Left to right: Aliko Dangote, CEO of Dangote Group; Paul Kagame, President of Rwanda; Nana Akufo-Addo, President of Ghana, with BBC's Sophie Ikenye at far left

Stability more important to investors than tax breaks

Policymakers faced with a difficult choice between offering tax incentives and maximizing resources for development, should keep in mind that some things are more important to big investors than tax breaks.

by Elijah Kimani | Aug 1, 2018

One of the more memorable exchanges at the recently concluded African Transformation Forum (ATF2018) was between Aliko Dangote, the shrewd billionaire president of the Dangote Group, and Presidents Paul Kagame of Rwanda and Nana Akufo-Addo of Ghana over tax incentives. At the heart of the conversation was the quandary of a government's need to maximize revenue mobilization while at the same time giving fledgling enterprises tax breaks and incentives to allow them to overcome teething pains.

The discussion in Accra came just months after a $600 million dispute between Dangote Cement and the government of Tanzania over tax incentives that the government promised to the conglomerate for the construction of a new cement plant in Mtwara, southern Tanzania.

The cement company was flourishing until a change in government brought changes in regulations and policies that saw the company suspend its operations in protest, putting thousands of jobs on the line.

To be clear, in principle, exemptions should not be entertained as they create market disequilibria, resulting in price distortions. In addition, tax exemptions easily become politicized and in the absence of strong institutions can be used to appease cronies or advantage political allies. As Edward Larbi, the Ghanaian revenue mobilization expert credited with setting up Rwanda's and Uganda's revenue authorities aptly stated during an ATF2018 resource mobilization and management breakout meeting, the quickest way to increase revenue is to eliminate tax exemptions or raise VAT, with consensus on the latter being a regressive measure. Eliminating tax exemptions should therefore be every government's golden wand for higher revenue mobilization.

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However, fiscal regimes the world over point to the need to protect small and medium size enterprises (SMEs) that need room to grow by exempting them from tax for a certain period of time or up to a certain level of turnover. In doing so, ideally, the SMEs are expected to reinvest these "savings". The question then is whether the same argument should suffice for conglomerates like the Dangote Group when setting up shop in new markets. Such concessions inevitably disadvantage SMEs and hence run counter to tax incentives as a means to boost SME growth. With Nigeria set to rake in $6 billion in revenue from Dangote's companies over the next few years, many countries would readily offer tax breaks for a share of Dangote's profits.

In spite of this appeal, countries continue to rein in on incentives with Guinea's new finance bill of 2018 cancelling all tax incentives and consequently generating 40 million francs in the first quarter. Similarly, Senegal's stop-gap measure for its declining tax revenue – occasioned by low mobilization in petroleum revenue – has been to refocus on increasing the tax base by terminating tax relief arbitrarily granted to individuals by the state. Many African governments are engaged with the IMF's Fiscal Affairs Department with the intention of reducing unnecessary loss of revenue.

During the ATF2018 breakout session on revenue mobilization, Dr. Uzziel Ndagijimana, the Minister of Finance and Economic Planning of Rwanda, counselled against throwing out exemptions in totality but instead argued that if exemptions are well regulated and target promotion of specific sectors they could have a positive outcome, as has been the case in Rwanda's manufacturing sector. A reliable incentives policy that would cover the entire sector would bode well for investors, he argued. Nevertheless, there is need to separate fledgling indigenous SMEs from global conglomerates when formulating such policies as the latter have access to the financial muscle to weather any initial headwinds.

In the case of Dangote Cement and the Government of Tanzania, the more salient concern seems to be on the consistency of fiscal policy across Tanzanian regimes. While incentives are great for businesses, large capital investments do rely heavily on predictability in the political and business environment. When asked by BBC journalist Sophie Ikenye about his main consideration before committing to an investment, Dangote pointed to reliability ▸

and predictability of government policy and political leadership with incentives dwarfed by comparison. To put it simply, global outfits will be attracted more by prospects of stability than by tax incentives.

This statement affirms the view that tax incentives should therefore not be used to lure international enterprises but instead, governments should focus on creating a conducive environment to attract such enterprises. However, for SMEs, a conducive business environment may not suffice in keeping them afloat and hence the need for fiscal policies that allow them to compete with established entities on equal footing.

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Many advanced economies are known to have relatively high corporate tax rates yet are still very attractive for business ventures. The reliability of a tax regime makes it possible for a business to make long-term plans, a point made perfectly clear by the Dangote Group to the Tanzanian government. It was wrong for the new government to change the terms of the original agreement but those terms should not have been offered to Dangote Cement in the first place. So, instead of dangling shiny objects to investors to pursue their attention, African countries should work on establishing reliable fiscal policies and a predictable business environment, knowing that investors will catch a whiff and surely come calling.

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