Domestic Resources Mobilization for Financing Development in Africa

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Introduction

The concerns on financing development in Africa can be traced back to the MDGs era (2000-2015) when assessment[1] of the implementation of the global development agenda found that some progress has been made, but more actions are needed on national ownership and fostering of pro-poor and socially inclusive sustainable economic growth, encouraging Domestic Resources Mobilization (DRM) and delivering on the Official Development Assistance (ODA) commitments.

The commitment of Africa to implement Agenda 2030 and the SDGs have expanded the depth and breadth of financing for development concerns in the continent. The continent has developed Africa 2063, which is a shared strategic framework for inclusive growth and Sustainable Development[2]. These commitments have tremendously expanded the scope and scale of implementation and monitoring of the development agenda in the continent, and have increased the financial needs and the financial resources gap in Africa. According to UNECA Economic Report on Africa 2020, the cost to achieve the SDGs in Africa by 2030 is estimated at $ 1.3 trillion a year and could increase to $19.5 trillion as a result of population growth.

Indeed, implementation of Agenda 2030 and the SDGs requires significant financial resources, which is a quite heavy financial burden[3] at the time when the African economies have suffered from the negative impacts of COVID-19 lockdown measures and policies, and the war on Ukraine have increased food and fuel prices in Africa. These crises have weakened the financial resources, and pushed more people into poverty in the continent. Both of these issues make mobilization of financial resources a more pressing need than ever before.

Strategies on the mobilization of financial resources are incorporated in each of the SDGs, and SDG 17 has been devoted entirely to the means of implementation, including finance. The Addis Ababa Action Agenda have emphasized the need to mobilize domestic resources, and have established the foundation for implementing the SDGs. Also, Africa Agenda 2063 provides a continental strategy for DRM and external financing for the achievement of the future aspirations of the continent.

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[1] See for example UNDP 2010. What will it take to achieve the MDGs? An Internal Assessment. United Nations Economic Commission for Africa, African Union, African Development Bank and United Nations Development Programme, 2015. *MDG Report 2015. Lessons Learned in Implementing the MDGs. Assessing Progress in Africa Toward the Millennium Development Goals.*

[2] African Union 2015, Agenda 2063 The Africa we Want. A shared Strategic Framework for inclusive growth and sustainable Development. First Ten-year implementation Plan 2014-2025

[3] UNECA Economic Report on Africa 2020.

The main objective of this paper[4] is to briefly analyze the role of Domestic Resource Mobilization (DRM) and Official Development Assistance (ODA) in providing finance for development in Africa. Besides this brief introduction, section 1 provides insights on harnessing DRM and ODA for financing sustainable development. Section 2 discusses how COIVD-19 impacted on the DRM and the financial space in Africa. Sections 3 and 4 briefly analyze DRM through tax revenues and public expenditure, and leveraging domestic private resources, respectively. Sections 5 and 6 focus on stemming illicit financial outflows, and on strategic partnerships for DRM, respectively. The paper concludes in section 7 with some notes on financing poverty eradication.

Section 1: What is DRM?

Agenda 2063 defines domestic resources mobilization as "the savings and investments generated by households, domestic firms, and governments…. DRM offers the advantages of greater domestic policy ownership and greater coherence with domestic needs"[5]. This definition has been elaborated more eloquently in OSAA report, which adopted a holistic definition that covers both of revenue and expenditure sides of DRM. Besides ensuring ownership, this definition provides a broad scope for understanding DRM and the challenges and opportunities of both sides of revenue and expenditure in the continent.

DRM is not only finances, but also more effective and inclusive means of channeling funds (including financial institutions and markets, and financial services) to where they can be more effective, and where there is failure in harnessing and efficient allocation of the needed resources. The continental Agenda 2063 have identified domestic and external financial resources for attaining seven continental aspirations. According to the first ten-year implementation plan 2014-2023, domestic resource mobilization is "meant to contribute at least 75% to 90% of the financing of Agenda 2063 on average per country" namely through:

1) enhanced fiscal resource mobilization,
2) maximization of natural resource rents
3) leveraging of the increasingly important pool of African institutional savings – pension funds, central bank foreign exchange reserves, sovereign wealth funds and capital market development;
4) enhanced retail savings mobilization through financial inclusion;
5) curbing of illicit financial flows;
6) reduction of inefficiency and governance/corruption-based financial leakages and wastages – government, infrastructure services, agriculture value chain, etc.

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[4] This paper draws on Agenda 2063 The Africa we Want. A shared Strategic Framework for inclusive growth and sustainable Development. First Ten-year implementation Plan 2014-2025. Also, it draws on a flagship publication prepared by the UN Office of Special Advisor on Africa (OSAA) titled: *Financing for Development in the Era of COVID -19: The Primacy of Domestic Resource Mobilization.*

[5] African Union 2015. Agenda 2063. The Africa we Want. A shared Strategic Framework for Inclusive Growth and Sustainable Development. First Ten-year implementation Plan 2014-2025.

The resources mobilization strategy for the 2063 Agenda includes the following external sources of finance:

1) FDI, official development assistance (ODA);
2) financial cooperation from emerging development partners such as BRICS countries, Arab world, etc.;
3) Public private partnerships and other forms of investment partnerships;
4) leveraging of Diaspora remittances and savings;
5) Improved access to the international financial markets

Clearly, achievement of the future aspirations of Africa rests primarily on domestic resource mobilization, which are not only funds, but also real ownership to finance own development: to identify national development priorities, interests and future aspirations, and to mobilize domestic resources for their achievement. In other words, to become less dependent on external financial flows without replacement of what each country and the continent as whole need to do.

Section 2: How *COVID-19 impacted on DRM in Africa?*

COVID-19 has reshaped the landscape of finance for development in Africa. While it has weakened the sources of finance and widened the finance gaps, it has opened new opportunities for recovery. Real GDP growth have declined by an average of 2.2% in 2020. It has recovered to 3.8% in 2021 and is projected to reach 3.6% in 2023. This recovery, which is partly due to removal of the lockdown measures, is slow compared to the pre-pandemic period. According to IMF estimates, Africa requires additional funds of about $ 285 billion to increase spending to counter the impacts of the pandemic.

The pandemic have negatively impacted on domestic (revenues, private savings, etc.) and external financing (FDI and ODA). However, domestic financing remained the largest source of finance in the continent. In 2018 for example, domestic financing was four times the foreign inflows (FDI, ODA, Remittances and portfolio investment). Though the tax revenue as a share of GDP rose to 16% in 2019, Africa still lags behind other developing regions, and has a long way to go. Low tax to GDP ratio means the continent have limited financial resources to spend on education, health and social protection, for example.

Domestic savings and pension funds are an important source of domestic finance in Africa Though not much affected by the pandemics, domestic savings remained steady at 20.1% of GDP, but are much below other developing regions. Much of pension funds are invested abroad. If pensions were invested in Africa they would reduce the financing gap significantly in the continent.

Africa’s share of global FDI flows is marginal (4% in 2020), and the total FDI flows to Africa have declined to $ 39.8 billion due primarily to the pandemic. FDI flows to SDGs related sectors fell considerably in 2020. There are opportunities for increasing FDI flows to Africa, and for directing FDI to high growth sectors (industrial sector, infrastructure, energy and human resources development).

External debt is growing rapidly. As a percentage of GDP, external debt have increased from 20% in 2010 to 45% in 2020, and external debt service have jumped from 3.5% to 6.3% for the same years, respectively. Rapidly growing debt is a cause of shrinkage in the fiscal space. In other words, the debt service could have been invested in the production sector to support economic growth, and to financing SDGs related sectors such as health, education and social protection.

Remittances are important source of finance for development in Africa. They have decreased by 4% in 2020 due to the pandemic, and have recovered in 2021 and reached $ 91 billion. However, the flow of remittances to Africa are constrained by high transaction cost of about 8%, which is higher than target of 3% (SDG10.c). The flow of remittances is hindered by lack of adequate financial services and exclusion of a large number of the poor and vulnerable people from the financial system. Therefore, the availability of remittances for financing development is limited, and the potential is high if countries develop the banking sector, reduce the high transaction costs and make the financial sector more inclusive to the poor and vulnerable. Also, the savings of the African diaspora in their countries of residence remain largely untapped potential for financing development in their countries of origin in Africa.

Africa is the largest recipient of ODA, which reached $42.9 billion in 2020. However, this financial disbursement is below the 0.7% target of gross national income, and insufficient for meeting the huge financial needs of the continent. There is need to unlock the resource potentials of ODA to support economic growth and DRM.

Illicit financial flows out of the continent, such as smuggling, illegal trade practices, tax abuse, criminal activities, and corruption, are huge and they constitute significant loss to financing development in Africa. These outflows constitute about 3.7% of the GDP or $ 88.6 billion annually. Reducing illicit outflow will tremendously increase finance for development, thereby increasing the potential to finance infrastructure, health and education.

Section 3: DRM through tax revenue and public expenditure

Ensuring efficient tax revenue system and efficient management of public expenditure are important for DRM in Africa. Both of these two source areas suffer from financial inefficiencies, and they provide opportunities to remove bottlenecks and contribute to more financing for development. Besides low tax to GDP ratio, inefficiencies in the tax revenue systems in the continent are reflected in high levels of tax avoidance and tax evasion, weak linkages of taxes to development activities, and weak administration of taxes. Also, tax collection is expensive.

Likewise, public expenditure suffers from considerable waste. The average efficiency score of public spending in Africa is 0.585 compared to 0.825 for developing countries. This means

Africa could have achieved the same level of output using about 42% to 48% less resources[6]. At the sector level, inefficiencies of public spending are high in infrastructure (52%) education (49%) and health (13%) sectors. In other words, public spending in Africa is not associated with the desired outcomes, due to weak institutional structures and capacities, and weak governance and administration. Therefore, considerable financial space exists in public spending in Africa, and countries need to harness this space through increasing efficiencies. The potentials of increasing public savings exist in the better management of wages and the wage bill, removal of unnecessary administrative costs, reducing disguised and redundant labor, better management of public expenditure on services, energy, electricity and water, better procurement of goods and services. Also, gradual removal of subsidies will provide more space for financing development, provided that the removal of subsidies does not hurt the poor and vulnerable people.

There is large financial space in both of fiscal incentives granted to foreign investors and digitization of the economies. The overuse of fiscal incentive, such as tax holidays and reduced tax rates, deprives governments of important financial resources estimated at 2.5% of GDP (US$ 46 billion in 2019). These resources could have been invested in infrastructure development, for example, to attract more foreign direct investment and promote its contribution to production and economic growth.

With regard to digitization, its pace and coverage have considerably expanded due in part to the lockdown measures and policies associated with COVID-19. Digitization is now widespread in many countries in Africa and in many sectors such as digital cash transfers for social protection, digital payments for health, trade and food delivery, and digital payment of water, electricity and energy bills. Digitization have enhanced financial inclusivity in many African countries. The contribution of digitization to economic activities in Africa have increased to $115 billion in 2020, and is expected to increase to $180 billion by 2025. There is more potential contribution of digitization to the finical space in Africa if countries adopt measures to expand it to all financial sectors including collection of taxes and custom duties.

Section 4: Leveraging Domestic Private Resources

Domestic savings in Africa are low, averaging around 20% of the GDP for 2010-2020, compared to 35% for East Asia and 28% for the Pacific and South Asia. This is coupled with a shallow financial sector as evidenced in a low financial development index. A large proportion of the population in Africa are out of the banking system.

Low savings in Africa are due to low and volatile income, young age structure of the population, high informality of the economy and underdeveloped banking systems. African countries need to increase their domestic savings through formalizing the economies, increasing income levels, encouraging businesses and developing the banking and financial

[6] The public spending efficiency scores presented in the OSAA report are estimates of the spending amounts that would have been saved by a country in order to reach the same level of output in comparison with its peers, based on the data envelopment analysis methodology

institutions. There is high potential for increasing the use of mobile technology to extend financial services to a large number of people, especially the poor and vulnerable ones.

Other large potential sources of finance for development in Africa are stock market shares and pension funds. Stock market shares have reached $1.43 trillion in 2021 and pension funds have reached $1.1 trillion in 2020. However, both these two sources of finance are low compared to Asia and the Pacific. While participation rates in pension funds are low, partly because of high informality of the economies, the market shares are constrained by the inefficient banking systems.

The African diaspora, who have doubled in size from 14.6 million in 1990 to 40.6 in 2020, are an important source of finance for development in the continent. Total remittances to Africa were $67 billion in 2016 and $87 billion in 2019. They have declined by 4% in 2020 due to the pandemic. However, they have increased to $91 billion in 2021. Remittances play a major role in financing health, education and housing, and supporting household expenditure on food and other costs. However, the flow of remittances to Africa is constrained by high transaction costs, and much of the funds are transferred informally through the *Hawala* system. In addition, remittances are a small portion of the diaspora savings abroad, which is a potential source of financing for development in the continent.

Section 5: Stemming Illicit financial outflows

Illicit financial flows pose serious challenge to domestic resource mobilization in Africa. The financial outflows from Africa are estimated at $129 billion in 2012. Throughout the period from 1970 to 2018 Africa lost a total of $2.0 trillion. The annual financial outflows from Africa far exceed the annual inflows of FDI ($54 billion) and ODA ($48 billion). These large amounts of illicit financial flows are deleterious to domestic resource mobilization for financing development in Africa.

The main drivers of illicit financial flows are commercial practices related to trade and tax abuse, followed by criminal activities such as money laundering, and corruption. Limited research and knowledge show that illicit financial flows deprive Africa from funds needed to address poverty and implement the SDGs.

The main challenge to address illicit financial flows out of Africa is lack of a global plan or strategy to provide coherent legal and institutional framework. Africa have established a High-level Panel on Illicit Financial Flows (the Mbeki Panel). According to this Panel, Africa must address corruption and money laundering through strengthening legal and institutional frameworks, and strengthen the use of digital technology. Also, it is important to engage more effectively with the international community on ways and means of reducing illicit financial outflows from the continent.

Section 6: Strengthening Partnerships for DRM

Partnerships at the national, regional and global levels are needed to support domestic resource mobilization in Africa. While DRM must be home-made and must originate from within the continent, it needs to be strengthened by innovative partnerships at the regional and international levels, to create more fiscal space for financing the SDGs, especially poverty eradication.

Three types of partnerships need to be strengthened to support resource mobilization: domestic, regional and international partnerships. Domestic partnerships have been described in Agenda 2030 and the SDGs: in the form of a new social contract between government and people. Particularly to adopt a transformative approach to development where people, especially women and youth, can participate and exercise their human rights, and enjoy the benefits of development.

Agenda 2030 and the SDGs are transformative and call for tearing down work-in-silos, strengthening coordination among government ministries and public institutions, and harmonizing policies laws and regulations. The transformative agenda embrace good governance of public institutions, better management of resources, transparency and accountability. The role of ODA would be to strengthen DRM through supporting, for example, financial institutions to achieve inclusive financing, promoting the efficacy of customs and tax collection systems, and supporting the value-added chain in the productive and services delivery sectors.

The regional partnerships mentioned in Agenda 2063 include free movement of people and goods, open skies agreements, African Continental Free Trade Area, and African financial institutions, among others. The regional partnerships will facilitate domestics resource mobilization across the continent. By contrast, international partnerships are needed to improve the international tax cooperation and stemming of illicit financial flows. They are key for securing concessional financing and for ensuring debt sustainability, besides accelerating technology transfer and knowledge sharing, all of which will enhance the production capacity in Africa.

Section 7: Some notes on Financing for Poverty Eradication

Poverty eradication (SDG1) is the most important goal in the global, regional and national development agenda. Undoubted, progress on poverty eradication is crucial for achievement of human rights, and for implementation of all SDGs by 2030. Especially in Africa, financing poverty eradication as a national development priority will improve the income levels of the poor and vulnerable people. When African countries succeed in increasing the income levels of the poor people, and in uplifting more and more of them out of the poverty trap, national prosperity will also improve. In other words, the eradication of income poverty will have virtuous impacts on the achievement of all SDGs, especially SDG8 on decent work employment and economic growth, SDG2 on hunger, and on food and agriculture production, SDG3 on health, SDG4 on education, SDG13 climate action, and SDG16 peace, justice and strong institutions.

However, financing poverty eradication should be multisectoral, mainly because poverty is multidimensional and the SDGs framework covers the whole spectrum of development policy. Therefore, besides the macroeconomic frameworks for mobilization of financial resource for poverty eradication often analyzed in the poverty reduction strategy papers, the financing strategies should cover sector-related development dimensions such as food production, hunger, poor health, homelessness and inability to meet basic human needs (humanitarian assistance). That is to say, financing of development at the sector level should target the poor and vulnerable people, and the financial sector itself should be inclusive of the poor and vulnerable people.

On the other hand, when crises occur in the financial, health, food production, environment and climate sectors, for example, the poor and vulnerable people are the most likely to suffer from multiple negative impacts. And often their situation will get worse when conflict occur and quickly spread. In other words, multiple health, financial, food, and conflict crises will make financing poverty eradication a very daunting task for African countries. Therefore, it is important to ensure that all financing strategies are friendly and do not hurt the poor and vulnerable people. Meanwhile, it is important to ensure that financing of development contributes to building the resilience of the poor and vulnerable to the multiple repercussions of unexpected shocks and crises. Besides the need for financial planning and strategies to address emergencies when they occur, building resilience of the poor and vulnerable people will help to stop deterioration and to sustain the gains made in the development agenda.

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