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Building Capacity for Domestic Resource Mobilization: Role of the Private Sector

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The Issue

Success in implementing Agenda 2063 and the Sustainable Development Goals depends largely on the availability and adequacy of resources. Africa realizes that industrialization is the way to go, as outlined in the two continental development plans, but it is inevitable that resources to fund these programs must be mobilized domestically. Domestic resource mobilization (DRM)[1] was recognized as one of the six leading sources of finance for the Millennium Development Goals (MDGs), but many African countries did not fully achieve the MDGs due to overreliance on donor funding. One part of DRM is generating taxes and savings, which implies that governments and the private sector have key roles in this process. Specifically, the private sector should mobilize private savings, expand its productive investments, conduct responsible business by not engaging in tax avoidance and illicit financial flows, and ensuring corporate social responsibility.

The 2015 Africa Capacity Report (ACR 2015) identifies the private sector as very important in partnering and cooperating with governments and other key stakeholders to maximize tax revenues and promote savings and investment. This policy brief puts forward possible interventions for the private sector to enhance domestic resource mobilization in Africa.

The Study

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 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 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 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.

Box 1 illustrates the innovative initiatives on financial inclusion and savings mobilization by the private sector in a number of African countries.

Box 1: Financial inclusion and mobilization of savings in Africa

Africa lags behind other developing regions in financial inclusion and savings mobilization. The cost of pooling funds is high largely due to weak institutions. Given that many households in Africa have low incomes and do not have collateral security to access funds from the formal sector, financial participation by most Africans is limited.

Some African countries have introduced and embraced mobile money to reach out to the poor. Consider Kenya's M-PESA, Zimbabwe's eco-cash, telecash, and netcash, and Ethiopia's mobile money transfers and deposit-taking microfinance. These innovative approaches have increased financial inclusion and promoted informal transfers of funds into the formal system.

Local bond markets in Africa promote a deeper and more efficient local financial system, reducing transaction costs and enhancing risk management. Kenya, Nigeria, and South Africa are the most advanced countries with local currency bond markets that cater to corporate and government bonds. Nigeria and Zimbabwe mobilize domestic savings through institutional and nonbank sources such as sovereign wealth and country funds. Because of the financing gaps in Africa, some African states with fragile economies, like Angola and Democratic Republic of Congo, use resource-for-infrastructure funding, and others embrace public-private partnerships. The private sector will reach out to the public sector more if the policy environment is conducive for business and investment and sustained in a win-win situation.

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

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, 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.

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 and retain skilled staff. So, technical, institutional, human, and soft capacities are all needed. These challenges are most elaborately compounded by low incomes 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. In light of these challenges, the private sector can support capacity building initiatives through corporate social responsibility programs. It can also support training for public officers in efficient tax administration and formalizing the informal sector to widen the tax base, which in the long run will reduce the tax burden on the private sector.

Recommended Policy Options for the Private Sector

The private sector can improve the continent's ability to curb resource leakages and maximize tax revenue collections from all possible sources—by mobilizing domestic savings, ensuring financial inclusion, and maximizing development impact in strategic priority areas. The private sector should, in partnership with African governments and other key stakeholders, support the following policy recommendations:

- Beyond paying taxes and mobilizing savings, the private sector can support domestic resource mobilization efforts by contributing, through corporate social responsibility, to interventions that make governments accountable and transparent in the use of tax revenues.
- The financial sector should promote financial inclusion and integration (for example, through mobile money transfers and e-banking) and domestic savings, especially through use of information and communication technology.
- The private sector should invest in human, technical, legal, regulatory, and financial capacities to deal with illicit financial flows. Investments in financial and human development can develop the capacities of government officials, universities, civil servants, and business schools to produce finance, procurement, and management graduates who can efficiently trace and recover illicit funds. The private sector can share information with governments on fund movement, tax evasion, and tax avoidance—and assist in plugging illegal fund transfers. Multinational companies and even informal firms can volunteer to remit taxes due to the government, and assist in simplifying and rationalizing the tax system to tap hard-to-tax sectors.
- Private savings for future productive investments should be increased to broaden the tax base. The private sector should retain and plough back profits and find innovative ways to raise capital for investment in productive assets. These can include private-public partnerships, private partnerships, local currency bond markets, and e-banking.
- Diaspora bonds and infrastructure bonds can mobilize diaspora resources and channel remittances through formal channels to boost liquidity and supplement household income and savings.
- The private sector can take part in public–private partnerships to fund large capital infrastructure projects that cannot be fully accommodated under government budgets.
- Private financial service firms can direct credit to attractive sectors of the economy and to micro, small, and medium enterprises.

Implications

The private sector is arguably the most important stakeholder in Africa's domestic resource mobilization strategy. Growth in tax revenue and reductions in illicit financial flows will not happen without a responsible private sector. The compliance and active participation of the private sector in tax laws and other revenue mobilization strategies require equal attention. Also important is unleashing the innovative capacity and creativity in Africa's private sector to mobilize domestic savings and promote financial inclusion.

References

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