Importance of sovereignty in African Tax Policy

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Many people have campaigned against the infringement of African sovereignty involved in OECD proposals[2]. Prof Annet Oguttu has been a major player on this issue. However, as she is a professor of law, many see her concern with sovereignty as merely a technical aspect of law. This is far from the case so below is an attempt to show the role of sovereignty and its importance.

The Harrogate Case Study:

Harrogate was a major player in the housing development market in the UK. Its budget for development was £1.4bn. It was the most successful social housing developer and the model for the industry. Then came the 2008 crash. I was a member of the Group Board so this story is first hand. A thorough review of our exposure was undertaken. Our target market for our housing was first-time buyers in low-cost housing in London. At a theoretical level even if demand halved as a consequence of the financial crash demand would still exceed supply in London. When we looked at our sales pipeline we still had buyers for all available property at the prevailing prices.

Our business model was based on borrowing £1.4bn and then selling sold properties and using the cash to finance the borrowings. For example, (these numbers are fictional and for illustration purposes to avoid breach of confidentiality) on £1.4bn loans we may need to pay annual interest of £70m and need to repay £300m of the old loan in order to be able to draw down an additional new £300m for a new development keeping the overall loan balance at £1.4bn. On this model, we need to make sales each year of £370m. Despite our expectation of making sales actual sales dried up causing a major financial crisis. If we were unable to meet our loan terms it would be front-page news and would be discussed at the Treasury and the Cabinet Office.

What happened? We urgently investigated what had happened and what the situation was. Basically, we found that we had plenty of customers with mortgage-qualifying economic situations. However, as a secondary consequence of the financial crash the Bank of England insisted that banks refinance their lending ratios (i.e. loans/equity ratio), which involved either finding new equity or reducing their loan portfolios or both. One of the quickest ways to reduce their loan portfolios was to cancel mortgage lending. As a consequence, our potential buyers were unable to obtain mortgages. This was entirely unpredictable. There was nothing that Harrogate could do about this situation.

The matter was so serious that discussions with the Bank of England had to be undertaken in strictest secrecy. Board meetings were held on a Sunday so that there was no risk of attracting attention among staff wondering why there were so many secret Board meetings. My girlfriend at the time threatened to leave me as she did not believe that I had board meetings on a Sunday and clearly I had some other agenda. Even telling her I had a board meeting was technically breaching the secrecy guarantee I had given the Bank of England, so I did not say which company it was. In the end, the matter was resolved

1. by Harrogate floating a £1.4bn bond on the capital market as the bond market was a form of disintermediation and allowed borrowing without infringing bank liquidity and equity ratios.
2. The government increased the threshold for people who could buy social housing from under 45% of the population to 95% of the population.
3. There was pressure put on the lending banks to assist Harrogate as it began to disintermediate from them.

Relevance to International Tax Policy

In this situation despite all the best planning unexpected consequences of larger effects threatened the existence of Harrogate. Unusual steps were required to save Harrogate. But for countries that are connected to the international economic order unusual consequences of international events that any particular country played no part may have serious consequences. A small country in Africa may have no opinion in respect of the war in Ukraine but has significant loans for development outstanding that are budgeted at say 3%. The Federal Reserve now increases interest rates from close to zero to over 5% and their loan rates increase by over 5%. On a $10bn development loan the increase could cost over $500m per year unexpectedly. It becomes essential for the small country, actually any country, to be able to take countervailing measures such as changing tax rates and tax policies. OECD rules seek to bind subsequent African governments not to change certain tax policies whatever happens. It should be clear that any such commitments are not merely infringing sovereignty but also threatening economic viability of African countries by preventing them from being able to independently respond to unexpected economic shocks.

Endnotes

1. IFA is International Fiscal Association see ifa.nl
2. (*What Is OECD Pillar 1?*, 2023)What is OECD Pillar 1? | TaxEDU. (2023, May 11). Tax Foundation.

    https://taxfoundation.org/taxedu/glossary/oecd-pillar-1/

References

What is OECD Pillar 1? | TaxEDU. (2023, May 11). Tax Foundation.

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