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Domestic Resource Mobilization in Africa: a Focus on Government Revenue

United Nations Economic Commission for Africa (ECA)

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1. Introduction

The implementation of Agenda 2030 and the African Union's Agenda 2063 hinges on Africa's ability to mobilize sufficient, predictable and timely financial resources. The Addis Ababa Action Agenda reaffirms that mobilization and effective use of domestic resources, underscored by the principle of national ownership, are central to achieving the sustainable development goals. . Governments welcome efforts by countries to set nationally defined domestic targets and timelines for domestic revenues as part of their national sustainable development strategies. Further, Governments committed to enhance revenue administration through modernized, progressive tax systems, improved tax policy and more efficient tax collection as well as addressing illicit financial flows.

In this global context, Africa has recently stepped up its policy initiatives aimed at strengthening the mobilization and effective use of domestic resources. These initiatives include the work of the Planning and Coordination Agency of the New Partnership for Africa's Development (NEPAD), the Ninth African Development Forum, the High-Level Panel on Illicit Financial Flows, and the Common African Position on the Post-2015 Development Agenda.

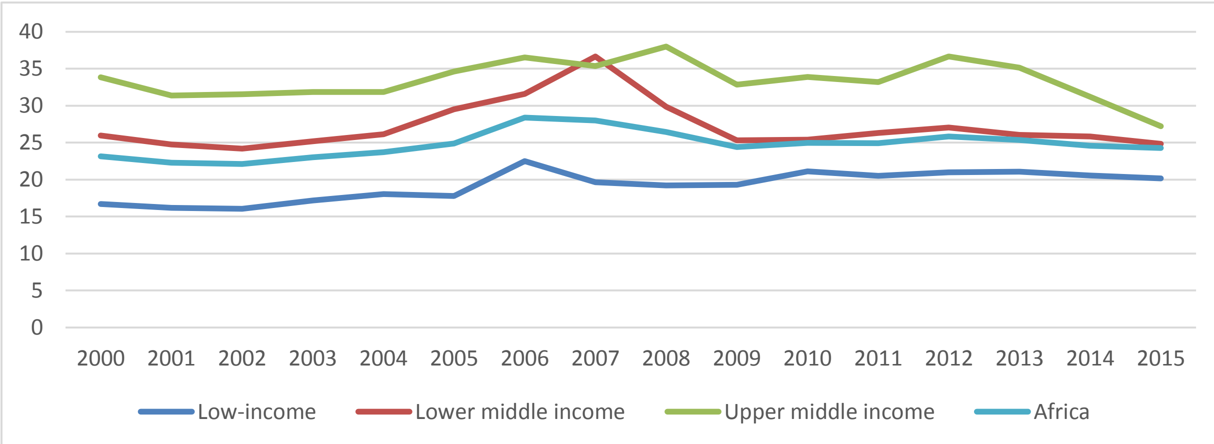
2. Stocktaking

2.1. Domestic revenue has been on the rise, with variations based on income and natural resource-based grouping

Since Monterrey, Africa has increasingly mobilized its domestic resources to finance the development priorities of agriculture, industrialization and infrastructure. However, the regional trend masks a number of variations among individual countries. Although most African countries have improved their tax revenue to GDP ratio from 2000 to 2016, the Government revenue as a percentage of GDP was higher in countries with high income (see figure 1). The same applies to the disaggregation by natural resource base. Prior to the recent decline in commodity prices, the trend shows that oil rich countries outperformed other countries (figure 2).

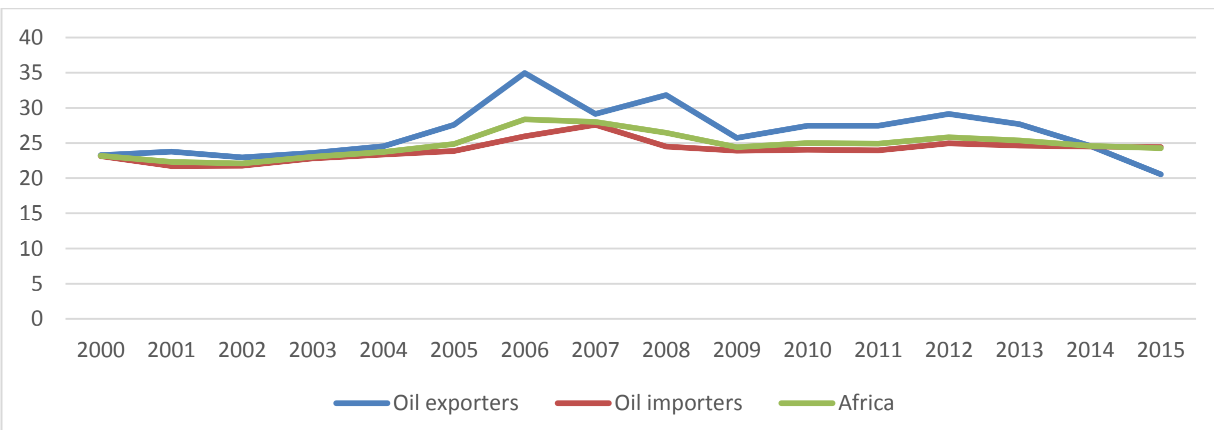
[1] Gamal Ibrahim, Derrese Degefa and Jean Abel Traore

Figure 1: General Government Revenue (% of GDP) in Africa by income group



Source: Calculations based on the International Monetary Fund, World Economic Outlook Database, April 2016.

Figure 2: General Government Revenue (% of GDP) in Africa by economic group



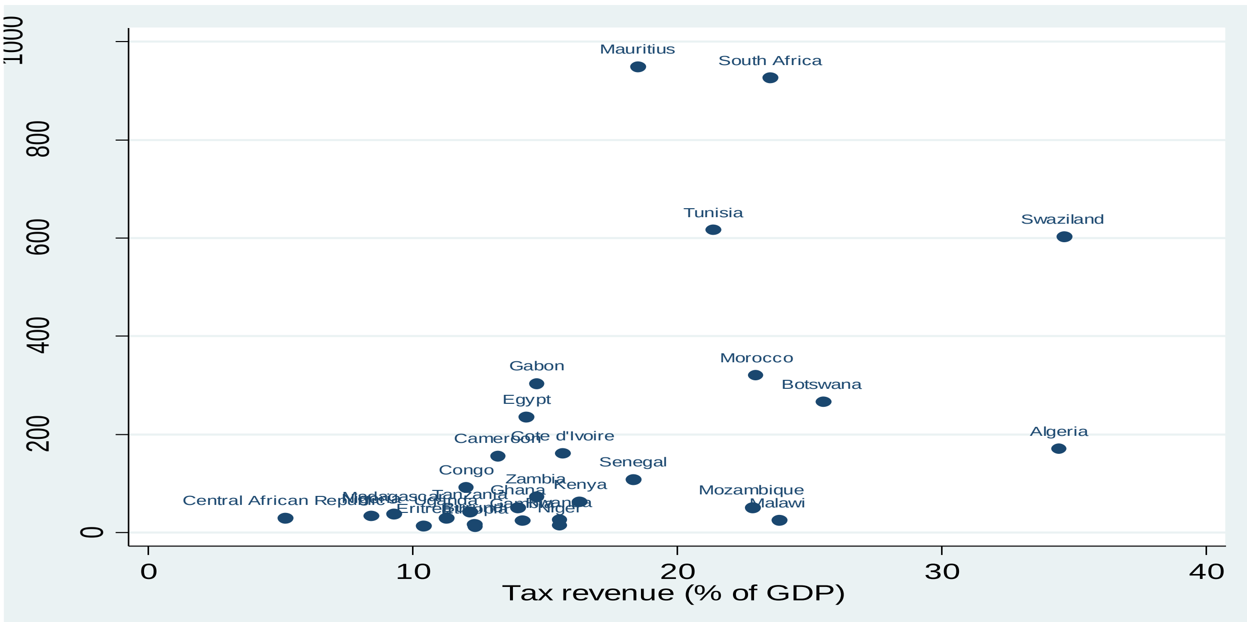
Source: Calculations based on the International Monetary Fund, World Economic Outlook Database, April 2016. Country classification according to the ERA 2016

2.2. Relatively diversified and industrialized African countries are also performing well in mobilizing tax revenue

Recent data reveals a positive correlation between the degree of manufacturing and the level of tax to GDP ratio in Africa (see figure 3). The degree of manufacturing is captured by the manufacturing value added per capita (MVA) identified as a relevant indicator for the industrialization level of a country. More diversified African countries such as Mauritius, South

Africa, Swaziland, Tunisia and Morocco with higher MVA per capita tend to have higher tax revenue.

Figure 3: Manufacturing per capita (USD) and Tax revenue (% of GDP) in 2013



Sources: calculations based on World Revenue Longitudinal Data (WoRLD), June 2015 and UNIDO database , December 2014

2.3. Despite reforms, tax collection remains weak

Despite significant tax reforms, the performance of tax revenue mobilization has been mixed, limited by structural factors such as low per capita income, large informal sector, large peasant agriculture and very small manufacturing and modern services implying very low effective tax bases despite the growth profiles. Moreover, domestic revenue losses are significant drain on domestic resource mobilization for many countries in Africa. This is often the result of lack of coordination between investment promotion objectives and resource mobilization needs, excessive tax incentives and large drains through illicit financial flows (ECA, 2016).

2.4. Unlocking idle resources through innovative finance

The role of central banks in unlocking idle resources and channeling them into productive investments remains critical. Currently, over US$1 trillion of excess reserves have not been effectively put to work to finance Africa's development. African stock markets could also be developed to attract further investment opportunities. Stock market capitalization in Africa increased from $113 billion in 1992 to $2 trillion in 2007, but declined to US$1.5 trillion in 2013 (ACM 2013). Africa is now home to 15 sovereign wealth fund African countries could also opt for the establishment of sovereign wealth funds to manage their large excess reserves. African pension funds represent a growing domestic source of capital for private equity estimated at over US$29 billion (Ashiagbor et al. 2014). They can fuel investment in local businesses, infrastructure projects and services that are desperately needed for Africa's continued transformation and growth. The insurance sector also has similar potential in the financing of Africa's development. Further opportunities arise through the better management and use of extractive industries. Recent proven stocks of extractable energy resources in Africa (oil, natural gas, coal, and uranium) worth between US$13-14.5 trillion and identified US$1.7 trillion of potential wealth and additional production potential in six key sectors - agriculture, water, fisheries, forestry, tourism and human capital (Africa investor 2010).

3. Policy options and recommendations

3.1. Strong institutions are needed to ensure effective implementation of domestic resource mobilization efforts

Moving forward, domestic resource mobilization will undoubtedly continue to underpin development financing in Africa since the region has considerable potential to raise more domestic resources. However, effective implementation of domestic resource mobilization agenda requires strong development planning institutions to strengthen tax systems, expand the tax base, address the challenges of the informal sector and fight tax evasion and avoidance. African countries also need effective tax frameworks for monitoring the extractive industries to maximize the benefits from the region's natural resource wealth. Improvement of tax performance involves innovative measures and incentives that are required to attract the informal sector into the formal sector, where transactions are taxable. Tax-administration capacities can be strengthened with innovative tax implementation schemes. And better utilization of information and communications technology by tax authorities to lower the high transaction costs faced by Governments.

Development partners have a key role in assisting African countries enhance the effectiveness of domestic resource mobilization agenda through providing effective financial and technical support to enhance tax capacity-building efforts and improve tax administration in priority areas defined by African countries. For African countries to make better use of concessional finance, there should be a greater focus on investment and trade-oriented Official Development Assistance (ODA) which can be used to unlock and leverage domestic resources to address the critical challenges hindering pro-poor economic transformation such as poverty, exclusion and deprivation, inequitable cross-state revenue sharing and issues related to climate change and natural disasters.

3.2. Improving the regulatory responses to emerging and Innovative sources of finance

The shortcomings associated with the traditional source of domestic resources have made the emerging and innovative sources of domestic finance attractive. International financial markets present a largely untapped pool of capital to finance the structural transformation of the African continent while institutional investors also have the potential to provide an additional source of long term finance. However, there is a critical need to ensure that African countries are well equipped to undertake the necessary reforms to ensure that due attention is paid to the institutional arrangements governing these modes of finance.

3.3. Greater global transparency is key to successful financing of development strategies

Greater global transparency is needed to achieve accountable taxation, enhance the regulation and supervision of under-regulated financial markets, and reduce systemic risks of banking and shadow-banking systems. It is also equally important to ensure that investment treaties are fully aligned with long-term performance and sustainable development.

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