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Central Bank Independence in the Southern African Development Community: Legal Reform Progress and Prospects

Mzwanele Mfunwa and Henry Lubinda

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Public commitments by political leaders to fast-track economic integration in the Southern African Development Community (SADC) have been at variance with the extremely slow pace of domesticating the 2009 SADC Central Bank Model Law. This paper identifies specific legislative gaps in the national central bank laws that member states need to address in order to enhance institutional uniformity and promote central bank independence in the SADC region. Countries with recent amendments have made adjustments for more compliance, while others have not done so. The paper recommends that member states should speedily effect the needed legislative alignments if the frequently delayed economic integration agenda is to move apace.

1. Introduction

The Southern African Development Community (SADC) Central Bank Model Law (SADC, 2009) was adopted by the SADC Committee of Central Bank Governors in 2009 to promote closer cooperation among the region's central banks. The Model Law encourages the adoption of general codes to facilitate operational independence, establish transparency and accountability standards, and facilitate the harmonisation of legal and operational frameworks of SADC's central banks. Through the Model Law the SADC leadership are supporting the "independence of the central bank [as] (…) a condition sine qua non for the achievement of price stability" (SADC, 2011).

Worldwide central bank statutes make extensive use of the term 'independence'. In the literature however the label 'autonomy' is sometimes preferred seeing that it entails operational freedom, whereas the expression 'independence' may indicate freedom from institutional constraints (Mfunwa, 1998: 9). Henceforth this paper will adopt the term 'independence' because of its wider use in the region, even if both terms refer essentially to the same status. 'Price stability' describes an economic and financial environment where inflation is so low as not to be a factor in economic agents' decision making processes (Blinder, 1995).

Central bank independence (CBI) is defined in terms of a mixture of political, economic and informal factors. Political independence is largely determined by the relationship between the central bank and the government in monetary policy formulation,

including the authority to choose the final policy goal of a certain inflation rate or level of economic activity, and procedures for the appointment and removal of central bank head. Economic or financial independence refers to the financial and budgetary relationship between the central bank and government, including lending to the government (Mfunwa, 1998: 18). The informal factors are difficult to assess and include whether central bank governors serve their full terms of office, particularly when there is a change of government; personalities, educational and occupational background of principal officials within the central bank; and the quality of the central bank's research programme.

The need for price stability in the SADC region was brought to the fore when Zimbabwe's hyperinflation reached the 231 million percent rate in July 2008 (Reserve Bank of Zimbabwe, 2012). Secondly, when South Africa's public protector recently adjudged the central bank's price stability mandate as 'too narrow', the public reaction was visceral and negative. Besides lessons from Zimbabwe, South Africa's economy is about half of the region's total economy and several neighbours' currencies are linked to the Rand, especially in the context of the Southern African Customs Union. Therefore, price instability in South Africa would destabilise the entire SADC economy.

By understanding the mismatches between the SADC Model Law and individual country laws, this paper is commenting on the independence of country central banks. It is important to state upfront that this paper does not seek to assess the reliability and consistency of the SADC Model Law against the stricter elements of the CBI. With this caveat in mind, this paper's main objective is to ascertain the extent to which central bank laws among 12 countries in the SADC region comply with the new regional model law; it identifies areas requiring amendments.[1] The paper is structured as follows: Section 2 briefly reviews literature on the theoretical rationale for granting independence to regional and national central banks, from which the SADC Model Law draws its inspiration. Section 3 highlights the key elements of CBI that form part of the Model Law. Section 4 unpacks the various central bank laws in the SADC region and highlights areas of convergence with and divergence from the adopted regional model law. Section 5 provides recommendations and concludes.

2. Literature Review: Solving the Inflationary Bias of Monetary Policy

The theoretical foundations of the SADC Model Law are found in the Finn E. Kydland and Edward C. Prescott model (1977), which sought to solve the time-inconsistency problem of policy making. Titled 'Rules Rather than Discretion', the model argued that monetary authorities' policy decisions are often time-inconsistent; that is, monetary policy changes intended to remedy an immediate problem such as unemployment will often have

[1] Central bank laws of three other SADC member states (Madagascar, Democratic Republic of Congo and Mozambique) were not available in English, and therefore could not be reviewed due to language limitations of the authors.

unintended outcomes that work against the goal of reducing joblessness. When a government announces a remedy to a short-term problem, individuals and firms adjust their behaviour and make new decisions based on that information. Those decisions change the economic landscape, obviating the need for the government to fulfill its promise on policy changes. Thus, if a government has the discretion to pursue any policy it wants, given the particular economic situation on the ground, and cannot remain committed to the promises it makes, a credibility problem arises. To counter this, it is wiser for a central bank to focus on long-range goals and not interfere in the economy too aggressively by trying to boost employment or boost economic activity in the short run. The model underscored the critical importance of policy consistency over time rather than thinking about what is optimal right now.

The Kydland-Prescott model was followed by the work of Robert Barro and David Gordon (1983) who added a 'rational expectations' idea to the original model. The rational expectations theory argues that people make choices based on their rational outlook, available information and past experiences. In the Kydland-Prescott model the government policy could influence people's decisions in the short run, while no such influence exists in the Barro-Gordon model because the current expectations in the economy are the same as what people think the future state of the economy will become. Simply put, if government attempts to reduce unemployment or stimulate economic activity using monetary policy, this action can only lead to higher inflation without achieving the intended goal. In this regard, the attempt will only trigger inflation in wages and engender generalised inflation; the unemployment rate or economic activity will remain unchanged. As such, the monetary policy stimulus will have no real effects on the economy other than inducing price instability.

These models brought fundamental changes to how monetary policy is conducted worldwide. Institutionally, they have influenced how central bank frameworks are calibrated to enhance operational independence, thereby injecting credibility in the face of short-term changes in the economy. Many central banks around the world have committed themselves to a long-range policy of seeking price stability. Moreover, from the early 1990s countries such as New Zealand, Sweden, South Africa, Thailand and Argentina have adopted an inflation-targeting policy – a specific range for inflation that the central bank commits to pursuing (Central Bank News, 2017). To a very large degree, the SADC Model Law has adopted these models' principles for enhanced CBI. However, there are areas where this law is accommodating regional peculiarities that may therefore be less strict than other regions' regional laws, such as the European Union.

3. Determinants of Central Bank Independence

The determinants of CBI are theoretically and empirically well studied, among others in the work of Cukierman (1992), and Alesina and Summers (1993); whereas the studies by

Presnak (1996), Wessels (2004) and Wessels (2009) have offered insights on CBI in Southern African countries. This section discusses formal or *de jure* independence determinants and how the SADC Model Law incorporates them. This paper does not concern itself with informal determinants of CBI although these may be more important in practice than formal determinants.

Outlined below are key elements of CBI that charters or statutes of central banks should contain to entrench formal political and economic independence.

3.1 Political Elements of Central Bank Independence

Clarity of objective(s): The primary objective of the central bank should be to maintain price stability. If the act assigns multiple objectives such as promoting economic growth or employment creation, then price stability should be stated as the principal objective which should prevail in cases where policy conflicts arise (Alesina and Summers, 1993). Regional monetary authorities have embraced this element (for example, the European Central Bank ECB, 1997). In this regard, sections 4, 5 and 6 of the SADC Model Law state that while the national central bank may support general economic policies of the country, its primary monetary policy objective should be price stability. The central bank should pursue this objective independently and without fear, favour, prejudice or direction from any authority or institution.

Governing structure of the bank: Political appointments to the central bank board should be prohibited but if that is not the case, then the legislature should ratify such appointments. This is to shield the board from political manipulation (Alesina and Summers, 1993). The SADC Model Law embraces this principle, with sections 11 and 14 stipulating that the governors and directors of the central bank should be appointed by the Head of State. Alternatively, the Head of State can merely nominate these persons, and the legislature should ratify such nominations. Section 8 establishes the Board of Directors with a responsibility to determine the central bank governance policy, consisting, among others, of the governor as chairperson.

Governors and Board of Directors: The governors' tenure of office should exceed or straddle the term of office of politicians in the executive and legislative arms of governments (Alesina and Summers, 1993). This principle, which is contained in the SADC Model Law, seeks to ensure that governors are more impervious to undue political pressure and ensures the retention of a central bank's institutional memory. The Model Law further recommends that the governors should be appointed for a renewable six-year term. However, the governors' office terms should not coincide with parliamentary elections.

Coordination between monetary and fiscal policy: The SADC Model Law's section 43 states that without prejudice to the powers of the central bank to formulate and implement monetary policy and to any other provisions of the act, the central bank shall consult with the minister responsible for financial matters in areas necessary to ensure coordination between monetary and fiscal policies (Alesina and Summers, 1993).

Accountability and transparency: The Model Law's section 61 stipulates that the central bank should submit to the minister an annual report containing among other information, the annual accounts, the central bank's operations, report on the state of the economy and the conduct of monetary policy. The report should also be published. The minister shall table such annual report in parliament. Furthermore, Section 62 requires that the governor appear before parliament at least twice a year and at any other time as parliament or the governor may request, to report, among others, on the current operations and affairs of the bank, the state of the economy and the conduct of monetary policy (Alesina and Summers, 1993).

Absence of politicians and representatives of private banks on the Board: No politicians or private bank representatives should be allowed on the central bank board. Should government have a representative, then it should not have voting powers on monetary policy stances (Alesina and Summers, 1993). The SADC Model Law (section 17) directs that a person should not be appointed as or remain a board member if s/he becomes a member of cabinet, parliament, other executive or legislative authority; civil servants (except if they do not have voting rights); director, officer, employee or a shareholder in a bank or financial institution; or provides or is appointed to provide professional services to the central bank, or any financial institution.

3.2 Economic Components of Central Bank Independence

Financial independence: The SADC Model Law (sections 10, 65 and 66) embraces this principle. To avoid government interference, the central bank should have sufficient financial resources as well as full authority over its budget. Furthermore, the central bank should not be responsible for fiscal losses or conduct quasi-fiscal operations. Financial independence also entails that only realised net profits, after prudent provisioning by the central bank and allocations to general reserves, should be given to the fiscus. Such independence will also allow the central bank to operationally conduct timely and sufficient open market operations without financial constraints and in line with the set policy goals (Alesina and Summers, 1993).

Credit to government: The law should prohibit or severely limit demands on the central bank to finance government budget deficits. This principle, captured in the SADC Model

Law's section 40, argues that temporary advances and loans can be allowed if strict limits on the amount are clearly spelt out, and as long as the central bank has authority to determine the terms and rates of interest payable. Furthermore, such credit, including any indirect credit to the government should be guided by set monetary policy objectives and targets (Alesina and Summers, 1993).

Instrument independence: The central bank should have unimpeded authority to use all monetary policy instruments available in its toolbox, as and when it sees fit. Instrument independence shields the central bank from failure to achieve otherwise attainable objectives and targets due to interference from the government. To ensure that the central bank is not constrained over instruments in executing monetary policy, Section 10 empowers the board to determine policies applicable to the bank's administration and operations (Alesina and Summers, 1993).

4. Comparison of National Central Bank Acts with the SADC Model Law

The study by Wessels (2009) focused on legal independence of twelve SADC central banks by applying the international best practice CBI yardsticks to the statutes or charters of the relevant central banks. This study, however, explores *legal* CBI in the SADC region by examining the convergence or divergence between the SADC Central Bank Model Law and the existing central bank charters or acts of twelve of the fourteen SADC member states. The extent to which the central bank law goes beyond the leniency provided by the Model Law shows a shortfall in the national law and therefore weakens CBI. As in Wessels (2009) we examine the content of the central bank acts (with amendments up to the end of 2017) of Angola (2010), Botswana (1996), Lesotho (2000), Malawi (1989), Mauritius (2004), Namibia (1997), Seychelles (2011); South Africa (1989), Swaziland (1974); Tanzania (2006); Zambia (1996) and Zimbabwe (2004); and compare them with the CBI related elements of the SADC Central Bank Model Law. Results of this comparison across the Central Bank Acts of the 12 SADC member states are outlined in the table below:[2]

[2] As in other studies of a similar nature, the CBI elements contained in the SADC Model Law were treated with equal weights on a simple binary basis, i.e. *compliance* with the criteria was assigned 1 for *'Yes'* and *non-compliance* was regarded as 0 for *'No'*.

Table 1: National Central Banks and the SADC Model Law: Assessment of CBI Compliance and Identifying the Gaps

CBI Elements of the SADC Model Law	ANG	BOT	LES	MAL	MAU	NAM	SEY	SOU	SWA	TAN	ZAM	ZIM	Total
1. Single; clear price stability objective *(s.4,5)*	0	0	1	0	1	0	1	1	0	1	1	0	**6**
2. Governors appointed by Head of State, ratified by parliament *(s.11)*	1	1	1	1	1	1	1	1	1	1	1 (Ratify)	1	**12**
3. Tenure of Governors is 6 years; eligible for re-appointment *(s.11)*	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	1	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	**1**
4. Term of Governors does NOT coincide with elections *(s.11, note 17, 19)*	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	**0**
5. Absence of politicians or Govt. employees on Board *(s.17, note 24)*	0 (Unclear)	0 (Govt. officers)	1	1	1	0 (Govt. officers)	1	1	0 (Govt. officers)	1	1	0 (Unclear)	**7**
6. Grounds for removal of Governor; commission to investigate outlined *(s.22)*	0 (No Comm.)	1	1	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	1	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	**3**
7. Locus of decision making (formulating, implementing monetary policy) lies with Bank *(s.5, 6, 44)*	0 (Unclear)	0 (govt. intervene)	1	0 (govt. intervene)	1	0 (govt. intervene)	1	1	0 (govt. intervene)	1	0 (govt. intervene)	0 (govt. intervene)	**5**
8. Transparency & accountability (audited records made available to govt. & parliament in time *(s.60-64)*	1	1	1	1	1	1	1	1	1	1	1	1	**12**
9. Financial independence (including control over its policies, operations & budget) clearly stipulated: *(s.10, 65-67)*	1	0 (Unclear)	0 (Unclear)	1	1	0 (Unclear)	1	1	0 (Unclear)	1	0 (Unclear)	0 (Minister approves)	**6**
10. Strict limits on lending to Govt. (amounts & repayment period stipulated, i.e.	1	1	0 (7-year repayment)	1	0 (20-year govt. securit	1	1	0 (Unspecified period)	1	1	1	0 (Intervene)	**8**

only short term but best practice is to prohibit lending) *V (s.41)*					ies)								
11. Instrument independence *(s.5,6,10)*	0 (Unclear)	1	1	1	1	0 (Unclear)	1	1	1	1	1	0 (Unclear)	**9**
TOTAL	**4**	**5**	**7**	**6**	**7**	**3**	**10**	**7**	**4**	**8**	**6**	**2**	**69**

NB: Angola (ANG), Botswana (BOT), Lesotho (LES), Malawi (MAL), Mauritius (MAU), Namibia (NAM), Seychelles (SEY), South Africa (SOU), Swaziland (SWA), Tanzania (TAN), Zambia (ZAM), Zimbabwe (ZIM); Comm. = commission to investigate; govt. = government

In Table 1 above, 11 CBI related elements of the 2009 SADC Central Bank Model Law were applied to the central bank acts of twelve SADC member States to assess the extent of compliance with the regional Model Law. Although various CBI determinants could be more important than others, this paper uses a binary approach rather than assigning weights to each of the criteria. The limitation of this methodology is that it does not cover macroeconomic or monetary policy implementation, which could explain why relatively well performing central banks (in terms of price stability) may not have a correspondingly high score. Despite this limitation this approach nonetheless provides a general indication of the state of compliance by central bank laws to the SADC Model Law and by extension to the CBI principles.

Based on these criteria the 12 countries had a combined score of only 69 out of a possible 132 points, representing a 52 percent overall compliance. With a score of 10 out of a possible 12 points, Seychelles was the best performer, followed by Tanzania with 8 points. Namibia and Zimbabwe score lowest at 3 and 2 points, respectively. We observe a slight improvement in the overall scores in this study compared to the Wessels (2009) results. One reason is that a few countries such as Angola and Seychelles have since reviewed or amended their central bank acts for strengthened CBI. Furthermore, instead of employing the more stringent international best practice CBI criteria, in this study we used CBI elements as contained in the Model Law.

5. Key Recommendations and Concluding Remarks

Before countries can start using this work and adopting its recommendations a lot of work would be required to: (a) determine the reliability and consistency of the SADC Model Law; and (b) the compatibility of the Model Law with provisions for fiscal management in fiscal (public finance) laws. The results from the analysis of this paper show that some of the central bank charters fall short of meeting the critical elements of the regional model law. The paper therefore makes the following specific recommendations:

First, the central bank charters of Angola, Botswana, Malawi, Namibia, Swaziland and Zimbabwe should explicate that achieving and maintaining price stability is the primary objective of monetary policy, and any other objective is subsidiary to this.

Second, since in all countries the Head of State appoints governors as suggested by the SADC Model Law; therefore, parliament should ratify such appointments as in Zambia's case. Furthermore, countries should follow the example of Botswana, Lesotho and Seychelles by bestowing an independent body with powers to investigate and sanction any dismissals of the governors or directors by the executive. Beside Seychelles which has already done so, SADC countries should expound clearly that the governors are eligible for reappointment, and that the duration of each term is 6 years, thus avoiding coinciding with the usual 5-year political electoral cycles.

Third, Angola and Zimbabwe are silent on the participation of politicians and government officials on the central bank board. The central bank acts of Botswana, Malawi, Namibia and Swaziland provide for senior government officials to be part of the board with voting rights. All these countries need to effect the needed corrections.

Fourth, Botswana, Malawi, Namibia, Swaziland, Zambia and Zimbabwe should remove the provision allowing government to intervene in the conduct of monetary policy. Angola, which is mute on the matter, should clearly state that only the central bank has a right to conduct monetary policy.

Fifth, Lesotho and Mauritius should comply with the provision to restrict the repayment periods of central bank finance to government. South Africa should specify limits on repayment period and the credit amount that the central bank can provide to government. Finally, Zimbabwe should reconsider the stipulation giving government leeway to set its own credit limits from the central bank.

Finally, Botswana, Lesotho, Namibia, Swaziland and Zambia should clearly stipulate the bank's control over its budget. Zimbabwe should relax the need for the Minister of Finance to approve the central bank's budget. Angola, Namibia and Zimbabwe should explicitly allow central banks to exercise control over instruments used in executing monetary policy.

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Transfer Mispricing in Africa: Contextual Issues

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Transfer pricing is a significant tax issue and lies at the core of international trade and globalisation. This brief raises contextual issues and challenges surrounding the experience of transfer mispricing in Africa. The brief comes at a time when African countries have consistently exhibited high real Gross Domestic Product (GDP) growth rates in the past two decades, and increased FDI inflows and technological upgrades have aided their high participation in global trade. Despite the profitability of MNEs operations in Africa, the investing firms are paying less in terms of tax. This has created a problem for African countries to raise their revenue base for financing development and poverty reduction programmes. Therefore it is important for Africa to stay abreast with transfer pricing rules and issues worldwide. The brief recommends the way forward for African countries in developing capacity to understand and resolve transfer pricing issues and disputes.

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1. Introduction

The Tax Justice Network – Africa and the Strathmore Tax Research Centre Round Table Meeting on Curtailing Transfer Mispricing in Africa was held at the Strathmore Business School, Nairobi, Kenya in November 2013. The meeting provided a platform to share knowledge and experiences in the global trends in Transfer Mispricing (TP). It focused on the TP problem in Africa and Africa's response to the rising challenges. Experiences from different stakeholders were shared. These ranged from civil society, revenue authorities, academia, parliament, the private sector, the Organization of Economic Cooperation and Development (OECD) and African governments. This brief has been prepared by drawing on the presentations and discussions at the 2013 Round Table Meeting and other related materials and resources.

2. The Context

During the past two decades African countries have consistently exhibited high real growth rates. Between 2004 and 2013, the average real Gross Domestic Product (GDP) growth rate was at 5.3% per annum. Much of this growth was on the back of expanded resource output from resource-rich countries in Africa. This was boosted by increased global trade. Africa's

growth has been supported by high commodity prices and strong economic activity in resource rich countries. Increased agricultural production has produced good harvests in many countries and helped to mitigate adverse effects of high international food prices on consumers. Further, internal structural changes that have spurred the broader domestic economy have also contributed to the rapid growth of African countries.

Most African economies have continued to grow and to exhibit an increased ability to withstand global economic turbulences. While global growth remains weak, the growth momentum in African economies continues to be stable with high rates at the individual country level. In 2013, Libya, the Ivory Coast, the Democratic Republic of Congo (DRC), Angola and Ghana stood out as the fastest growing countries in the region. Libya and the Ivory Coast were the region's leaders with real GDP growth at 15% and 8.9% per annum respectively. Angola and DRC grew at 8.2%, while Ghana recorded a real GDP growth rate of 8% (ADB, 2014).

Furthermore, African countries have recorded robust growth in capital inflows. High commodity prices and location advantages have for the past two decades induced large foreign direct investment (FDI) inflows. These are mainly in the extractive industries and the services sector. FDI inflows grew by 16.2% to US$43 billion in 2013 (World Bank, 2014). This scenario of increased FDI inflows, increased global trade and globalisation, along with advanced information technology, have increased the number of Multi National Enterprises (MNEs) expanding into African markets. The increased numbers of MNEs have expanded transfer pricing risks for most African countries. Furthermore, the globalisation and digitalisation of African economies has led to increased mobility of capital. This environment has facilitated ways and means for MNEs to engage in aggressive transfer pricing actions. This has led to the erosion of the tax base and increased profit shifting.

The global advances in the way that MNEs are organised have exacerbated the TP risks. Globally most MNEs are now, more than ever before, organised as a collection of entities rather than a single entity. They are divided into operating entities and a hub entity. The locations of the operating entities which bear routine functions and bear subordinate risks are based on business and tax considerations. The operating entities receive low and controlled profits. The residual profits are shifted to the hub entity located in a low tax jurisdiction. The hub entity bears the business risk and receives residual profit in the form of intangibles such as management fees, royalties, etc.

This environment has produced a great tax challenge for most African countries. Most of them get less than 17% of their GDP from taxation (IMF, OECD, UN and World Bank, 2011: 8). This can be compared to the 35% of GDP that most developed countries get from taxation (Fuest and Riedel, 2009: 1). Although the profitability of MNEs in Africa is extraordinarily high, they are paying less in terms of tax due to TP (Mold, 2004). This has created a problem concerning how to raise their revenue base for financing growth and development. This also implies that poverty reduction efforts in African countries may

continue to be hampered because governments are denied resources to fully exploit their financial capacity to implement poverty reduction programmes.

Globalisation and growth have increased the level of inter-company transactions tremendously. It is estimated that more than two thirds of all business transactions worldwide take place within groups (OECD, 2013: 8). Africa and most developing countries are experiencing immense growth in intra-group transactions because their economies are still opening up and attracting large amounts of FDI inflows.

The implication of the above context is that African countries are or might continue to grow very fast. It is estimated that African countries might soon surpass Asian countries. This has meant increased FDI inflows and MNE dominant presence in Africa. Fuelled by the global changes in the way that MNEs organise their production, African countries are, more than ever before, faced with aggressive TP practices from MNEs. These practices erode the tax base and severely constrain the capacity of most African countries in mobilising additional resources for development.

Meanwhile MNEs are making huge profits through manipulative TP. African countries are losing huge amounts of local revenue through tax evasion and avoidance. These resources are needed for spending on health, education and infrastructure. The harmful effects of TP practices and the consequent tax avoidance of MNEs is a major problem and policy issue facing all African countries (Wayne, 2014).

African countries face problems in dealing with TP issues. Most revenue authorities are inexperienced and lack capacity in dealing with TP issues. Most of them do not have legal frameworks to deal with TP, consequently their understanding of TP issues is rudimentary. On the other hand, there are currently global initiatives at rule-making for TP. Africa is likely to be left out of these initiatives because of its lack of capacity.

3. Challenges to Transfer Mispricing

TP is the price at which goods, services or intellectual property are transferred between company entities within one country or between related entities of an MNE across international borders. In other words any scheme used to shift profit from one jurisdiction to another, usually from tax jurisdictions where the effective tax rates are higher to jurisdictions where the effective tax rates are significantly lower. TP takes various forms. There is underpricing of exports from high tax jurisdictions to a low tax country resulting in less profit being earned in the high tax jurisdiction. It also happens when exports from low tax jurisdiction to high tax jurisdiction are overpriced resulting in more profits being recorded in the low tax jurisdiction. TP can also take place where trade is channelled through third countries, in intra-company transactions, through transfer of royalties and through ownership of intangible assets. It is estimated that 60% of trade transactions into or out of Africa are mispriced by an average exceeding 11%, resulting in a capital flight

component of 7% of African trade. This totals about US$10-11 billion annually (Kazibwe, 2013: 15).

The loss of revenue from TP practices by MNEs has various implications for African countries striving to improve the quality of life and eradicate poverty. These include the erosion of the tax base through profit shifting, loss of revenue for public expenditure programmes, reduced investment in social capital, switching of tax burden between factors of production and increased tax administration costs. It is, therefore, urgent for policy makers in African countries to address the TP issues at both the individual country level and regionally. It is also important for African countries to participate in the global TP rule-making process. However, in this process they face a number of challenges. Among these are:

Lack of a legal framework: Most African countries lack appropriate rules and legislation on TP. Most countries have adopted the OECD guidelines but have not gone further to build legal institutions to implement them. The judicial system has presented problems in TP cases brought before the courts. In most cases, as was pointed out in the Round Table meeting deliberations, courts have dismissed such cases as lacking merit.

Lack of resources and expertise: There are skill gaps in Africa with regard to TP issues. This makes it important to build capacity. This can be done through training and sharing experiences and knowledge in TP issues. Such organisations as Tax Inspectors without Borders (TIWB) are useful for sharing information. Others are the African Tax Administration Forum (ATAF) and the Tax Justice Network-Africa (TJIN-Africa). The revenue authorities lack auditors, economists, and lawyers experienced in TP, financial databases used in TP analyses and sufficient staff to process TP compliance and disputes.

Limited access to information: Most revenue authorities are faced with lack of access to information. There is need for African countries to share knowledge and experience. They can use existing international networks and regional networks. Bilateral agreements on information sharing among African countries can be enhanced.

Lack of political will to address the issue of transfer pricing: Some of this lack of political will comes from the lack of appreciation or understanding of the issues. There is, therefore, need to actively promote awareness among political leaders in various fora. This will ensure that TP issues are addressed at policy and legislative levels.

Lack of a uniform and consistent regional approach to prevent tax avoidance: Regional institutions, like, the Common Market for Eastern and Southern African States (COMESA), the Economic Community of West African States (ECOWAS), the East African Community (EAC), the Southern African Development Community (SADC), and ATAF, among others, lack a regional approach to TP issues. The importance and complexity of TP risks have increased as a result of growing globalisation, cross-border mergers and the increased sophistication of the financial sector (OECD, 2012). Concerted efforts at the regional level are necessary to deal with these challenges.

Lack of local comparisons and access to databases: There is a serious problem of the lack of comparable data. Comparables are selected from European and Asian markets. These do not resemble African markets. African comparatives are not useful because most companies are subsidiaries of the same MNEs. Given the lack of comparable data, there is need to put in place measures that equip tax officers with proper data and tools for analysis. This can be done through capacity building activities in African revenue authorities in cooperation with global tax initiatives such as the TIWB.

The role of intangibles such as trademarks and brands, royalties and management fees in TP has become unprecedented. African subsidiaries pay MNEs for brands. How are these valued? The greatest abuses in TP are in the area of intangible rights (Christensen, 2013). Here, there are practical difficulties of following up the issue of pricing. There might be need to look elsewhere for solutions e.g. increasing use of profit-split arrangements.

Allocation of capital: The question begs whether subsidiaries based in low tax jurisdictions are over capitalised based on their operations. African countries should encourage MNEs to use equity rather than debt so as to reduce the opportunities available for TP.

Tax avoidance schemes: Many MNEs use off- shore or safe havens to avoid paying tax. Tax avoidance techniques have worked to create a financial services sector geared to rent-seeking activity. In addition, tax authorities find themselves outnumbered by lawyers and accountants of MNEs. The complexities of the tax avoidance schemes take up much of the tax authorities' resources and time. Furthermore, the tax avoidance techniques create a complex and secretive environment that breeds crimes of evasion, money laundering, embezzlement, fraud and bribery, among others.

4. Legal Framework

Most African countries apply the OECD Guidelines on TP to determine the appropriate TP policy for MNEs operating in Africa. The arm's length (ALS) principle is the central feature of the OECD Guidelines. However, the implementation of the ALS principle is resource-intensive and costly for many African countries (PWC, 2012).

The guidelines outline five methods to determine the arm's length nature of transfer prices. These are the comparable uncontrolled price, resale price, cost plus, transactional net margin and the profit split methods (OECD, 2013: 11). The OECD has developed draft TP legislation for developing economies which African countries can look at (OECD, 2013: 12). To have an idea of how much African countries have done in setting up TP regimes, we show in Table 1 a summary of TP regimes among selected Southern African countries from available evidence.

Table 1: Summary of Transfer Pricing Regimes in Selected Southern African Countries

Country	1	2	3	4	5	6	7	8
Angola	Yes	Yes	Yes	Yes	Yes	Yes	No	No
DRC	Yes	Yes	No	Yes	No	No	No	No
Malawi	Yes	Yes	Yes	Yes	Yes	No	No	No
Mozambique	Yes	No	No	Yes	No	No	No	No
Namibia	Yes	Yes	Yes	Yes	No	No	No	Yes
South Africa	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Zambia	Yes	Yes	Yes	Yes	Yes	No	No	No
Zimbabwe	No	No	No	No	No	No	No	No

Notes: 1=Tax code provides some guidance on TP, 2=TP regulations, 3=TP methods, 4=ALS, 5=Document requirement, 6=Thin capitalisation rules, 7=Safe harbours, and 8=APA programme

Source: PWC (2013: 8)

African countries' TP regimes are based principally on the arm's length principle and loosely on OECD rules. The OECD rules express values of the OECD member states. Africa must therefore evaluate whether these guidelines serve their purpose within the African context.

Many African countries have their own tax avoidance provisions in their laws. These are focused on the substance of a transaction or an arrangement so that tax benefits flow only to the intended beneficiary. This is done by giving power to the revenue authorities to reject claims for benefits that are regarded as artificial or contrived (Ernst & Young, 2013). However, these provisions are not adequate. Some of the provisions that are needed are the mandatory requirements on document presentation, the mandatory declaration of all tax planning methods employed in the MNE and the mandatory declaration of transfer pricing methods used by the MNE.

TP regulations need a strong and robust legal framework. Many African countries have weak legislative frameworks and judicial systems. The OECD model is suited for developed countries with well-developed infrastructure. In Africa, the transformative role of taxation is more important than in developed countries (Tax Justice Network-Africa and Strathmore Tax Research Centre, 2013). That is why an Africa specific method that addresses African objectives must be developed.

Although there are significant challenges associated with the implementation of the TP legal frameworks based on the ALS principle in African countries, the benefits are likely to outweigh the perceived risks especially as African countries have now developed their own unique TP frameworks and there is no universally agreed framework. Also in the sense that a stable TP framework is likely to increase tax revenues and attract FDI.

5. Global Transfer Pricing Rule Making

TP is a product of globalisation and international trade. Globally revenue authorities are focused on TP as a mechanism for the protection of their tax bases and as a means of ensuring that a reasonable basis is used to identify and extract economic benefits from economic entities operating in their jurisdictions.

The pace of global rule making in international taxation gained momentum after the 2008 global financial crisis. The focus has been on monitoring national and global fiscal trends, delivering expert advice and setting standards which national states are free to adopt or not. The prominent actors have been the United Nations and the OECD. The OECD Guidelines were first issued in 1979, revised and updated in 1995 and 2010 (PWC, 2013: 6). The centre piece of the guidelines is the ALS principle. Although the OECD has been prominent, it lacks representativeness. It has an exclusive membership of the leading industrial countries. Africa is not represented. It might, therefore, not be an appropriate forum for global rule making (Wouters and Meuwissen, 2011: 9).

The United Nations has sought to create a TP framework designed to address the concerns of African countries. It has produced a United Nations Practical Manual on TP to assist developing countries in dealing with TP legislation, databases, setting up TP units and on how to implement the ALS principle. The United Nations provides an inclusive forum for global tax policy. However, it lacks the resources and the institutional capacity to lead and guide the process. In most cases it has to draw its expertise and advice from the OECD (Wouters and Meuwissen, 2011: 10).

African countries need to increase their efforts to have African input on these global processes of TP rule making. ATAF presents a good opportunity and platform to advance African interests. One of these interests is to push for multilateralism rather than bilateralism in global rule making. In that situation African voices are likely to be heard.

African countries must work with other countries and institutions in rule making. If they work on their own, there is a danger that there will develop a large diversity in TP rules in various countries around the globe. This will work to their disadvantage. There is need for a set of TP rules that can be adhered to globally.

During this process, there is need to adopt international tax instruments and for Africa to engage with global standards. The need for the exchange of information within Africa is not as great as the need to exchange information with states where these MNEs are based. Still more, African revenue authorities have a lot to share through information networks and capacity building activities among themselves.

There have been other efforts at the global level aimed at addressing the challenges of TP. The United Nations has developed a model double taxation agreement to be used by developing countries when entering into tax treaties with developed countries. OECD has established a task force on Tax and Development. International Financial Reporting Standards Foundation (IFRS) and International Accounting Standards Board (IASB) are

investigating opportunities to include country by country reporting as a standard for companies in the extractive industry. African countries must actively seek inclusion and participation in these global policy making processes on TP issues. So far discussions have not effectively included Africa. They can use regional vehicles such as ECOWAS, SADC and EAC to express their concerns and interests.

6. African Responses

Many African countries have implemented or are working on implementing TP rules that allow their revenue authorities to adjust the prices of related-party transactions. These include South Africa, Kenya, Uganda, Egypt, Ghana, Benin, Zambia and Tanzania. They have worked on the regulations and set up units within revenue authorities to deal with TP issues.

TP enforcement has provided governments with a means of reducing fiscal deficits through the collection of TP adjustments and taxes e.g. in Kenya and Tanzania. This allows governments to raise additional revenue to finance education, health and infrastructural programmes.

Most African countries that have enacted TP rules and regulations have based them on the OECD model. However, the current laws are inadequate. There is need to develop adequate legal frameworks to address TP issues in most African countries. This needs political will which is currently lacking. There will, therefore, be need for lobbying to policy makers to take the issue of TP more seriously.

Some African countries such as Kenya, Rwanda and Tanzania have improved their TP legislation. In such cases MNEs are required to develop TP policy documents. The documents are available to auditors. They are also required to disclose the global organisation structure, details of transactions under consideration, all related parties, their shareholding and management structure. There is resistance from MNEs arguing that the process is time-consuming and costly.

African countries are at different levels with regard to addressing TP issues. The signing of bilateral and multilateral information sharing agreements among African countries would help reduce the existing information gap.

Furthermore, the OECD transfer pricing methodologies are not easy to apply in African countries. There is need to design a model that suits Africa. The data available for accessing TP does not provide good comparisons for Africa. For this reason, the arm's length principle may not be the best for Africa. And without proper comparisons, it is very difficult to apply the OECD model.

Since there is no African approach to TP, can OECD and UN come up with guidelines that will serve Africa without an African input? For Africa, tax is not only for revenue but must be transformative (Tax Justice Network-Africa and Strathmore Tax Research Centre,

2013). Where should the global level discussion take place? These are the issues which should underpin African discussions on TP.

6.1 Advanced Pricing Agreements

An Advance Pricing Agreement (APA) is an agreement between the MNE and the revenue authority, specifying the pricing method that the MNE will apply to its related company transactions. This is usually for a period of time. Some African countries, such as Uganda, have used APAs. It has been argued that African countries should approach APAs with caution. They should not enter into APAs until they have the capacity to have those agreements. Premature entry into APAs before capacity building will lead to adverse effects on tax generation. Players from other markets have access to huge information networks, which Africa does not have. If African countries enter into APAs before there are enough guidelines, these countries will lock themselves into the wrong value. Capacity building before entry into APAs is crucial.

6.2 Double Taxation Agreements

Many African countries have entered into double taxation agreements (DTA) with several developed countries. This has been done as a means of avoiding double taxation but also for the purposes of sharing information. However, before entering into DTAs African countries should analyse their impact on revenue collection, especially in economies that are dominated by MNEs. The impact of the DTAs might challenge the legitimacy of tax regimes, legal institutions and democratic processes.

7. Policy Recommendations

It is clear that African countries need to do a lot of work to catch up with what is happening globally as a result of the increased presence of MNEs in their economies. Several policy recommendations flow from the discussions at the Round Table and from TP related literature.

There is great need for public transparency by MNEs in the African countries that they operate in regarding information on TP. Civil society organisations and the media can assist in promoting this public transparency. One way to increase transparency is to encourage subsidiaries of MNEs to incorporate as public limited companies. There is need to encourage subsidiaries of MNEs to have some local ownership by listing them on the local stock exchanges. This will not only create an incentive for the growth of local capital but will open the companies to increasing public transparency and scrutiny.

Given the complexity of TP issues, there is need for information exchange. This can begin with information exchange between revenue authorities within Africa. It is proposed

that an information-sharing network involving all African countries be developed. The ATAF would be a good forum to address this issue. TIWB would also be a useful forum in addressing TP issues within Africa. Furthermore, collaboration and co-operation among African countries is very important because MNEs have great capacity within themselves. A collaborative effort to curb TP would greatly improve Africa's effectiveness in combating the practice.

Besides African countries sharing and exchanging information between countries and tax authorities, they should invest in more research and sharing of information on MNEs seeking to invest in Africa. Because of global interdependence, it is no longer plausible to consider TP as a country specific problem. There is need to share information and exploit resources from international organisations such as the UN, OECD, European Union and other countries in the world.

Currently TP issues are not on the top of the political agenda in Africa. It is important to raise political awareness of these issues since Africa is losing and will continue to lose huge amounts of tax resources annually through TP. There is need to sensitise politicians on these issues so that they can become part of the agenda. Sensitisation can be done through training, coalition building and advocacy by civil society and the media.

Capacity building is fundamental in addressing TP issues. There is need for capacity building among revenue authorities, the judiciary, academia and professionals. Many African courts are unable to meaningfully adjudicate cases of TP. It is important to train the judiciary so as to appreciate the repercussions of the practice. There is also need to engage parliament. It has a role to play in legislation. Capacity building should include politicians, parliamentarians and parliamentary committees such as the budget and finance committees. Increased and continuous training of revenue authority staff, judiciary and prosecutors on issues of TP is important because the issue of TP practice is an art and not a science. Capacity building activities should include research by universities and research institutes. This should focus on the context of TP and bring out concrete practical policy proposals and recommendations. This should bring on board such professionals as tax consultants, lawyers and accountants.

African countries must work together to make sure that the incentive structures among countries within Africa are harmonised. An effort must be made in this direction. African countries offer location benefits to investors. The advantages range from natural resources, young growing markets and high returns on capital, among others. As a result of this, African countries do not need to offer high tax incentives to attract FDI into their countries. Rather like China, African countries need to recognise that the location advantages they offer are enough to attract investment into Africa. In this regard, African countries should analyse annually the costs of the tax incentives given.

There is need to review the provisions of DTAs and any incentives granted to ensure that countries are not losing out on their fair share of taxes. African countries must act to

stop reckless tax competition which involves attracting FDI through tax breaks, exemptions and other incentives even when research has conclusively shown that investment decisions are only minimally based on taxation regimes. There is need for a common policy which is mutually beneficial and takes into account the harmonisation of policies.

African countries should adopt country-by-country reporting. There should be a common template developed for country-by-country reporting to be used by MNEs. This will increase transparency. Country-by-country reporting will allow each tax administration to have access to information on the profits being created in each country. Such reporting will reduce the disincentives for cross-border investments and also reduce the expenses for compliance. It will reduce TP problems. It can further reduce disputes and may reduce or increase revenue depending on the country and formula used. Country-by-country reporting is what African countries need to tackle TP by MNEs. Information available from country-by-country reporting should be made available to all tax stakeholders, such as media and civil society.

MNEs should be treated as a single large entity and not as a collection of entities. All members of the consolidated group should be treated as engaging in a common purpose. The taxable income of each entity in a particular country should be a proportion of the total taxable income of the consolidated business as determined by an apportionment formula. The apportionment is based on the country where the entity carries out its economic activities. The advantage of this approach is that it overcomes the problem of double taxation. If there is a single set of combined accounts and profits are attributed based on economic substance, there will be no scope for double taxation.

African countries should introduce a continuous review process on tax and investment policies. This will enable them to continuously review their legislation so as to make it effective. Perhaps, they should consider a peer review mechanism on tax and investment legislation.

TP requires a strong and robust legal framework. Countries should introduce, develop and strengthen TP regulations and the legislative framework to enable them to adequately tackle the TP problem. The laws, guidelines and rules enacted should be relevant to the African experience. The judicial and court systems need to be sensitised on TP issues so that African justice systems support the efforts of tax authorities. This can be done through legislation and training. Good legislation and policies will not be effective if corruption is not eradicated. This is currently manifested at all levels of government. There is need for a focused and concerted effort to eradicate corruption especially in tax administration matters.

African countries should participate in global rule making so that African voices, interests and experiences are reflected in emerging global rules. To this effect, it is essential to evaluate to what extent the OECD guidelines apply to the African situation. Guidelines can then be formulated more suitable to the unique challenges that TP poses to Africa.

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