequality, referring to inequality in incomes for an individual over his or her lifetime, inequality of wealth, distribution of wealth across households or individuals at a moment in time, and inequality of opportunity, impact on income of circumstances over which individuals have no control, such as family socioeconomic status, gender, or ethnic background (IMF, 2020). The Gini coefficient is derived from the Lorenz curve, which ranks the population from poorest to richest and shows the cumulative proportion of the population on the horizontal axis and the cumulative proportion of expenditure or income on the vertical axis (Haughton and Khandker 2009). A Gini coefficient of 0 represents perfect equality, while an index of 100 implies perfect inequality.

Income inequality can persist across generations, reflecting differences in economic opportunity. The restricted opportunities are exacerbated by a number of factors chief among them being lack of access to education and lack of access to certain professions or business opportunities (OECD, 2011a; Corak, 2013). This lack of access is in turn reinforced by low incomes and family background.

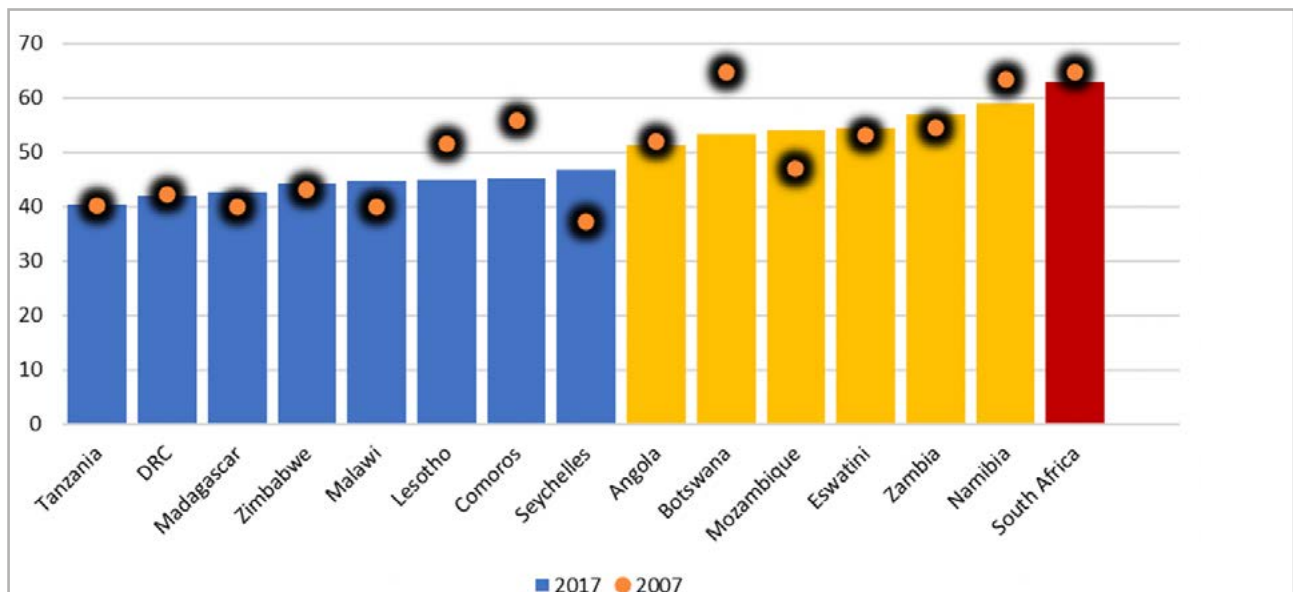
Low levels of both taxes and social spending limit the redistributive impact of fiscal policy in developing economies. While average tax ratios for advanced economies exceed 30 percent of GDP (IMF 2014), tax ratios in SADC generally fall in the range of 15–20 percent of GDP. As a result, social spending is also much lower in SADC economies, which substantially reduces the redistributive effects of fiscal policy. The redistributive impact of these social transfers is further diminished by low coverage of low-income groups, resulting in most of the benefits going to higher-income groups.

The United Nations (UNDP, 2017), noted that inequality in Sub-Saharan Africa is driven by

structural factors such as, the highly dualistic economic structure, characterised by employment of a few elites in the government, multinational companies (MNCs) and the resource sector, while the majority of labour earns much lower incomes in the informal or subsistence sector; the high concentration of physical capital, human capital and land, in certain groups or regions; and

the limited resources distributive capacity, which often manifests in the 'natural resource curse'. The graph below shows trends in inequality in SADC countries from 2007-2019.

**Figure 10: Trends In Inequality In SADC Region In 2017 Compared To 2007**

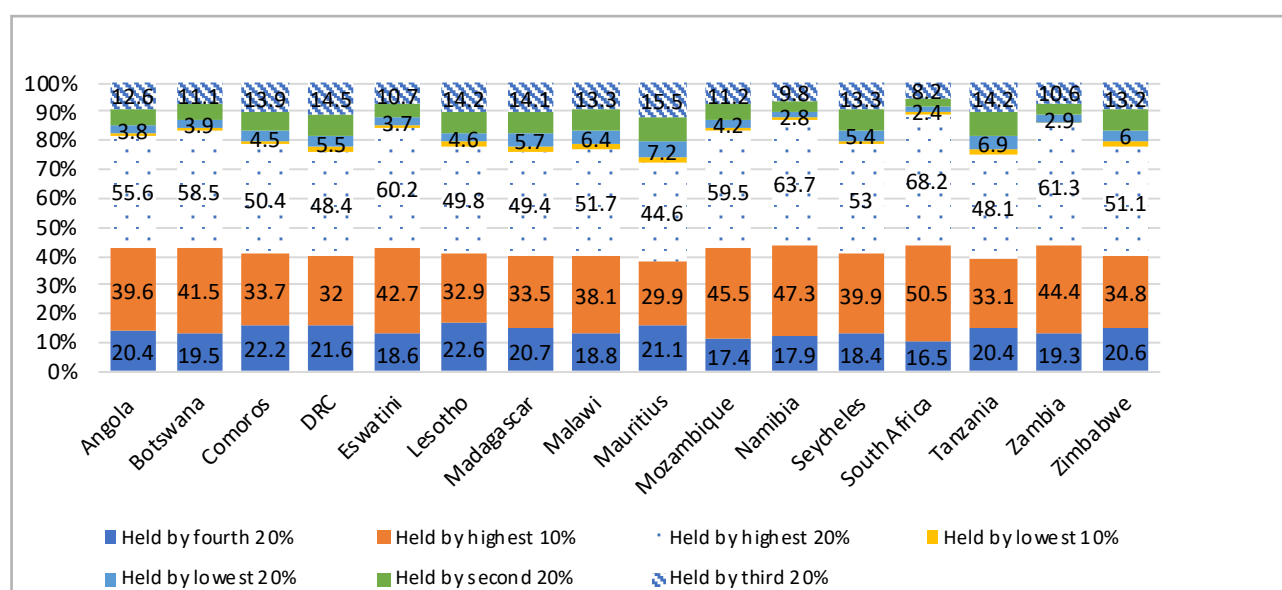


Source: Poverty and Equity Database, the World Bank (2019)

The graph above shows that inequality in 8 out of 16 SADC countries remained fairly static since 2007, with the exception of Malawi, Mozambique and Seychelles, which recorded noticeable increases. Significant declines in inequality were noted in Botswana, Namibia, Lesotho and Comoros. South Africa, however, continued to have the highest levels of inequality in the SADC region and globally, with a Gini coefficient greater than 60, followed by Namibia with a Gini of 59 as at end 2019. In essence, SADC countries, notably, South Africa, Namibia, Botswana, Comoros, and Zambia are among seven of the 10 most unequal countries in Africa (IMF, 2014). Significant inroads in reducing inequality have, however, been recorded in Botswana, Lesotho, Comoros and Namibia. More importantly, Lesotho is considered more equal than other countries in

the Common Monetary Area (CMA), with a Gini coefficient of 44.9.

The stagnating economic growth across SADC countries, except Tanzania, has compromised the ability of member countries to create enough jobs, necessary to absorb the unemployed and new entrants to the labour market. In this regard, promotion of inclusive growth that generates additional low-skilled jobs for the unemployed will assist in reducing inequality. According to World Bank data, inequality in SADC countries is also reflected by the fact that the top 20 percent of the population holds over 68 percent of income, while the bottom 40 percent of the population holds 7 percent of income (Figure 10). The graph below shows the income distribution in SADC countries.

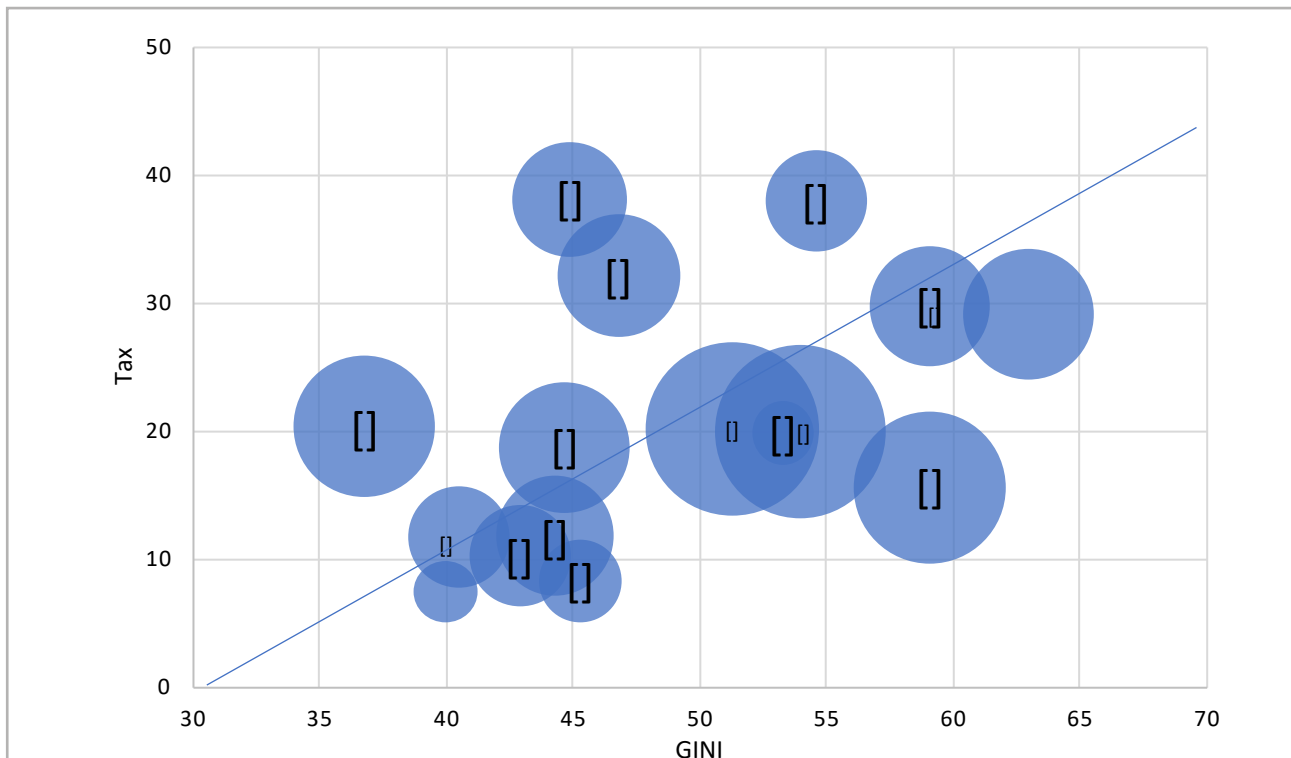
**Figure 11: Income Shares By Categories of Population**

Source: *Poverty and Equity database, the World Bank (2019)*

The table above, shows that South Africa, Namibia, Eswatini, Mozambique and Zambia have the largest skewness in income, with the top 20 percent of the population accounting for more than 60 percent. This is followed by Angola, Malawi Zimbabwe, Seychelles where the 20 percent account for more than 50 percent while the lowest 20 percent account for less than 6 percent. In Angola for instance, 20 percent of the population with the highest incomes receive 55.6 of all incomes, whilst the poorest 20 percent receive only 3.8 percent. In South Africa, the highest 20 percent receive, 68.2 percent while the bottom 20 percent receive only 2.4 percent. Interestingly, Seychelles has the highest GDP per capita of about US\$17 billion (2019), in SADC and Africa at large, but inequality is significant. The observed high-income shares of the income held by the top 20 in SADC countries is also attributed to rent-seeking behaviour of top executives at the expense of other incomes and wealth accumulation (Stiglitz, 2012).

### 3.2 Nexus Between Tax and Inequality

Taxation policy can be a powerful tool for addressing inequality if appropriately administered. More importantly, tax policy can achieve the three main objectives, of supporting macroeconomic stability, provision of public goods and redistribution of income. For example, in-kind benefits, such as education spending, can affect the inequality of incomes through their impact on future earnings. Other fiscal instruments, such as income taxes and cash transfers, can reduce the inequality of disposable incomes (IMF, 2014). The graph below shows the nexus between tax, debt and inequality as measured by the GINI

**Figure 12: Nexus Between Tax, Gini And Debt**

Source: World Development Indicators (2019)

The graph above suggests that countries with a tax to GDP ratio of greater than 20 percent have on average a Gini coefficient of greater than 45. This finding was also found by the IMF 2014 study, which provided a comprehensive review of the evidence of fiscal policy on inequality in advanced and developing economies. The main conclusion from the 2014 IMF study is that the income disparities across regions during the period 1990-2010 can be explained by differences in levels and compositions of taxes, public spending and labour market institutions (IMF, 2014).

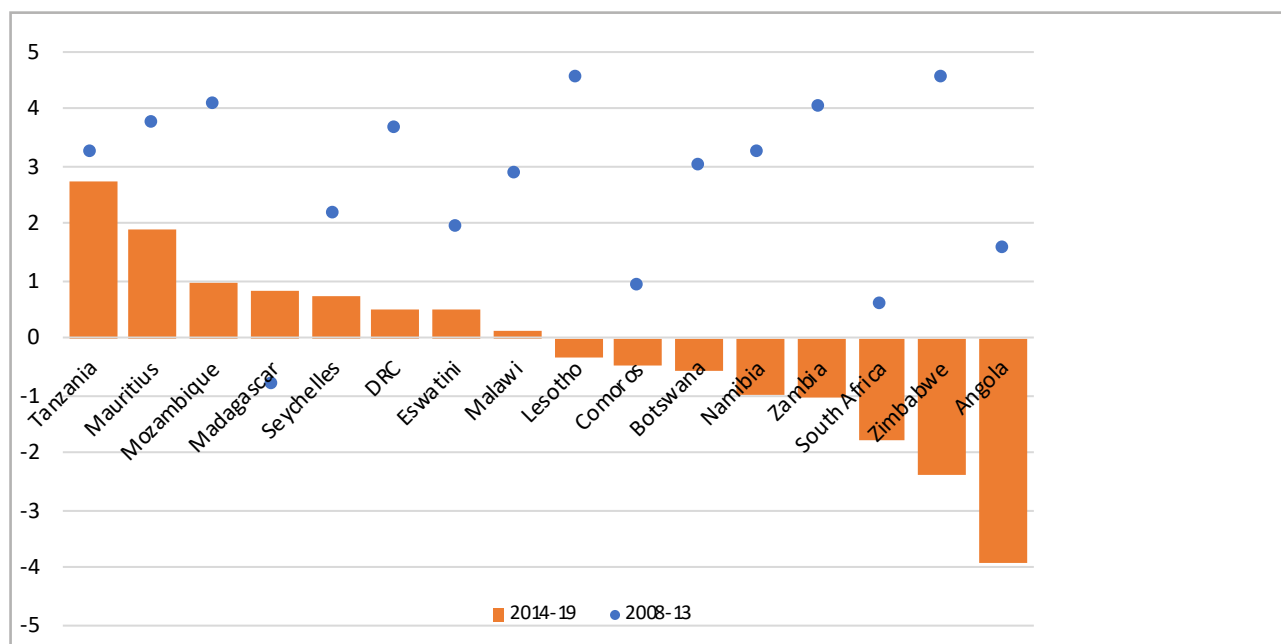
### 3.3 Nexus Between Debt and Inequality

Debt affects inequality through various channels. First, higher debt service requirements crowd out social expenditure and in the process compromise countries efforts to reduce inequality. These debt

services are high in some countries taking as much as 20 percent of government revenue (Figure 5) and in the process crowding out financing of social programs. Second and most importantly, countries resort to fiscal consolidation as a way of containing fiscal deficits and dealing with high debt levels. Fiscal consolidation measures have been adopted by a greater number of SADC countries and this phenomenon is confirmed by the five-year adjustment in primary balances as shown in figure below.



**Figure 13: Five years Average Fiscal Adjustments In SADC 2007-2019**



Source: IMF WEO 2019

As shown by the graph above, 15 SADC countries' primary balances, significantly reduced during 2008-2019 period. These include Botswana, Namibia, South Africa and Zimbabwe. In general, fiscal positions improved significantly when comparing the 2008-13 average and the 2014-19 average. The improvements in fiscal positions reflects fiscal adjustments measures to contain fiscal deficits and manage debt within sustainable levels.

Fiscal adjustment can, however, leads to a short-run reduction in output and employment, which is often associated with a decline in the wage share. This tends to increase inequality, given the relatively high share of wages in the incomes of lower-income groups (Jenkins and others, 2011). The accompanying rise in unemployment as a result of fiscal consolidations also tends to widen wage inequality, since unskilled wages fall relative to skilled wages as employers hoard skilled labour (Mukoyama and Sahin, 2006). Fiscal consolidation also affects the level and composition of taxes and spending and thus disposable incomes. Income inequality tends to increase the more fiscal adjustment relies

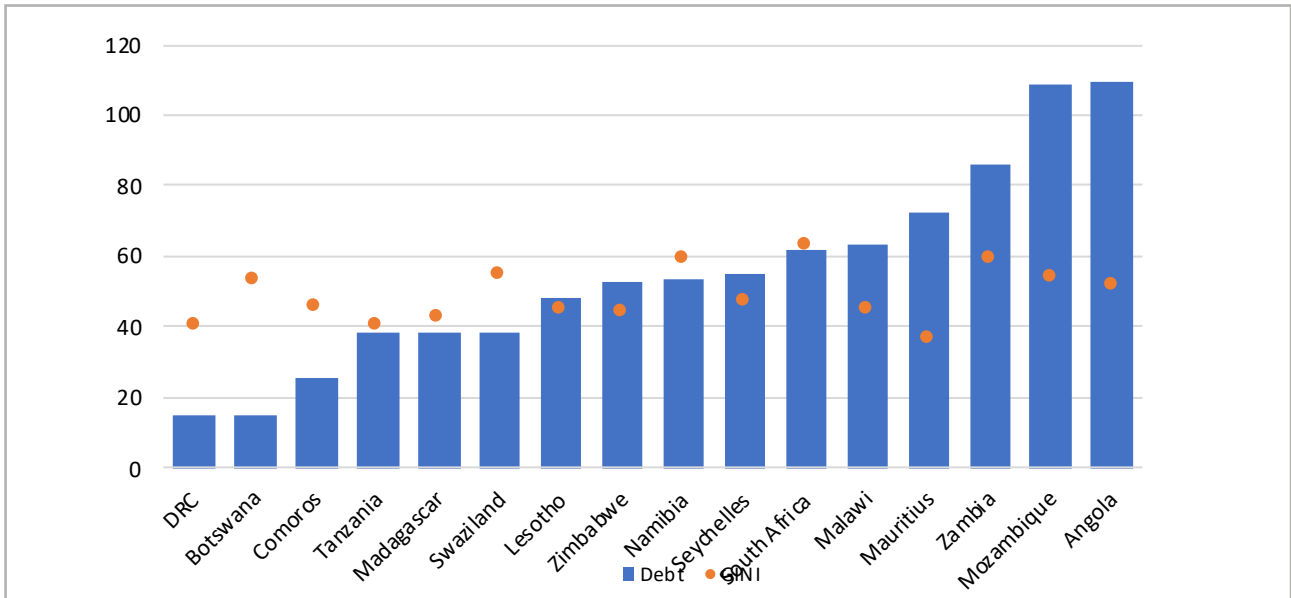
on raising regressive taxes and cutbacks in progressive spending. Econometric studies find that fiscal consolidations based on spending cuts worsen inequality by more than revenue-based ones (Ball and others, 2013). Cutting less progressive spending, such as generalized subsidies and government wages, improving targeting of social spending, and improving the incidence of in-kind spending such as education and health can also help prevent a surge in inequality during adjustment. Fiscal adjustments may nevertheless need to include revenue measures to be sustainable (Bevan, 2010).

A study by Luca and Sousa (2012) using a panel of 18 industrialized countries from 1978 to 2009, suggest that inequality significantly rises during periods of fiscal consolidation. Moreover, a study by Furceri et al (2018) on inequality and fiscal shocks in 103 developing countries during 1990-2015 suggest that unanticipated fiscal consolidations lead to a long-lasting increase in income inequality, while fiscal expansions lower inequality (Furceri, Ge, Loungani, & Giovanni, 2018). Fiscal consolidation is, however, not necessarily bad as its effects may be reversed

in the long-run, thereby reducing inequality and unemployment, particularly if the consolidation helps to bring down inflation. In this light, spending

cuts undertaken as part of fiscal consolidation are not necessarily damaging to inequality if accompanied by appropriate social safety nets. The graph below shows the relationship between inequality and debt in the SADC region.

**Figure 14: Nexus between public debt to GDP ratio and Gini Index**



Source: World Development Indicators (2019)

The graph above shows that countries with higher debt to GDP ratio has consistently higher levels of inequality.

# ADEQUACY OF POLICIES, TO ADDRESS INEQUALITY IN SADC

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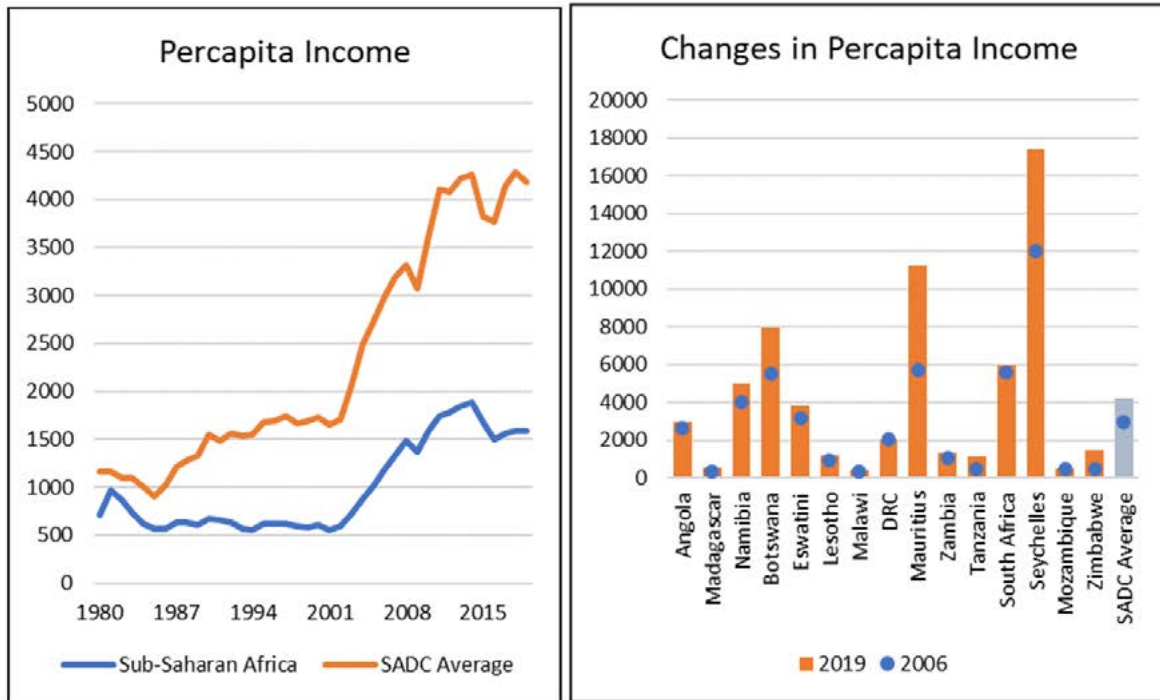
## 5.1 Overview

SADC countries have adopted various tax allowances in their personal income tax related to children, education, housing, health insurance, commuting and charitable donations. A threshold, either in the form of a zero-tax bracket, a basic deduction or a general tax credit, supports tax progression by reducing or eliminating the tax burden on people with the lowest incomes. The African Development Bank (AfDB, 2011) report noted that implementation of well-targeted social protection systems; policies that facilitate school enrolment and transition across primary, secondary and tertiary education systems, the adoption of free basic health services to the marginalised (e.g. Mauritius); and the reform of the labour market institutions, especially the

adoption of minimum wages (Zambia) have played a critical role in bridging the gap between the bottom 40 per cent and the top 10 per cent of the population in Africa. SADC countries also continue to provide social expenditure on education, particularly primary and secondary education and scholarships for university education to enhance skills for low income households aimed at improving job opportunity for low income households.

The policies implemented by SADC countries have assisted in improving per capita incomes, with lower income countries gradually catching up with upper countries. This is shown by the scatter graph below.

**Figure 15: Trends and changes in Percapita Income.**

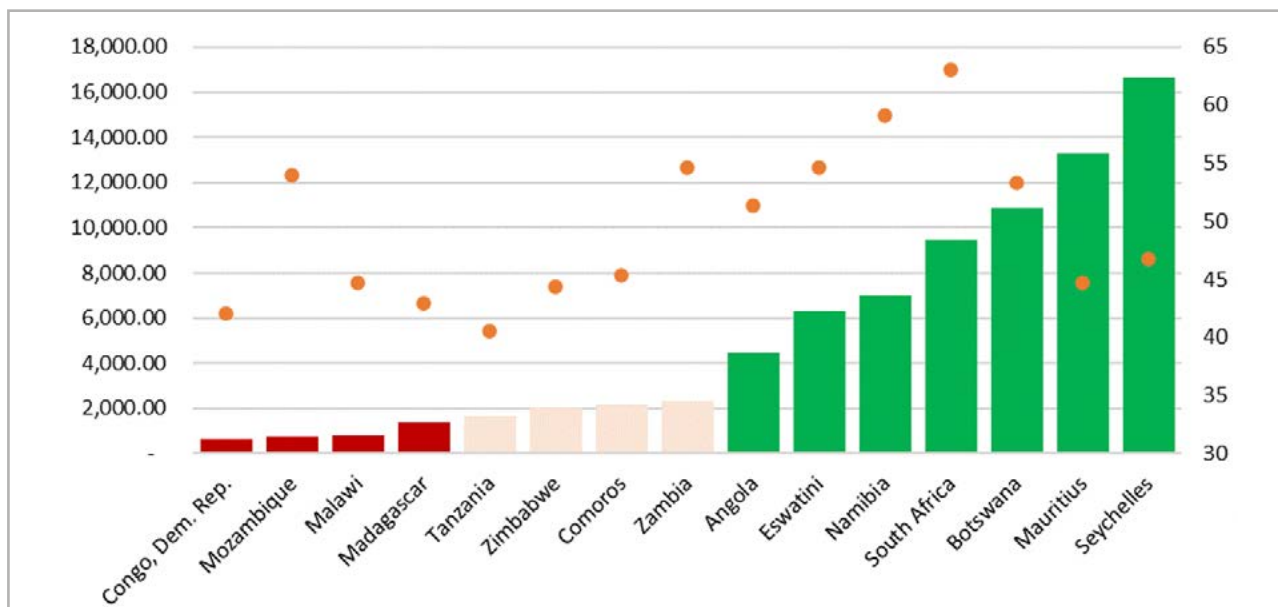


Source: World Bank Development Indicators (2019)

Small changes in percapita income between 2006 and 2019 are apparent in Madagascar, DRC, Malawi, Lesotho, Angola and Mozambique, while significant progress was noted in Botswana, Mauritius and Seychelles. Surprisingly, the high-

income countries in SADC have consistently high levels of inequality, with the exception of Mozambique, which are in the low-income category but characterised by high levels of inequality. This is shown in figure below.

**Figure 16: Percapita Incomes And Inequality**

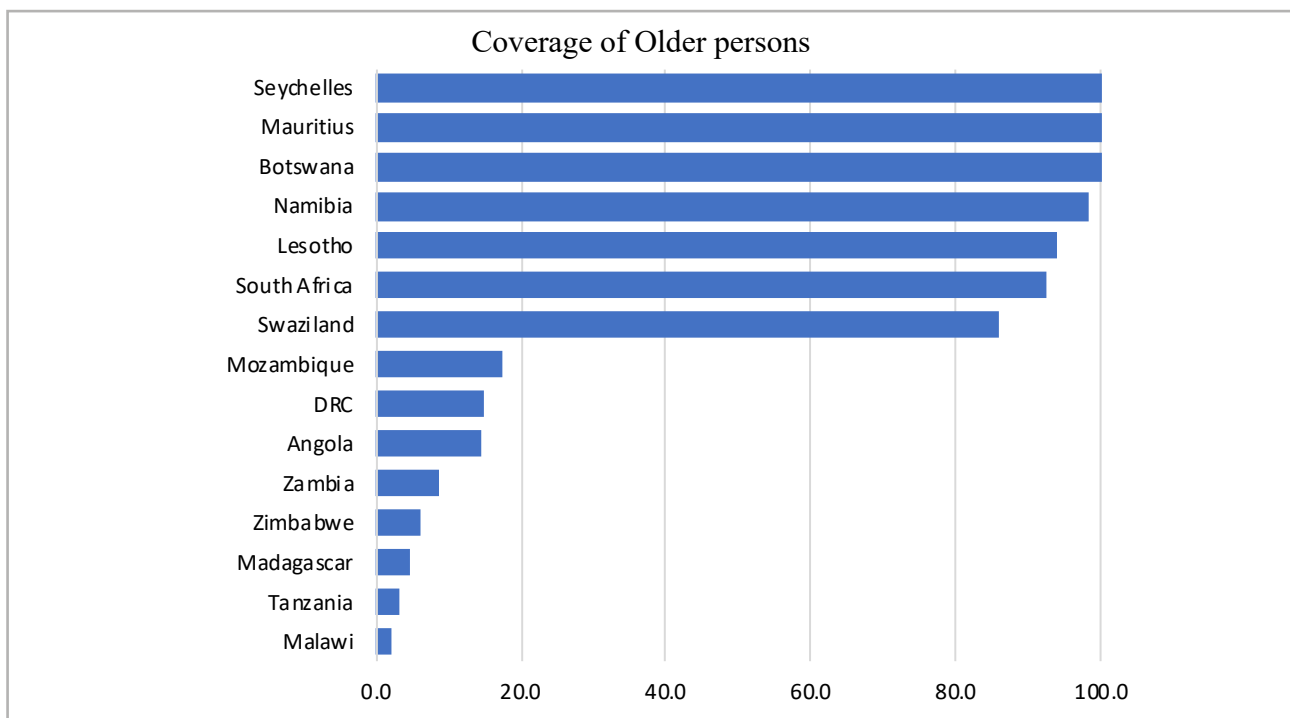


Source: Poverty and Equity database, the World Bank

Although an increasing number of SADC countries notably, Zimbabwe, Zambia and Tanzania have seen their percapita increasing from lower income category to lower middle income category and Namibia from lower middle income to upper middle income, the reclassifications have not substantially resulted in concomitant improvement in inequality as the Gini of these countries remained fairly static as shown in figure 9 above. The effectiveness of the social program in reducing inequality is, however, affected by the fact that the spending, particularly on education and health are not well targeted. As shown in figure 10 above, the poorest 40 percent receive less than 40 percent of the total benefits, which contributes to inequality of opportunity

and low inter-generational mobility. The levels of redistributive is also lower on the expenditure side as depicted by resources channelled to social protection. Precisely, substantial leakage of benefits to non-poor households' compromises efforts to sustainably address inequality and also increases the fiscal cost of social programs. Some countries spend significant amounts on food distribution programs which are prone to large leakages, including due to theft and wastage and involve large overhead costs. Overhead costs can be as much as 50 percent higher than the value of the in-kind benefit to beneficiaries (Grosh, Ouerghi, Tesliuc, & C. del Ninno, 2008). The figure below shows coverage of such expenditure.

**Figure 17: Social Protection Expenditure and Coverage for Older People (% of GDP)**



Source: World Social Protection Report Data 2019

The redistributive impact of these social transfers is further diminished by low coverage of low-income groups, resulting in most of the benefits going to higher-income groups. Many SADC countries also have energy subsidies as a form

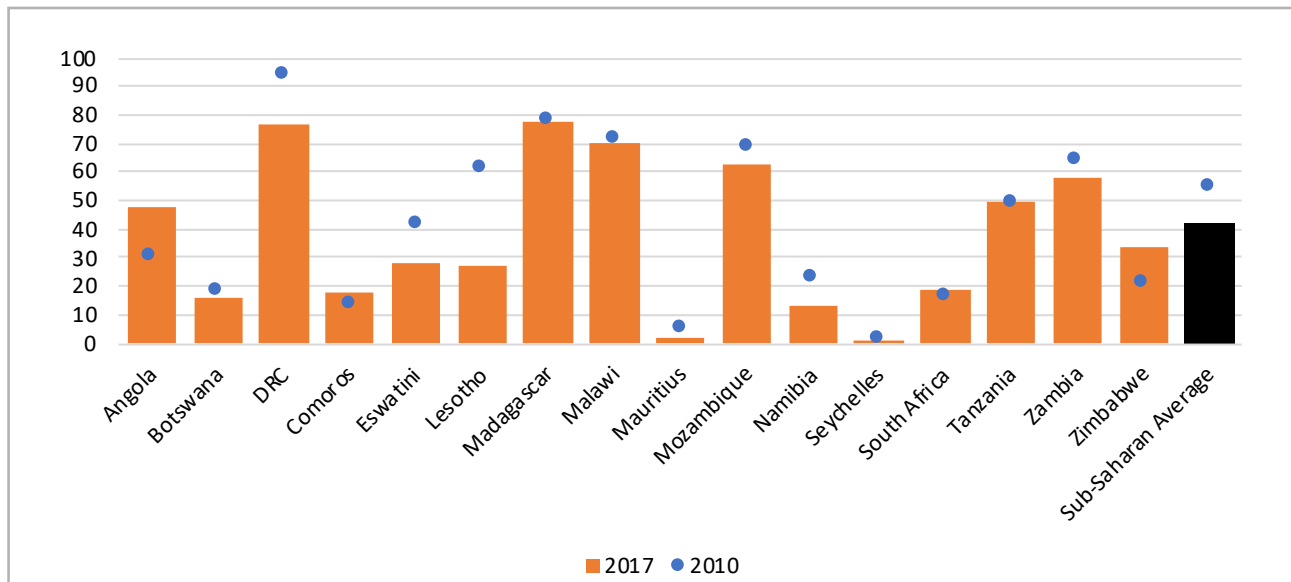
of social assistance. However, these subsidies disproportionately benefit upper-income groups. The policies being pursued by SADC countries have not substantially reduced the poverty ratio which has remained generally high (Figure 16).



According to the (World Bank, 2019), the number of extremely poor people continues to rise in Sub-Saharan Africa, while falling rapidly in all

other regions. The effectiveness of fiscal policy across SADC countries as measured by changes in poverty headcount is shown in figure below.

**Figure 18: Poverty Headcount Ratio At \$1.90 A Day (2011 PPP) (% Of Population)**



Source: World Bank PovcalNet and Poverty & Equity Data Portal

As shown by the graph above, the poverty headcount ratio deteriorated in countries such as Angola and Zimbabwe and significantly improved in DRC, Eswatini, Lesotho and Namibia. It remained fairly the same in countries such as Botswana, Madagascar, South Africa and Tanzania. Namibia's fiscal policies have made an impact on inequality, progressive social benefits and tax system in which the rich pay more taxes than the poor (World Bank 2017).

## 5.2 Shared Prosperity

The World Bank data on shared prosperity also assist in evaluating the effectiveness of policies to reduce inequality. The data tracks growth in the consumption or income of the poorest 40 percent of the population in each country to monitor progress against the goal of boosting shared prosperity. The table below shows progress made by SADC countries on shared prosperity.

**Figure 19: Progress on Shared Prosperity in SADC Countries**

| Country   | Period    | Annualized Growth in Mean Consumption or Income Per Capita <sup>a,b</sup> |        |                  |
|-----------|-----------|---|--------|------------------|
|           |           | Bottom 40%  | Median | Total Population |
| Botswana  | 2009-2015 | 0.42  | -0.95  | -3.30            |
| Mauritius | 2012-2017 | 2.71  | 2.56   | 2.02             |
| Malawi    | 2010-2016 | 3.05  | 1.40   | 1.57             |
| Namibia   | 2009-2015 | 5.73  | 8.67   | 6.64             |
| Eswatini  | 2009-2016 | 4.67  | 4.46   | 6.14             |
| Tanzania  | 2011-2018 | -0.15   | 0.11   | 0.92             |
| Zambia    | 2010-2015 | -0.59   | 3.03   | 2.93             |
| Zimbabwe  | 2011-2017 | -3.75   | -4.54  | -3.50            |

## **WORLD BANK 2020: GLOBAL DATABASE OF SHARED PROSPERITY**

The data in the above table confirms that Botswana and Mauritius have been doing well in reducing inequality since the growth in consumption and income of the bottom 40 percent has significantly been higher than the average of the total population. This trend reflects catching up of the bottom or poor households which is key in reducing inequality. However, the growth of income of the bottom 40 percent was low in Zambia and Eswatini, compared to that of total population. This trend if sustained would

increase divergence of income of the population and in the process entrench the already high levels of inequality.

A World Bank study found that Namibia's taxation and spending have been effective in reducing inequality. Namibia has high levels of investment, which allows it to fund policies like free secondary education for all students, and increases in spending on social protection (World Bank, 2017).

## FISCAL AND DEBT MANAGEMENT POLICIES TO REDUCE INEQUALITY

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The study noted that the revenue to GDP ratios of most SADC countries are far below sub-Saharan African averages of 24 percent and global averages of 34 percent. This phenomenon provides scope for SADC countries to increase both tax effort and capacity to raise domestic revenues for redistributing from high income earners to low income and poor households. On the tax side, direct taxes such as personal income taxes are preferable for achieving redistribution than indirect taxes, such as VAT because they directly take account of the ability of households or individuals to pay. On the spending side, cash transfers to poor households are considered superior to indirect methods such as price subsidies.

The surveys undertaken by the IMF on the general perspectives of Civil Society Organizations and labour unions on the role of taxation and debt in reducing inequality emphasized need for developing countries to consolidate social assistance programs and improving targeting; introducing and expanding conditional cash transfer programs, improving access of low-income families to education and health services; and expanding coverage of the personal income

taxes as necessary for reducing inequality. The options discussed hereunder are some of the strategies that can be implemented by SADC countries to boost domestic revenues, reduce inequality, while maintaining debt at sustainable levels.

### **i. Minimise Tax Exemptions**

As alluded earlier, a number of SADC countries have exemptions or reduced rates on necessities, such as food or energy, to mitigate the regressive impact of the VAT. These taxes are levied on the assumption that a larger share of these goods are generally higher for the poor. on VAT products. However, such policies are blunt redistributive instruments, because high income earners spend more in absolute terms on these goods and thus enjoy significant benefits. Moreover, exemptions and special VAT rates unnecessarily reduce the tax base and opportunity to finance redistributive spending. These exemptions, therefore need to be minimised in order to raise additional revenue to help finance pro-poor spending. However, in cases, where capacity constraints prevent spending programs from reaching the poor, differentiation in VAT rates may be justified as is currently the case in a number of SADC countries.

SADC countries also offer a variety of tax incentives and holidays to foreign firms. These tax incentives create inequality of opportunities between local and foreign firms, and in the process crowds out the activities of local firms. As such, these tax incentives need to be minimised to reduce inequality. SADC countries should also ensure that multinational corporations and rich elites pay their fair share of taxes by taking steps to reduce tax evasion curbing illicit financial flows. Concerted efforts should also be devoted to bring informal operators into the personal income tax to enhance fairness and equity.

## ii. Expand Level and Coverage of Social Expenditure

SADC countries need to deepen access of low-income families to social services, particularly education and health, which have been empirically proven to be an efficient tool for boosting equality of opportunity. Many households fall into poverty because of high out-of-pocket spending and many others are just one major illness away from poverty. Access to health care therefore, provides financial protection to households from catastrophic illnesses, which can free up households from the need to accumulate unproductive precautionary savings.

Strengthening universal access to quality secondary education by eliminating tuition fees for remote poor households can increase equality of opportunities. Government also need to ensure fair distribution of employment opportunities in the public sector for skilled and educated people in poor and remote communities. Capacitating low income families with access to quality education and employment opportunities is necessary to reduce intergenerational inequality caused by differences in economic opportunity. In addition, improved education and health outcomes among lower income groups will lower future income inequality, thus, reducing the need for redistributive taxes and transfers.

## iii. Expanding the Coverage of Property Tax

As suggested by Oxfam, SADC countries should consider introducing a wealth tax for redistribution to poor households to reduce inequality. This can be achieved through expanding the coverage of property tax given the fact that property is among the most visible indicators of personal wealth across the globe. More importantly, properties are easily identified and immovable, making it easier to impose a tax on them. Property tax is also a stable source of financing, particularly for local governments. In developed countries, property tax accounts for 2.2 percent of GDP on average, compared to averages of only 0.38 percent in Africa (ICTD, 2017). In the SADC region, Namibia and South Africa, collect more than 1 percent of GDP through recurrent property taxes (OECD 2019). The increasing trend in urban-centric economic growth and continued urbanisation have resulted in significant growth in urban real estate values, generating huge unearned wealth for property owners (Goodfellow, 2015) However, property taxes remain underused in most developing countries, including SADC, despite being a potential source of progressive tax revenue. In this regard, improving the coverage of property tax provides opportunities for SADC countries to raise additional revenue for redistribution to social sectors.

## iv. Expand Conditional Cash Transfer Programs

The conditional cash transfer programs make access to benefits conditional on the attendance of say children at health clinics and at school. These transfers accounted for one-fifth of the reduction in inequality between 1995 and 2004 in Brazil and Mexico (Os'orio, Soares, Medeiros, Zepeda, & Soares, 2009). These programs target cash transfers at poor households, with the level of transfer depending on the number, age and gender of children in a household. These programs have also been used in some advanced economies stipends conditioned on

education performance in the United Kingdom and in targeted education and health subsidies in New York city (IMF, 2014). There is also evidence that the use of cash transfers helps address short-term liquidity constraints resulting in increased investments in human and physical capital that help break the inter-generational transmission of poverty. The CCT programs are, however, administratively intensive and may require complementary investment in health and education facilities to be successful. In this regard, countries need to have the capacity to design and implement effective targeting mechanisms, as well as to deliver cash transfers nationwide.

#### v. Leverage on Technology

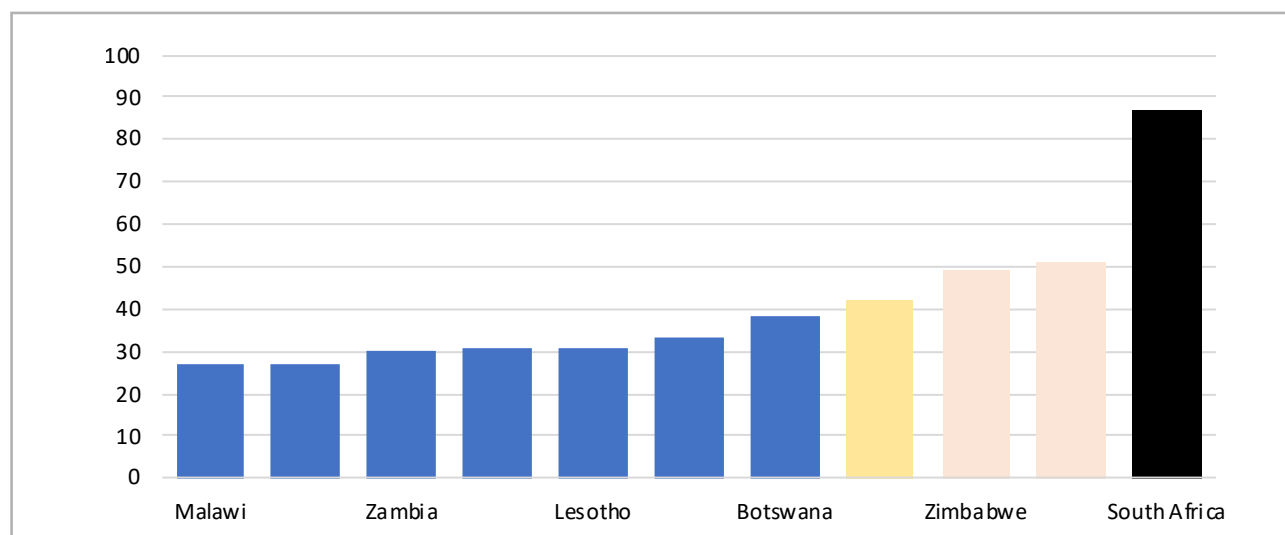
The emerging technology, particularly on national payment platforms through internet and mobile banking provides a good opportunity for SADC countries to leverage on them and impose a tax on electronic transactions. Zimbabwe for instance has adopted a 2% Intermediated

Money Transfer Tax (IMTT), which has enabled it to raise additional revenue from the informal sector and greatly assisted in reducing its high fiscal deficit. The additional revenue raised increased spending flexibility, including to social expenditures. However, there is need to make this tax more progressive by putting limits that remove low income families from this tax.

#### vi. Strengthening Institutions


The strong linkage between institutions and fiscal space points to the importance of strengthening institutional factors relating to tax administration and management as a critical necessary step to expand tax revenues. Moreover, issues relating to fraud, tax evasion and discretionary tax waivers should be reviewed and concrete actions taken. The World Bank's Open Budget Index (OBI) provides a comprehensive view of a participatory, transparent and accountable budgetary process, including revenue generation and management. The graph below shows the OBI in participating SADC countries.

**Figure 20: Open Budget Index**



Source: World Bank OBI (2020)



A photograph of a man with dark skin and thick, dark dreadlocks. He is wearing a dark, textured suit jacket over a light-colored shirt. He is sitting at a desk, looking off to the side with a thoughtful expression. The background is a bright, modern office setting with a lamp and a window. A large orange semi-transparent box is overlaid on the left side of the image, containing text.

As shown by the graph above, South Africa is ranked highly in terms of OBI. This performance partially explains why it has the largest fiscal space in the SADC region. Namibia, Botswana, also scored very high in OBI over the past years and are also among countries in Africa with revenue-to-GDP ratio of more than 20 per cent. Countries with low OBI, such as DRC are among countries with very low revenue to GDP ratio in the SADC region. Low revenues in turn constrain the ability of countries to finance social expenditure for fighting inequality. Low domestic revenues constraints the country's debt carrying capacity, and also resources for redistribution to the social sectors for fighting inequality and poverty.

#### **vii. Effective Debt Management**

Strengthening debt management is critical to prevent SADC countries from falling into default and economic depression. Effective debt management entails implementing public debt strategies that minimises both costs and risks. When the costs and risks of public debt are minimised, this would help reduce the risk of crowding out social expenditure or unnecessarily raising direct taxes in a bid to settle high debt obligations. In this context, fiscal consolidation must balance the need for debt sustainability and social safety nets.

## CONCLUSION

The general increase in fiscal space observed in SADC countries due to a combination of rising tax revenue as percent of GDP and new borrowing opportunities from both external and domestic sources, greatly assisted in financing public expenditure, including to social sectors aimed at reducing inequality. The study found that inequality has slightly reduced in SADC countries with the exception of a few SADC countries where it increased or remained static. The reduction in inequality observed in SADC countries is, however, under threat from the rapid pace of debt accumulation, whose accompanying high debt service obligation could potentially crowd out social expenditure. The tax revenue to GDP ratios in SADC countries are also lower than desired and attainable suggesting the need to increase tax effort.

The study also noted that SADC countries have been undertaking fiscal consolidation to reduce fiscal deficits and maintain debt within sustainable levels. The fiscal consolidation measures have, however, significant implications on inequality in the short to medium term through reduced employment and job losses. The potential implications of fiscal consolidation in the short term, underscore the need for SADC

countries to undertake fiscal consolidations in a manner that balances the need for debt sustainability while putting in place social safety nets for the vulnerable.

The study also noted the need for expanding, the fiscal space, measured by tax revenue-to-GDP ratio and enhancing the re-distributive role of fiscal policy as critical for reducing inequality and promoting fiscal citizenship. It was noted that the top 20 richest in SADC country account for over 55 percent of total income on average, while the bottom 40 accounts for less than 10 percent of the income. This phenomenon calls for SADC countries to introduce a wealth tax and increase the progressivity of the tax system. This measure needs to be complemented by mechanisms to eliminate tax loopholes and reducing tax exemptions, particularly tax holidays and incentives to multinational companies. The study also noted that increasing social expenditures including its coverage to public services, such as healthcare and education, is the surest, quick and sustainable way of dealing with inequality.

The study, therefore, recommended the need for SADC countries to strengthen policies that ensure progressive tax and spending on social

safety nets to protect vulnerable households during fiscal consolidation periods. The study also underscored the need for SADC countries to put in place labour policies that reserves a quota of employment opportunities in the public sector for educated and skilled people in remote areas. Reforming labour policies in favour of low-income groups and poor households in remote areas can go a long way in reducing inter-generational inequality. The need for strengthening debt management capacity is also critical to avoid accumulating public debt to unsustainable levels and in the process crowding out social expenditure through higher debt service obligations.

SADC countries should also take advantage of the growing values of properties in urban areas to expand the coverage of property taxes as an additional source of revenue for financing social expenditures. Moreover, emerging national payment streams, including, internet and mobile banking provide opportunity for SADC countries to boost their tax revenue through electronic transactions tax. Technology can also be leveraged to enhance the efficiency of tax collection by modernizing and streamlining tax collection processes, reducing compliance costs, enforcing collection, and curbing leakages.

Overall, SADC countries needs to balance both tax and expenditure to achieve the distributional objectives of boosting economic growth and

reducing inequality. Boosting economic growth remains fundamental in expanding the tax base, reducing debt burden and ultimately reducing poverty, unemployment and inequality. Improving tax capacity will boost the ability of SADC countries to increase social expenditure on, health, education, infrastructure and other social spending necessary to reduce inequality. Increased tax capacity will also increase the debt carrying capacity, thus, enabling SADC countries to underwrite more domestic and external borrowing for financing the huge gross financing needs, while simultaneously safeguarding social expenditure.

In order for growth and accompanying rise in tax capacity to be effective in reducing inequality, emphasis should be on inclusive growth and progressivity of the tax system. Growth is considered inclusive when it is supportive of productive employment. In this regard, Civil Society Organisations and Labour Unions have an important role to play in continuing to lobby for improved budget transparency, effective debt management systems and fair distribution of income, including resource rents. Transparency in public debt and borrowing process is critical to help SADC countries make more informed borrowing and investment decisions that will not hinder social expenditure and aggravate inequality.

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