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Building Capacity for Domestic Resource Mobilization: The Role of Development Partners

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The Issue

Africa's ability to deliver on the ambitious post-2015 Agenda (also called the 2030 Sustainable Development Goals) and the African Union Agenda 2063 largely depends on the availability of adequate financial resources. But the funding sources for development programs have been neither stable nor predictable, particularly after the global financial crisis in 2008. It has become clear that while donor financing remains important, overreliance on donor funding will not sustainably drive the success of the two continental agendas, hence the need to focus on other development finance options such as domestic resource mobilization.[1] If new sources of financing are not in place, Africa's growth and industrialization strategies are likely to suffer an early setback.

Agenda 2063 recommends that countries strengthen domestic resource mobilization, build continental capital markets and financial institutions, and reverse illicit financial flows for Africa to be self-reliant and finance its own development.

So, development partners will need to align their efforts more toward supporting Africa's domestic resource mobilization initiatives. Africa falls short on the required capacity to generate savings and taxes and to allocate the available resources to economically and socially productive sectors. This is where development partners are needed most, building on their experience, expertise, and resources. Development partners are defined here as the nongovernment actors that build relations with governments, emphasizing the importance of long-term partnerships and focusing on results that are inclusive and sustainable.

This policy brief puts forward possible interventions by Africa's development partners in building capacity in domestic resource mobilization.

The Study

The 2015 Africa Capacity Report (ACR 2015) is based on a survey in 45 African countries profiling capacity trends and good practices from countries successful in capacity development. The survey centered on policies, strategies, and initiatives to improve domestic resource mobilization and curb illicit financial flows. ACR 2015 recommends several policy options for governments, the private sector, civil society, and development partners to enhance domestic resource mobilization and curb illicit financial flows.

Key Emerging Issues

State of domestic resources mobilization in Africa. Africa has the largest number of low income and fragile countries dependent on foreign aid, with official development assistance (ODA) still accounting for a large share of external resources. But since the global financial crisis, aid to Africa (particularly Sub-Saharan Africa) has declined in real terms. In 2014 only 5 of the 28 Organization for Economic Cooperation and Development (OECD) Development Assistance Committee donor countries met the Pearson Commission's recommendation for 0.7% of donor gross national income. ODA received by Africa was US$55.8 billion while the remittances were estimated at US$61.2 billion and tax revenues at US$508.3 billion in 2013. So, the most sustainable resource alternative for Africa is mobilizing resources from domestic taxes and savings, though foreign aid and capital inflows will remain important.

Savings rates. Sub-Saharan Africa has lower and more volatile gross domestic savings rates than other regions. Compare its 17% rate in 2013 with 46% in East Asia and Pacific, 26% in South Asia, and 19% in Latin America and the Caribbean. This gap is attributable to weak financial sectors that discourage savings, leaving a big part of household savings in the informal sector. Although North Africa had gross domestic savings rates above 40% in the last decade, the savings rate in Africa has been declining, impeding investments and income per capita growth.

Low savings and financial exclusion partly explain the inability to fully implement development programs and thus the persistence of absolute poverty and general backwardness.

Tax revenues. Africa's tax collections have increased more than fourfold in recent years—from US$123.1 billion in 2002 to US$508.3 billion in 2013, driven largely by resource rents. The increase in resource rents has caused a split between countries that are mobilizing high tax revenues due to the presence of natural resources, and others that are making significant effort but cannot mobilize revenues due to shallow tax bases. Tax performance metrics—such as the budget of the tax authority, the revenue it collects, and the tax effort index—reveal that Africa has imbalanced, very expensive, and inefficient tax collection systems. Instead of relying on few sources of revenue like resource rents, countries should have a more diversified and balanced tax mix, which is more sustainable in the long term.

Curbing illicit financial flows. Combating illicit financial flows can be a valuable source of domestic resources, but it remains an important challenge for most African countries. Because of weak institutions, poor governance, and a lack of regulation and information, the African continent lost US$60.3 billion to illicit financial flows over 2003–12. In 45 countries surveyed, there was no evidence of success in combating such illicit flows, which requires responsible business and political will.

In combating illicit financial flows, the economically developed countries, the less economically developed countries, and the development partners all have responsibilities to: identify resource leakages, stop and recover funds illegally earned or transferred, and punish those responsible. Development partners, using the Oslo Dialogue on Tax and Other Crimes based on a development partner-led approach, should help to improve operational and information sharing arrangements, and to build up expertise in developing countries to fight financial crime. Notably,

1 Domestic resource mobilization refers to generating savings and taxes from domestic resources and allocating them to economically and socially productive activities instead of using external sources of financing (ACBF 2015).

illicit financial flows are higher than levels of official development assistance to Africa, with corruption fueling much of the flows, thus hampering country abilities to effectively mobilize domestic resources. Box 1 illustrates the relationship and trends of illicit financial flows and official development assistance.[2]

Box 1: Illicit financial flows in Africa

Although there is no accurate figure of the amounts lost from Africa through illicit financial flows, there is a convergence of opinion that Africa lost more than US$1 trillion to illicit financial flows in the last 50 years and that it is currently losing more than US$50 billion a year. Trade misinvoicing and corruption are directly or indirectly the major sources of illicit financial flows. Since 2005 illicit financial flows in Africa have been greater than official development assistance (ODA). During 2007–09, illicit financial flows were almost double the ODA, which declined in 2009–10 due to the global financial crisis. This implies that Africa loses the equivalent of all its ODA to illicit financial flows and thus may continue to be aid-dependent if it does not improve the capacity to curb illicit financial flows and mobilize domestic resources.

African governments are now forced to accumulate higher debt to finance their spending while development partners have their own priorities and conditions on funds delivered as aid to Africa. That makes it important for development partners to help build tax capacity, curb illicit financial flows, and enhance domestic resource mobilization, as in Ghana and Rwanda.

Capacity challenges in domestic resource mobilization. It is clear from the 2015 Africa Capacity Report that the major capacity areas that require attention are stopping illicit financial flows, fighting corruption, ensuring efficient tax revenue collection, and strengthening revenue governance. Countries need the human capacity to set up and administer efficient and effective systems and processes that minimize resource leakages and maximize tax revenue collections. They also need the capacity to adequately fund DRM processes and to hire, retain and utilize skilled staff. So, technical, institutional, human, and soft capacities are all needed. These challenges are most elaborately compounded by low levels of income and weak financial development. The capacity constraints hinder improving tax collection and broadening the tax base by increasing informal sector taxation, boosting savings through both formal and informal financial institutions, and reducing capital flight.

Recommended Policy Options for Development Partners

Development partners can improve the continent's ability to curb resource leakages, maximize tax revenue collections from all possible sources, and increase development impact in strategic priority areas. They should, in partnership with African governments and other key stakeholders, support the following policy recommendations:

- Provide funding for training staff on tax collection systems. Scholarships can be offered to staff and prospective employees on tax collection, with scholars staying home to contribute to national improvements in tax collection. Study tours can be financed so that tax experts learn from best practices in successful countries.
- Invest in information technology infrastructure, data collection, and tax registries in revenue authority organizations. Continuing training on new technologies and hiring technical experts will also be needed to complement the upgraded infrastructure.
- Assist African governments to negotiate contracts with businesses, especially multinational mining companies, including appropriate provisions for reviewing royalty and revenue sharing mechanisms in view of fluctuating commodity prices.
- Partner in monitoring country resource endowments through reliable geological surveys of mineral resources and their rate of exploitation.
- Bring many informal businesses into the formal sector by underwriting setup costs for the registered small businesses and providing supporting infrastructure for the formalized businesses. This may encourage informal sector players to formalize their business activities, thus improving the tax base for African countries.
- Invest in human, technical, legal, regulatory, and financial capacities to deal with illicit financial flows. This includes supporting universities and public institutions in training of experts in illicit financial flows such as lawyers, accountants, tax officers, law enforcement officers, customs officials, and financial experts.
- Support information sharing with governments on intelligent fund movements, and thus stepping up prosecution of illegal activities on domestic shores by the multinational firms domiciled in their home countries and provide training assistance in necessary DRM capacities where they have superior know-how.

Implications

There is no doubt that Africa can sustainably mobilize domestic resources and fund its development programs. But the capacity challenges to domestic resource mobilization and curbing illicit financial flows remain notable drawbacks to achieving development agendas on the continent. Thus, partnerships and cooperation between African governments and development partners are critical given the capacity and experience of the development partners in implementing development processes and programs at all levels.

Notwithstanding the roles of the private sector and civil society, development partners remain very important in helping Africa mobilize its own domestic resources for capacity development. They know where Africa requires capacity the most, how best to intervene in Africa's development challenges, and with whom.

In the short term, development partners will need to support African countries in building capacity targeted at deepening the tax base in efficient and fair ways, assessing the efficacy of tax incentives, dealing with transfer pricing abuses by multinational enterprises, taxing extractive industries, and being transparent and accountable in using tax revenues. In the medium to long term, structural concerns require strategies that target the informal sector, enhance fiscal legitimacy, boost administrative capacity, and harness international and development cooperation to improve resource mobilization.

Thus appreciation of the capacity challenges and the need to intervene by development partners is critical if Africa is to sustainably mobilize resources for supporting its development agendas. This also requires a dynamic African political leadership and change-oriented democratic governance that engages development partners as "true" partners for inclusive and sustainable development.

References

African Capacity Building Foundation. 2015. *Africa Capacity Report (ACR 2015): Capacity Imperatives for Domestic Resource Mobilization in Africa*. Harare.

2 See the African Capacity Building Foundation (2015). *Capacity Imperatives for Domestic Resource Mobilization in Africa*. Harare: ACBF.