Afronomicslaw Sovereign Debt Quarterly Brief, No. 2 of 2025: The Impact of IMF - Recommended Consumption Tax Policy on Africa's Rising Public Debt Levels

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Executive Summary

Consumption taxes, including VAT and excise taxes, are essential sources of revenue worldwide. They are typically indirect, initially collected from businesses, and passed on to consumers. While effective in revenue generation, these taxes can negatively impact consumer spending power and economic growth. The IMF's influence on national fiscal policies, focusing on its recommendations regarding consumption taxes and their broader economic impact, is fast attracting public scrutiny. Key examples include Kenya's Finance Bill 2024 and Australia's stringent 2023 economic reforms (ahead of 2024),

both advised by the IMF. These cases illustrate the significant public backlash and economic challenges stemming from consumption tax increases and the ensuing concerns about socio-economic fairness and stability. Indeed, the IMF's evolving role highlights the ongoing debate over national sovereignty versus international financial influence.

Additionally, national consumption tax policies aim to achieve various goals,such as generating revenue, promoting economic efficiency, ensuring fairness,and supporting social welfare. Policymakers must manage trade-offs andpossible unintended effects. These tax policies must balance the need forrevenue with economic goals, which can result in either progressive (fairer) orregressive (less fair) tax structures and varying rates for different goods andservices. The global debt architecture, shaped by historical evolution andcontemporary financial policies, faces persistent challenges in balancingsovereign debt sustainability with developmental priorities. Despite IMFinitiatives in crisis intervention and debt restructuring, borrowing countriesoften encounter asymmetrical power dynamics and neoliberal economicpolicies that exacerbate debt burdens and divert resources from essentialsocio-economic goals. To align global financial systems with sustainabledevelopment, it is crucial to enhance transparency, accountability, and equity indebt management practices.

In Africa, public debt levels are generally unsustainable, with significantvariation among countries due to differing economic structures, governance,and external factors. Africa's public debt surged to US$1.8 trillion in 2022, withsub-Saharan Africa's debt exceeding 60% of GDP, highlighting the need forsustainable fiscal strategies. The legacy of debt from post-independenceperiods and the impact of structural adjustment programs (SAPs) have leftmany nations struggling with debt dependency and social inequalities. Empiricalevidence from global case studies, such as Ghana's VAT transition in 1998 andMexico's VAT reforms from 10% to 15% in April 1995, underscores the compleximpacts of IMF-supported consumption tax policies. In Mexico, the VATincrease was an austerity measure in response to the 1994 Mexican peso crisis,aimed at stabilizing the economy.

These reforms have often led to increased government revenue and improved fiscal stability but have also contributed to higher living costs for lower-income

families and challenges in achieving inclusive growth. Sri Lanka's VAT reforms, for example, bolstered government revenue but faced significant economic and distributional challenges, as the country's debt-to-GDP ratio was projected to remain high.

The IMF's involvement in tax reform includes technical assistance and policy advice that have not been necessarily tailored to each nation's needs. While IMF-supported consumption tax policies have improved short-term fiscal stability, their long-term effectiveness has adversely impacted public debt levels and sustainability, although their overall impact depends on broader economic stability and equitable policy design. The IMF's conditionalities often involve fiscal consolidation and tax structure reforms, which can impose austerity measures, reduce public spending on essential services, and exacerbate social inequalities.

By pushing for higher consumption taxes like VAT, the IMF shifts the tax burden onto ordinary citizens, which in turn can deepen inequality, stifle economic growth, and contribute to rising public debt rather than address the root causes of public debt. These policies, implemented with little regard for local economic realities, have repeatedly failed to foster long-term fiscal health in many developing countries. To mitigate these damaging effects, a fundamental overhaul of the IMF's approach to tax reform and debt management is urgently needed that prioritizes transparency, accountability, and the socio-economic conditions of each country over blanket, one-size-fits-all prescriptions.

This report critically explores the IMF's consumption tax policies and their adverse effects on borrower nations, particularly in Africa and the Global South. It examines how the IMF's emphasis on consumption taxes like VAT, when used as a tool for revenue mobilization, often leads to regressive outcomes by exacerbating inequality, increasing poverty, and contributing to unsustainable public debt. Through an analysis of the global debt architecture evolution and a review of IMF-backed tax reforms across various regions, the report highlights the disconnect between the IMF's policy prescriptions and the socio-economic realities of developing countries. The study underscores the need for reforming the international debt architecture to address the negative impacts of these policies and proposes recommendations for more equitable and sustainable debt and tax solutions.

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