THE AFRICAN CAPACITY BUILDING FOUNDATION | FONDATION POUR LE RENFORCEMENT DES CAPACITES EN AFRIQUE

BROCHURE

Capacity Imperatives for Domestic Resource Mobilization

This brochure features the preliminary findings of the upcoming 2015 Africa Capacity Report

Domestic Resource Mobilization (DRM) means both the mobilization and efficient utilization of resources.

Key Messages

Mobilizing and efficiently utilizing domestic resources is crucial for Africa to implement the post-2015 development agenda and African Union (AU) Agenda 2063

Yet, despite encouraging achievements, African countries face various challenges, capacity being the most important, preventing them from effectively mobilizing domestic resources

Notwithstanding these challenges, with the right strategies, it is possible to build the capacity to scale-up DRM provided the key stakeholders play their roles effectively

Key stakeholders must support the efforts of countries and regional and continental organizations in building requisite capacity for scaling up DRM

The African Capacity Building Foundation (ACBF) is taking the necessary steps to support country and continental efforts but to do this effectively, it needs the political and financial support of its member States and key partners and stakeholders.

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Mobilizing domestic resources in Africa is crucial for achieving continental and international development Agendas.

Africa must mobilize domestic resources to implement its development Agenda.
Recognized as an effective strategy to finance Africa's development, Domestic Resource Mobilization (DRM) - the generation of savings and taxes from domestic resources and allocating them to economically and socially productive activities - matters for Africa for many reasons.

First, there is need to mobilise internal resources to implement the Sustainable Development Goals (SDGs) and Agenda 2063, although this does not mean that Africa should not mobilize external resources as well. Second, African countries should not depend on donor aid alone: most donor countries have failed to live up to the long-standing commitment to deliver 0.7% of Gross National Income (GNI). Also, on the one hand, aid-dependent countries tend to be more responsive to donor than domestic priorities. Third, external financial flows can be unpredictable. On the other hand, Foreign Direct Investment (FDI) flows are more likely to respond to the profit motives of private firms with the remittances often used for immediate consumption not long-term infrastructure investment. Fourth, there is significant untapped DRM potential in Africa as domestic tax revenues mobilized are increasing and remain larger than external financial flows. Additionally, illicit financial outflows (IFFs), if curbed, can retain significant resources for development on the continent.

• The Official Development Assistance (ODA) share of total external flows has been diminishing, from 38% in 2004 to 27% in 2014 (estimated at USD 55.2 billion).

• Tax revenues continue to increase in Africa, and reached USD 507 billion in 2013, against USD 442 billion in 2007.

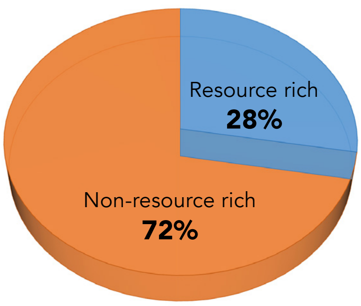
• IFFs volumes surpass those of ODA and FDI. Recent estimates show that Africa lost an average of USD 60.3 billion – about 4% of GDP – in illicit financial outflows during 2003-12 period.

Effectively mobilizing domestic resources in African countries faces significant challenges

ACR 2015 country case studies highlight a number of important constraints:

- The tax base is very narrow.
- The tax base is further eroded by high levels of capital flight, evasion and avoidance and proliferation of tax exemptions.
- Tax authorities lack legitimacy and capacity. Paying taxes is viewed as not being worthwhile because there does not seem to be tangible results from the ensuing public expenditure.
- Tax administrations have weak capacity
- Penetration of formal banking sector is relatively low. A large proportion of the population lacks direct access to the formal financial sector. Inability to collect taxes due to relatively large agricultural sectors that sell raw commodities and high level of informality in the service sector.
- Relatively poor business climate that hinders levels of taxable profits
- Countries lack the human, technical, legal and regulatory, and financial capacities to deal with IFFs.

Low tax collection effort remains a critical issue. Despite significant improvements in tax revenue collection over the decade 2006 - 2015, DRM remains low. Estimates show that during 1996-2010, 27 countries, representing 60% of the 45 countries covered by the 2015 African Capacity Report (ACR 2015), have made low tax collection effort.



Among the 18 countries that made high tax collection effort, the majority (72%) are non-resource rich countries.

The preliminary findings on tax from the Africa Capacity Report 2015 (ACR)

• 97% of countries surveyed have tax exemptions dedicated to investors.

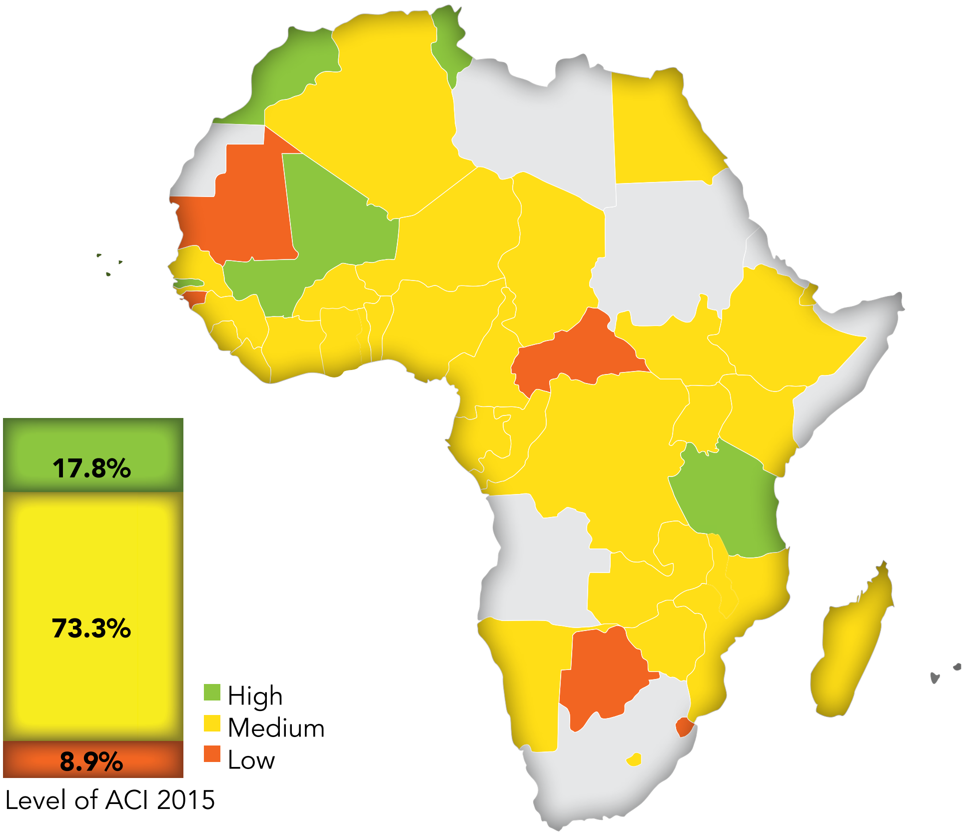
• Trust level of taxpayers vis-à-vis the tax system is assessed high and above in only 11% of the countries surveyed.

• The African Tax Administration Forum launched in 2009 is the first platform for exchange between tax authorities in Africa. However, 23% of countries surveyed are yet to become members.

• 72% of countries reported not to be a member of the Collaborative African Budget Reform Initiatives (CABRI), and 78% have not signed the Yaoundé Declaration on Tax and Development.

Capacity weaknesses represent the most significant challenge to DRM

Capacity, in its various dimensions, is still a problem for the continent not just for DRM. ACBF's Africa Capacity Index (ACI) 2015 shows that the bulk of African countries have medium capacity (73.3) with only 17.8 percent in the High bracket, while 8.9 percent are in the Low bracket. The ACI measures policy environment, processes of implementation, development results at country level and capacity development outcomes.



Level of ACI 2015

Countries have acute capacity needs for scaling-up DRM. Results show that almost all areas for ensuring effective and sustainable DRM face high capacity constraints.

Acuteness of capacity needs for DRM

Area of capacity needs	Very Low	Low	Medium	High	Very High
Fighting Illicit financial flows	6.8	13.6	22.7	40.9	15.9
Revenue collection	2.3	13.6	31.8	38.6	13.6
Fiscal sustainability	2.3	7.0	44.2	46.5	
Financial sector strengthening		4.7	48.8	41.9	4.7
Fighting corruption	4.6	11.4	29.6	38.6	
Social security and safety nets	4.7	25.6	30.2	34.9	4.7

Institutional and human capacity imperatives for scaling-up DRM. In addition to the rules and regulations, the capacity of institutions in the DRM chain must be reinforced to increase DRM. Rules and regulations encompasses sound public financial management which is integral to the process of improving DRM and ensuring that domestic resources are used to ensure inclusive and sustainable development. Besides, it is important to: (1) have legal system reforms aimed at law reform, especially where the laws are inadequate, or poorly functioning; (2) reduce crime and criminal activities of all kinds; (3) undertake reforms in the areas of taxation, banking and capital markets; (4) have flexible yet effective laws and regulations to access non-traditional sources of finance and curb IFFs and (5) work more on tax reforms that will ensure tax harmonization and a move away from tax exemptions, concessions and holidays.

Majority of surveyed countries expressed high needs for capacity building in 4 key areas:

- Fighting Illicit financial flows
- Revenue collection
- Financial sector strengthening
- Fighting corruption

Required soft and society level capacity:

- understanding the development issues
- understanding the importance of paying tax
- following positive social norms, values and practices conducive to DRM.
- Building strong political leadership
- Operational capacities.
- Adaptive capacities

Required institutional capacity:

- ability to design, implement, monitor and evaluate DRM policies
- ability to effectively plan expenditures and delivery of public services
- establishment and operationalization of appropriate regulatory and/ or prudential frameworks for conducting productive business
- ability to collect statistical information
- managerial capacity to ensure the recruitment and retention of specialists in areas such as ICT, accounting and finance, audit, and legal.

Required human capacity: sufficient skills for assessment, formulation and implementation of DRM-specific policies and measures, as well as for monitoring, reporting and reviewing the same.

Beside the rules, regulations and building of the required human capacity, it is imperative to build the capacity of key continental, regional and national institutions to increase DRM:

- The African Union Commission and its organs (especially those dealing with legal, audit, tax and parliament related issues)
- The specialized institutions such as the ACBF, the African Development Bank (AfDB), the African Tax Administration Forum (ATAF), the Collaborative Africa Budget Reform Initiative (CABRI) and the UN Economic Commission for Africa (ECA)
- Regional Economic Communities (RECs), specially the AU-recognized ones which will play a great role at the regional level in the DRM chain
- National tax administration and revenue authorities.

Need to foster visionary leadership, change mindset and address other soft capacities. A key element for successful DRM starts with an effective and visionary, committed and accountable leadership that sets the right tone at the top. While there is need for positive social norms, values and practices conducive to DRM, the ability and willingness to learn from experience is equally important.

With the right strategies, scaling-up DRM is possible as illustrated by African success stories

While there is room for improvement, a number of case studies show that DRM is possible and that successful strategies can be adapted to various countries.

Côte d'Ivoire: Central Bank of West African States (BCEAO) reform on e-money

In 2006, the BCEAO successfully issued regulation on electronic money that qualified non-banks for e-money issuer license. Under this regulation, an e-money issuer can be a bank (in partnership with an MNO) or a non-bank institution that has been granted a specific license by the central bank.

In just two years, the number of e-money subscribers increased from 2 million in 2011 to 6 million in 2013, generating 46 billion CFA francs (approximately, US$95 million) of savings.

Uganda: Anti-smuggling Measures

The Uganda Revenue Authority (URA) has implemented a series of anti-smuggling measures to curb tax evasion and avoidance, especially on imported goods entering and traded in the country. Examples of such measures include: a 24-hour border patrol by a paramilitary unit operated by the URA at the main border points of Busia, Malaba, Katuna and Entebbe International Airport. The URA has also implemented the Revenue Authority Digital Data Exchange (RADDEX) system to provide cargo details in a standardized electronic format– minimizing data errors and saving time.

- The anti-smuggling measures are partially credited with a reduction in tax evasion.
- International trade taxes increased in Uganda by 260% between the period 2004/05 and 2013/14, largely attributed to the anti-smuggling measures.

Zambia: Direct Deposit of Fees

From January 2013 the Government made it mandatory for all Ministries, Provinces and Revenue Collecting Statutory bodies to deposit all collections of fees and fines directly into the treasury bank account. This initiative led to improved revenue collection in 2013; improved Public service delivery efficiency; improved transparency and improved skill set for a number of officers in the Passport Office that were trained in internet banking for ease of tracking direct transfer deposits.

The Direct Deposit of fees initiative led to improved revenue collections in 2013. The envisaged budget collections from user fees and charges over performed by 200%.

African countries can do more to address capacity gaps. The capacity challenges in DRM calls for more concerted efforts by countries to put in place mechanisms for addressing them; these include (1) simplifying and rationalizing tax systems; (2) having a budget line on capacity development provided for in national budgets as initiated by Cameroon; (3) ensuring that revenue authorities have the capacity to engage with taxpayers to create awareness on their rights and obligations; (4) developing capacity to raise revenue from neglected sources such as small informal businesses/activities and real estate; (5) providing IT infrastructure, investing in finance data collection, and helping to set up tax registries; and (6) building the human, technical, legal and regulatory, and financial capacities to deal with IFFs.

Key stakeholders must play their roles

Governments must be at the forefront in developing requisite capacities. In the short term, capacity building initiatives should focus on (1) the ways and means to broaden the tax base by, for example, removing unnecessary tax preferences, dealing with transfer pricing abuses and taxing extractive industries fairly and transparently; (2) the conduct of training to develop or improve the skills of staff involved in DRM-related issues; (3) the active participation to initiatives such as the African Tax Administration Forum (ATAF) and Collaborative Africa Budget Reform Initiative (CABRI) which are crucial in sharing best practices; and (4) peer-learning activities via initiatives such as the Tax Inspectors without Borders initiative by the OECD and UNDP.

In the medium to long term, governments should build capacity around structural issues, namely (1) developing resource mobilization strategies that target the informal sector and other largely untapped sectors like urban property; (2) enhancing fiscal legitimacy through long-term capacity building in DRM especially taxation; and continuously modernizing all tax collection systems to ensure efficiency and effectiveness.

Other key stakeholders have important roles to play also. Beside the governments, the private sector, civil society, judiciary and parliaments have a crucial role to play in building capacity for DRM. The private sector, which includes both domestic and foreign entities, is critical through mobilisation of private savings and corporate social responsibility. The private sector has huge financial potentialities but need to be engaged in a profitable manner so that it can contribute to implementation of the development agenda.

Civil society in Africa has a role to play in building capacity for scaling up DRM. This can be done by (1) promoting greater dialogue on tax-related issues as well as efforts at curbing illicit financial flows; (2) demanding transparency in tax authorities' operations; (3) requesting accountability regarding governments' use of tax revenues; (4) monitoring performance indicators to assess the progress of national revenue authorities; and (5) advocating for information exchange and transparency.

The role of parliaments in capacity building for DRM cannot be overemphasized given that the trust between parliamentarians and citizens is a fundamental principle of taxation. Parliamentarians need to play a critical role in (1) passing registration that ensures efficiency, effectiveness, and fairness in revenue generation and utilisation as well as curbing of IFFs; (2) identifying where the different tax proposals brought to parliament are impacting the different groups they represent; (2) helping governments to maximize revenue inflows whist minimizing the impact or the incidence of taxes on the people they represent; and (3) over all, enforcing accountability to taxpayers on how money is spent, by exercising strong oversight (ensure that tax incentives are granted and managed in a transparent manner and serve the best interests of countries). Relatedly, building the capacity of the judiciary for recognising and enforcing laws aimed for curbing IFFs in particular, is eaually important.

ACBF continues to support member States in their efforts at building capacity for DRM

Knowledge generation and sharing. ACBF will continue to produce and disseminate knowledge products as well as advisory services on capacity building related to DRM. Examples are the Africa Capacity Report on "Capacity Imperatives for Domestic Resource Mobilization"; the Country Case Studies on Domestic Resource Mobilization; and the Joint sub-regional Workshops with partners like UNECA on Curbing Illicit Financial Flows on the continent.

Notably, ACBF has been assigned by the African Union Commission to undertake a Capacity Needs Assessment and develop a Capacity Development Plan for implementing Agenda 2063 and the flagship projects for the first 10 years. Along with this was an assessment of the risks associated with implementing Agenda 2063. Important knowledge products linked to DRM are stemming from the assignments. These efforts are crucial for understanding the capacity requirements for developing programmes towards successfully implementing Agenda 2063.

Targeted investment in capacity development projects and programs at the continental, regional and national levels. ACBF will continue to invest in capacity building through support at continental level to the African Union (AU) Commission; at regional level to the Regional Economic Communities (RECS) such as CEMAC, COMESA, EAC, ECCAS, ECOWAS, SADC, and UEMOA; and at national level to countries by strengthening the think tanks and direct investment aimed at addressing DRM capacity deficiencies.

Having already established regional training programs in Francophone and Anglophone Africa through such programs as the Programme de troisième cycle interunivesitaire en Economie (PTCI), the African Institutions of Science and Technology (AIST), and the Economic and Policy Management (EPM) Programs, the Foundation is seriously considering DRM training programmes as well. African governments, donor partners and development stakeholders must support ACBF in this endeavor.