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Research Report

Financing the Post-2015 Development Agenda: Domestic Revenue Mobilization in Africa

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by

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About The North-South Institute

Founded in 1976, NSI is Canada's leading independent policy research institution specializing in effective international development. Ranked in 2012 as the world's top small think tank by the Global Go-To Think Tank Index, NSI's mission is to conduct high-quality, policy-relevant research and stimulate constructive dialogue and debate that contribute to a safe and prosperous world free of poverty and extreme inequality.

Acronyms and Abbreviations

AEO	African Economic Outlook
DAC	Development Assistance Committee
DRM	domestic resource mobilization
FFD	financing for development
GDP	gross domestic product
HLP	High-Level Panel of Eminent Persons on the Post-2015 Development Agenda
MGD	Millennium Development Goal
OECD	Organisation for Economic Co-operation and Development
UN	United Nations

Executive Summary

Attention is starting to turn to how the ambitious post-2015 agenda will be financed. High expectations are being set for the role that domestic resource mobilization can play in financing the post-2015 development goals. Our new NSI Report analyzes recent domestic resource mobilization performance in Africa and estimates a *tax effort index* for sub-Saharan African countries. Tax mobilization in the region is increasing, but the trend is driven by resource rich countries and resource related taxes. However, mobilization remains low despite significant effort and recent reforms in non-resource rich sub-Saharan countries. This is often the result of a combination of structural factors, inefficient and ineffective tax systems, significant tax exemptions, tax avoidance and capital flight. Expectations regarding the extent to which domestic revenue can finance ambitious post-2015 goals need to be tempered. Mobilization goals need to be balanced against growth, investment and other objectives. Ultimately enhancing tax mobilization is about building a better state-citizen compact than exists across most countries in the region today.

Introduction

The debate about what should replace the Millennium Development Goals (MDGs) after 2015 provides an opportunity to reflect once again on the financing for development (FFD) agenda. It comes on the back of dramatic reductions in global poverty in the past decade, though with many of the so-called fragile and conflict-affected states—a number of which are located in sub-Saharan Africa—being the least likely to meet the MDGs. A coherent and realistic FFD agenda is critical to the achievement of ambitious new goals and targets for the post-2015 era. Much like the original MDGs were accompanied by the Monterrey Consensus on Financing for Development (see UN [2003]), the post-2015 framework will likely be accompanied by a new or updated FFD framework.

The Monterrey Consensus outlined six leading actions to meet the challenge of financing the MDGs. The first among these was domestic resource mobilization (DRM).¹ DRM, as outlined in the Monterrey Consensus, comprises fiscal revenue mobilization (in other words, tax and non-tax revenue mobilization) and strengthening the domestic financial sectors of developing countries by encouraging the orderly development of capital markets and sound banking systems and increasing financial inclusion. For the purposes of this report, the analysis of DRM is limited to domestic *revenue* mobilization,

¹ The other five leading actions include mobilizing international financial resources, including foreign direct investment and other private flows, stimulating international trade as an engine for development, increasing financial (i.e., official development assistance) and technical cooperation, adopting a sustainable external debt strategy, and addressing systemic issues such as the coherence of the international monetary and financial system.

in other words issues related to taxation and revenue mobilization, with an emphasis on DRM in Africa.

This report addresses three main issues. First, ongoing debates about the post-2015 FFD agenda are summarized and the implications of the agenda for African countries are discussed. Second, recent DRM performance in the region is analyzed. In particular, results from an estimation of a *tax effort index* for African countries are examined. Third, the implications of these findings, both for the international community (including donors actively engaged in supporting tax capacity-building efforts) and African governments that are increasingly looking to DRM as a source of financing for post-2015 goals and targets are outlined. A concluding section recaps the findings and main messages of the analysis.

Development Goals and the FFD Agenda

DRM is gaining prominence in discussions on what has come to be known as the post-2015 agenda (Bhushan 2013). Until the Monterrey Consensus of 2002, DRM had received relatively little attention as a development financing strategy, especially in poorer regions such as sub-Saharan Africa (Culpeper and Bhushan 2008, 2009, 2010). The Monterrey Consensus served to highlight and focus attention on DRM even in the poorest regions.

The international community has increasingly acknowledged the importance of DRM, as evidenced by support for initiatives such as the African Tax Administration Forum, an organization launched in 2008 to promote cooperation among African tax authorities, and the European Commission's 2010 communication on tax and development (see European Commission [2010]). Notwithstanding this recent interest, regional and multilateral institutions such as the World Bank, International Monetary Fund (through regional technical assistance centers), and African Development Bank have been working on supporting tax capacity building in Africa for decades. So a legitimate question is: what is the case for further enhancing DRM efforts? There are at least three important reasons to re-emphasize DRM now.

First, most donor countries have failed to live up to their long-standing commitment to deliver 0.7 per cent of gross national income as aid even in good times. In 2012, only five of the Organisation for Economic Co-operation and Development's (OECD) 24 Development Assistance Committee (DAC) member countries met that commitment, with (unweighted) average country effort being 0.43 per cent. More recently, donors have fallen far short of the Group of Eight Gleneagles commitments made in 2005 to raise the volume of aid and double aid to Africa by 2010.² Beyond the numbers, there is also a sense that donors' views on the purpose of aid are constantly shifting, and there

² Some DAC donors, such as Canada, have met this commitment, using 2003–04 as the base year.

is increasing skepticism about the utility of aid that has been provided over decades, given the development results that have been achieved. Moreover, the ongoing global economic crisis has brought aid budgets in many countries under pressure. After years of sustained increases, aid from the OECD's DAC members has fallen 6 per cent in real terms over the past two years. Past crises in donor countries caused aid budgets to decline and bottom out over several years, and some of these budgets did not return to pre-crisis levels (Dang, Knack, and Rogers 2009; Roodman 2008). This trend makes enhancing alternative sources, including but not limited to domestic revenue, a matter of urgency for many developing countries.

Second, the experiences of successful developing countries have served to highlight the importance of building strong domestic fiscal and financial systems. The experiences of China, India, and a number of East Asian countries have been seminal for many developing regions. As the independent Commission on Growth and Development, which examined the experiences of 13 high-growth developing economies since 1950, concludes, "there is no case of a sustained high investment path not backed up by high domestic savings" (CGD 2008, 54). In principle, countries could rely on foreign capital to finance investment, but capital inflows to developing and emerging economies over the past several decades have been very volatile. Foreign savings are an imperfect substitute for domestic savings, including public savings, to finance the investment that a booming economy requires. Moreover, effective fiscal systems are critical not only to public sector savings mobilization but to state building more generally. Political scientists have long emphasized the fact that taxation is fundamental to state building (Herbst 2000; Tilly 1975) and forms the foundation of the social contract between the state and citizens. Without taxation there can be no viable state (AfDB, OECD Development Centre, and UNECA 2010).

Recent research has refocused attention on the critical importance of domestic taxation to state building and the state-citizen compact in the African context (Bräutigam 2008). There is growing concern that heavy reliance on resources other than broad-based domestic taxation can be a disincentive to develop institutional capacity, improve accountability to citizens, and ultimately promote prosperity. Governments that derive the bulk of their resources from donors, for instance, may be more responsive to donor than domestic priorities (where the two differ). Indeed, the undermining of good governance and political accountability may be the most important reason to be concerned about high levels of aid dependence.

Third, it is now widely accepted that external resources will not be enough to meet financing needs to achieve the MDGs and sustain development performance beyond 2015. Aid to most countries will simply not be sufficient. Financing gaps to meet the proposed post-2015 goals are of relatively significant orders of magnitude and have been estimated, on an annualized basis, at US\$38 billion in the global education sector,

US\$37 billion in health, US\$26.7 billion in water and sanitation, and over US\$50 billion in food and agriculture (Greenhill and Ali 2013). These estimates place the total post-2015 development financing gap at around US\$186 billion annually (by comparison, total net official development assistance by DAC donors was US\$126 billion in 2012). Also, the cost of (theoretically) eliminating poverty at the US\$2 per day level through perfect transfers to those living below this income threshold has been estimated at US\$289 billion (Kharas and Rogerson 2012).³ Recent OECD estimates suggest the cost of financing the MDGs to be US\$120 billion, more than half of which would be needed in 20 low-income countries (Atisophon et al. 2011). How do these gap estimates compare with what is known about the role played by foreign aid? Meeting the cost of financing the MDGs would require nearly doubling the current annual level of country programmable aid⁴. If the international community wished to eliminate US\$2 per day poverty around the world and was prepared to target all country programmable aid in just this one area, there would still be a shortfall of over US\$200 billion.⁵ Clearly, external resources such as aid will not be enough to meet the financing needs of an ambitious post-2015 agenda. Domestically mobilized resources, through taxes and non-tax revenues, will be expected to play an increasingly important role.

The post-2015 development framework and implications for Africa

The process for establishing the post-2015 framework is well under way. Currently, two processes are running in parallel. The first is the post-2015 development agenda process, which has been led by United Nations (UN) Secretary-General Ban Ki-moon and to date has largely centered around the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda (HLP), co-chaired by the president of Indonesia, president of Liberia, and prime minister of the United Kingdom. The second is the Sustainable Development Goals process, agreed at the most recent UN Conference on Sustainable Development, widely known as Rio+20, in June 2012 and driven by an intergovernmental Open Working Group on Sustainable Development Goals. In May 2013, the HLP released its report, *A New Global Partnership: Eradicate Poverty and Transform Economies through Sustainable Development*, which offers concrete recommendations on what the post-2015 framework should look like. The Open Working Group on Sustainable Development Goals has been slower to mobilize. It met for the first time in March 2013 and will submit its report to the UN secretary-general in 2013.

³ This figure is the cost of covering the poverty gap ratio, or the theoretical amount of money it would take to get every person currently below the US\$2 per day level at least up to the US\$2 per day level.

⁴ The share of aid that is actually received by developing country governments and over which they have meaningful control
⁵ As mentioned, the theoretical cost of closing the poverty gap at the US\$2 per day level is estimated at US\$289 billion. The current level of country programmable aid from all DAC members is approximately US\$65 billion. Therefore, if this US\$65 billion were used to close the poverty gap at the US\$2 per day level, the shortfall would still be well over US\$200 billion. These figures should be interpreted with caution since they are merely theoretical calculations.

Both these processes emphasize the importance of FFD and the heightened role that DRM must play. The UN secretary-general's report to the 68th UN General Assembly, *A Life of Dignity for All: Accelerating Progress towards the Millennium Development Goals and Advancing the United Nations Development Agenda beyond 2015*, which draws on analysis and recommendations made by both processes, also acknowledges the importance of FFD for realizing the post-2015 agenda. Specifically, the secretary-general's report states that the "universal development agenda beyond 2015 will require a robust framework for sustainable development financing," and on DRM, argues that "the financing framework for the post-2015 period will require the mobilization of domestic resources, including by broadening the tax base and improving tax administration in developing countries, and improving corporate and public governance of extractive industries in resource-rich countries" (UNSG 2013,16). Alongside this, the Intergovernmental Committee of Experts on Sustainable Development Financing, mandated as an outcome of Rio+20, has been formed to consider how to mobilize resources from a variety of sources and utilize effective financing to provide strong support to developing countries in their efforts to promote sustainable development. This committee, which met for the first time in August 2013, is expected to prepare a report proposing options on an effective sustainable development financing strategy and complete its work by 2014.

The HLP report provides the most concrete recommendations on what the post-2015 framework should look like. It emphasizes the need for a universal agenda driven by five big "transformational shifts": leave no one behind, put sustainable development at the core, transform economies for jobs and inclusive growth, build peace and effective, open, and accountable institutions, and forge a new global partnership.

These "transformative shifts" can be interpreted in light of current global circumstances and the shortcomings of the MDGs. The call to "leave no one behind" is an implicit acceptance of a key shortcoming of the MDGs. The MDGs emphasize global-level progress first and national-level progress second, even if this means unequal progress across race, ethnicity, geography, gender, or income groups. The need to respond to a lack of attention to distributional issues in the MDGs can be seen in the transformative shifts that underpin the emerging post-2015 development framework. Similarly, the emphasis on sustainable development is recognition of the fact that more serious efforts are needed at the global level to address climate change than those that are being made in ongoing intractable climate debates. It is also an attempt to bridge the post-2015 agenda with the Sustainable Development Goals process. The emphasis on jobs and inclusive growth is not new when compared to the MDGs and therefore hardly a transformative shift, though it is a reflection of the current malaise in the global economy. The emphasis on peace, security, and accountable institutions is in response to these issues receiving inadequate attention in the MDGs, as pointed out repeatedly by the g7+ group of fragile states, which has argued that the special circumstances of

fragile states meant that they were set up to fail on meeting the MDGs. The call to forge a new global partnership is neither new nor transformative. MDG 8 is centred on this very issue and is one of the areas where the least progress has been made. The push for a new global partnership in the post-2015 debate is both recognition of the unfinished task and inadequacy of MDG 8.

It is worth noting that the HLP report is more of a starting point for further debate than an authoritative consensus on a new agenda. This is clear from the proposed illustrative goals and targets. Twelve illustrative goals have been proposed (see Table 1 below). The majority of these can be interpreted as extensions of the MDGs. For instance, while MDG 1 called for halving over 25 years the proportion of people living in extreme poverty defined as below US\$1.25 per day, the HLP proposes to bring the number down to “zero.” Goals relating to women’s empowerment and gender equality, education, health, food security and nutrition, water and sanitation, energy, employment, and an enabling global environment all have precursors in the MDGs.

However, there are important differences between the HLP’s proposed illustrative goals and targets and the MDGs. Unlike the MDGs, which were framed as “global” goals to which each country contributes, the HLP’s proposal envisions only “global minimum standards” around certain goals and leaves the specifics of target setting to individual national determination.⁶ In all, 54 specific targets are proposed for the 12 illustrative goals, but “global minimum standards” are only proposed for 26 of these targets. The HLP report recognizes that the majority of the proposed illustrative goals and targets require further technical work to find appropriate indicators that are sufficiently disaggregated (HLP 2013).

⁶ This formulation can also be interpreted in light of an important shortcoming of the MDGs. Given their emphasis on “global goals,” the MDGs created an odd situation where global targets could be met even if most countries were worse off. Take, for instance, the MDG 1 target of halving extreme poverty. The global target was met ahead of schedule, but this is only due to enormous progress in China and India. Meanwhile, the absolute number of people living in extreme poverty in sub-Saharan Africa, for instance, has increased.

Table 1. The HLP's illustrative goals for the post-2015 agenda

1. End poverty.
2. Empower girls and women and achieve gender equality.
3. Provide quality education and lifelong learning.
4. Ensure healthy lives.
5. Ensure food security and good nutrition.
6. Achieve universal access to water and sanitation.
7. Secure sustainable energy.
8. Create jobs, sustainable livelihoods, and equitable growth.
9. Manage natural resource assets sustainably.
10. Ensure good governance and effective institutions.
11. Ensure stable and peaceful societies.
12. Create a global enabling environment and catalyze long-term finance.

Source: HLP (2013)

How and where are taxation and revenue mobilization addressed in the HLP's proposal? The main area where taxation is explicitly referenced in the proposal is goal 12 on creating a global enabling environment and catalyzing long-term finance. The emphasis is on reducing illicit flows and tax evasion and increasing stolen-asset recovery. Tax incentives and subsidies are also referenced as means for financing investment in sustainable energy. Explicit reference is also made to the need for developed countries to pay more attention to exchanging tax information and combating evasion. The link between DRM in developing countries and international tax regulation is recognized. The HLP calls for continued investment in building stronger tax systems and broadening domestic tax bases especially in low- and middle-income countries. It is noteworthy that while the HLP's proposal calls for "universal domestic resource targets" based on the tax-gross domestic product (GDP) ratio, it falls short of specifying what the targets or indicators should be, or how they should be applied (for example, if there should be a global minimum).

Beyond the HLP report, a number of other proposals on what the post-2015 framework should look like have been put forth. An analysis of how taxation and resource mobilization issues are addressed in other proposals is possible by using The North-South Institute's Post-2015 Tracking Tool, an interactive aggregator (see NSI [2013b] and Higgins, Bhushan, and Bond [2013]). As of July 2013, 69 proposals, encompassing 1,111 goals, targets, and indicators, had been surveyed and coded in the Post-2015 Tracking Tool. Of these proposals, six make explicit reference to monitoring progress on taxation. Proposals address taxation from the perspective of reducing evasion and illicit flows, reducing tax competition, levying new progressive eco-taxes, raising taxes on the wealthiest, removing taxes on remittance transfers, and intensifying global transparency and tax information sharing. However, most proposals fall short of proposing specific indicators by which to measure progress.

It seems clear that even though the emerging post-2015 framework is not so different from the MDGs, its objectives (such as “ending extreme poverty”) are more ambitious. A serious implication for African countries is that while the new formulation “nationally determined targets” increases the level of agency that African countries may have when compared to the MDGs, the proposed “global minimum standards” may actually require disproportionately greater efforts by these countries since they are further from the proposed minimum standards. In fact, most areas where a global minimum standard approach is proposed apply largely to developing countries but not developed countries. Reaching proposed global minimum standards—such as ending extreme poverty, ending child marriage, ensuring the completion of primary education, ending preventable infant deaths, ending hunger, and ensuring access to safe drinking water—will require proportionately greater efforts by poorer countries to get to those standards. Meanwhile, in other areas—such as creating an enabling environment for long-term finance, delivering foreign aid and technical assistance in accordance with agreed aid effectiveness principles, developing country access to export markets, and climate change—that are where developed countries would need to make considerable efforts, curiously no minimum standards are proposed.

It can also be concluded that the discussion on taxation and revenue mobilization as they relate to post-2015 goals and targets remains undeveloped. Much of the emphasis is on international aspects such as tax evasion, capital flight, and tax havens, while the treatment of domestic tax systems, tax policy, and administrative reforms receives lesser attention. African countries, through regional and multilateral fora, could make further efforts to elevate the treatment of DRM within the emerging post-2015 framework, especially concerning the need to catalyze long-term finance.

The emerging FFD agenda and implications for Africa

How does the emerging post-2015 FFD agenda compare with the original Monterrey Consensus FFD agenda? What are the main differences and similarities? And what are the implications for African countries?

One general observation about the emerging post-2015 FFD agenda is that the roles of the international donor community and foreign aid are being decisively downplayed, while the roles of international private capital and domestic financing are being strongly emphasized. The HLP report, for instance, highlights that the majority of the money to finance post-2015 goals will come from domestic sources. The report notes that even where developing countries require substantial external resources, the main part of these resources will *not* be aid from developed countries. The most important source of long-term finance will be private capital, such as foreign direct investment and portfolio investment from pension funds as well as investment from sovereign wealth funds and development banks (HLP 2013).

This is a substantial change from the tenor of the Monterrey Consensus. While the Monterrey Consensus always recognized the importance of private capital, the broader emphasis was on foreign aid commitments and the role played by international donors. The ultimate “consensus” was very much a compromise embedded in the “donor-recipient” paradigm, which the post-2015 debates and emerging FFD agenda seek to change. There is a rapidly emerging consensus that private capital will play a far greater role in the emerging FFD agenda than it did in the Monterrey (UN System Task Team 2013; ECOSOC 2013; European Commission 2013; Sheng 2013; Prizzon 2013; Mohieldin 2013; Cutter 2013).

A second important difference is the timing of the formal FFD process. The International Conference on Financing for Development in Monterrey took place two years after the MDGs were in place. The emerging consensus now is that a similar formal FFD conference needs to take place, but either during or prior to the UN General Assembly Post-MDG Review Summit in September 2015. Holding the conference before this summit would send a strong signal that the post-2015 agenda will be backed by hard financial commitments (HLP 2013; Evans and Steven 2013; Prizzon 2013). The parameters of the emerging FFD agenda have also expanded when compared to those of the Monterrey Consensus and MDGs. Observers argue that the aim of the conference should be to “integrate development and environmental financing streams into one coherent agenda” (Evans and Steven 2013; HLP 2013).

These developments have important implications for African countries, especially poorer countries in the sub-Saharan region that are still some of the most aid-reliant states in the world and lack substantial experience attracting sustainable international private capital. On the surface, the emerging post-2015 FFD agenda may be very similar to the Monterrey Consensus. The HLP report recognizes that the vision for how to fund the post-2015 agenda was agreed at Monterrey in 2002 (HLP 2013). However, despite a vision having been laid out, donors have repeatedly failed to live up to aid commitments. A new or updated FFD agenda that de-emphasizes aid could increase the financing burden on developing countries, including low-income countries in Africa. And yet contemporary discussions are entirely devoid of realistic assessments of the financing potential of domestic taxation, non-tax revenue mobilization, and other alternative financing options. One rare study which looked at the potential for enhanced tax collection in developing countries found that there is a limit to how much can be expected from DRM in the foreseeable future. In the context of financing the MDGs, most countries that could improve revenue collection were found to be already well on their way to achieving the MDGs. Moreover, there is a stark contrast between the relative ease with which upper-middle-income countries can enhance tax collection and the challenges that low-income and lower-middle-income countries face. While upper-middle-income countries could raise tax collection by over 3 per cent of GDP and potentially raise an additional US\$60 billion, low-income countries would be expected to

raise tax collection around 2 per cent of GDP, yielding only US\$3 billion (Atisophon et al. 2011). Given this, in the context of the post-2015 agenda African countries should push for a more realistic approach—one that is prefaced by a systematic estimation of the untapped domestic revenue potential across Africa.

Importantly, while integrating development and environmental financing agendas sounds good on paper, in reality estimating costs in these areas is anything but straightforward. Adding environmental costs to the FFD agenda dramatically changes the scale of costs that the financing discussions must consider. The only available estimate of the cost of financing the post-2015 agenda indicates that the total financing gap is US\$186 billion. Adding environmental costs increases the financing gap to over US\$1 trillion (Greenhill and Ali 2013).⁷ When gap estimates get this large, they sometimes alienate stakeholders and risk making discussions unrealistic and unproductive. Even if financing could be mobilized on this scale, the disbursement, monitoring, and evaluation structures required to ensure effective expenditure are not yet in place. A key question for African governments and other stakeholders is whether it makes sense for climate financing to be part of the FFD agenda. African countries should play a larger role in further defining and limiting the parameters of the discussion on FFD moving forward to establish a realistic, accountable, and productive FFD agenda.

Most discussions on FFD are preoccupied with these estimates of financing gaps (Greenhill and Ali 2013). Gap estimates, while useful in providing a sense of the scale of costs involved, often make assumptions that do not hold in the real world. For instance, gap estimates assume that mobilized financing can be perfectly transferred to beneficiaries. For example, estimates on the theoretical cost of closing the poverty gap (discussed above) assume that those living in absolute poverty can be identified and targeted without cost and without leakage. These assumptions do not hold in reality. Secondly, gap estimates typically do not take into account the spillover effects of financing. For example, expenditure on basic education has complex and important impacts on estimated health financing costs, since education affects health outcomes and the demand for health care. Thirdly, and most importantly, gap estimates assume that lack of financing is the “binding” constraint, in that without removing this particular constraint further progress cannot be made, for example through more efficient spending or better policies and programs. This is a key weakness. The emerging FFD agenda, much like the Monterrey Consensus before it, pays insufficient or no attention to the efficiency and effectiveness of public expenditure in developing countries. Increasing attention would entail an important shift in focus, as public expenditure is beset by major data challenges despite significant donor investment in developing

⁷ It should be noted that the cited study is not entirely transparent about the methodology by which these estimates were arrived at. For an alternative study, which is, see Atisophon et al. (2011).

country statistical systems.⁸ A systematic assessment of potential gains through more efficient and effective public expenditure may bring down financing gap estimates in some contexts. However, the orders of magnitude involved in financing gap estimates are so large that all options—increased domestic and external financing, innovative financing, and expenditure efficiency—need to be considered.

The emerging post-2015 FFD agenda has set high expectations for developing country DRM efforts and the contribution of DRM to financing ambitious post-2015 goals. Indeed, during recent outreach missions, both the president of the World Bank and the lead author and executive secretary of the HLP Secretariat argued that one of the main reasons to be optimistic about delivering on an ambitious post-2015 agenda and goals such as “ending extreme poverty” is that more countries are now able to rely on their own resources to finance their own development (NSI 2013a; Kim 2013; Bond and Higgins 2013). Given this backdrop, the remainder of this report analyzes whether DRM expectations, especially those regarding African countries, are reasonable. To do so, trends in revenue mobilization, institutional performance, and tax effort are assessed.

Recent Trends in DRM in Africa

For the purposes of this analysis, the definition of DRM is restricted to tax and non-tax revenues (unless otherwise specified). The first important point to note regards data coverage and quality. Most analyses of taxation tend to rely on data from the World Bank’s World Development Indicators (WDI) database, which is one of the most widely used data sources in development research. For this analysis, the primary interest is 51 African countries over a relatively recent 15-year time period, from 1996 to 2010. Relying on the WDI for tax-GDP ratio data would give us at most 264 out of a possible 765 (country, year) observations. Clearly, coverage of tax data in the WDI is inadequate.⁹ Furthermore, data in the WDI tend to be lagged, often by about two years.¹⁰ Data are also insufficiently disaggregated, such as by the composition of tax types.

For these reasons and in order to provide a more comprehensive picture, two alternative data sources are used in this analysis: the *African Economic Outlook’s* (AEO) Database on African Fiscal Performance (see AEO [2013]) and USAID’s Collecting Taxes database (see USAID [2013]). Using AEO (2013) extends observations on African countries to 751 (out of 765). The AEO database also

⁸ A good example of a recent donor initiative is the World Bank’s BOOST initiative. BOOST strengthens public expenditure policy outcomes and accountability by improving the quality of expenditure data, facilitating rigorous expenditure analysis, and improving fiscal transparency. For more information, see World Bank (2013).

⁹ Similarly, for the most recent year where data are available (2011), the WDI only contains tax data for 115 out of a possible 214 countries. By comparison, the United States Agency for International Development (USAID) Collecting Taxes database used in this analysis provides data for 195 countries.

¹⁰ When last accessed in July 2013, the WDI database carried tax-GDP ratios and other tax data only up until 2010 and in some cases 2011.

disaggregates mobilized revenues into detailed tax types, which allows for analysis of which revenue sources are driving overall performance. USAID (2013) provides data for over 200 countries across 31 indicators including tax structure, administration and performance, productivity, and efficiency metrics. These data are useful for comparing African countries with countries in other developing regions.

Tax collection has been rising in Africa. It crossed the 20 per cent of regional GDP mark in 2009. However, the tax-GDP ratio is less than 17 per cent in more than half of African countries (AfDB, OECD Development Centre, and UNECA 2010; Atisophon et al. 2011). More recent data indicate that the (unweighted) average tax-GDP ratio for sub-Saharan African countries in 2011–12 was below 17 per cent (USAID 2013).

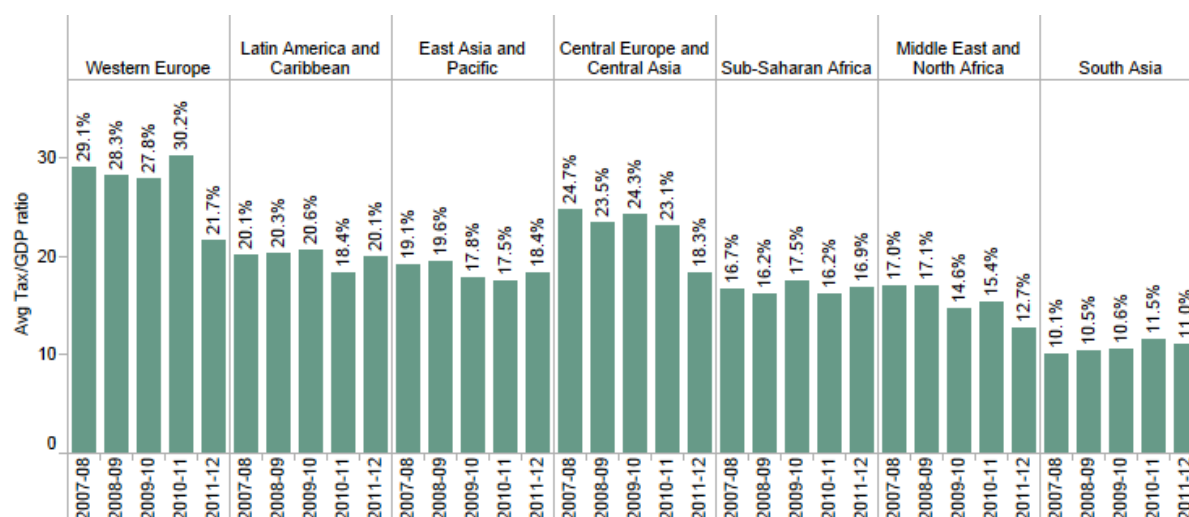
Figure 1 provides a comparison of tax-GDP ratios across select geographical regions. The data show a declining trend in tax-GDP ratios across most regions in recent years. A likely reason for this is that most regions are still recovering from the 2008–09 global financial crisis. The crisis dampened economic activity and affected revenue mobilization since most governments undertook fiscal stimulus measures (including tax cuts) to respond to the crisis and revive growth.

The tax-GDP ratio tends to be positively correlated with per capita incomes. The ability of countries to mobilize revenues increases with income levels and is positively correlated with economic structure indicators such as trade openness, but negatively correlated with the share of agriculture, which is typically a hard-to-tax sector (Bhushan and Samy 2012). Figure 1 shows that the highest tax ratios are in more advanced regions such as Western Europe, Central Europe, and Central Asia, while the lowest ratios tend to be in poorer regions such as South Asia. As Figure 2 shows, the ratio rises when moving from low-income to middle-income and high-income countries.

Notably, sub-Saharan Africa does *not* have the lowest tax-GDP ratio, even across developing regions. At around 16 per cent in recent years, the ratio is lower than that of Latin America, slightly lower than that of East Asia, but far higher than that of South Asia. The ratio is also higher than the average for low-income countries.¹¹

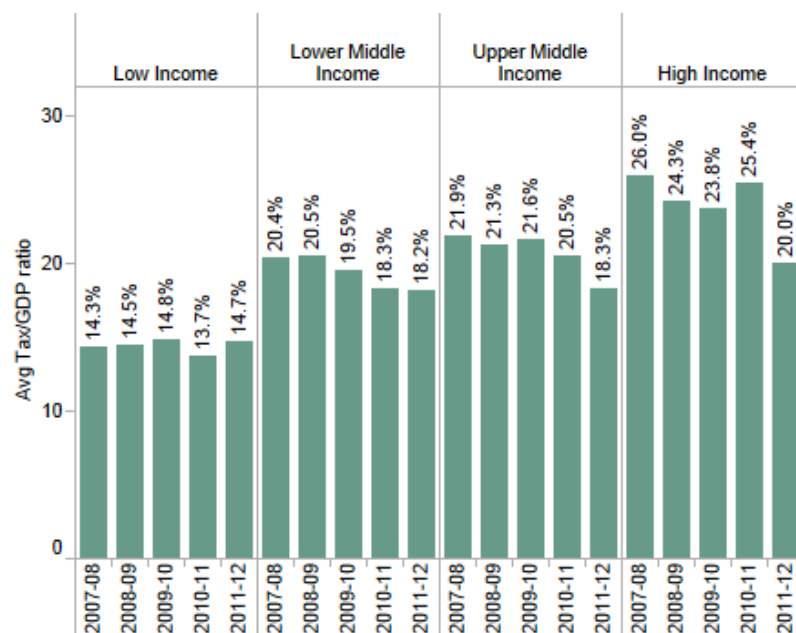
¹¹ For comparison, the latest value for the tax-GDP ratio reported by the WDI for sub-Saharan Africa is for 2005 (17.7 per cent).

Figure 1. Tax-GDP ratios across geographical regions



Source: USAID Collecting Taxes database, via NSI (2013c)

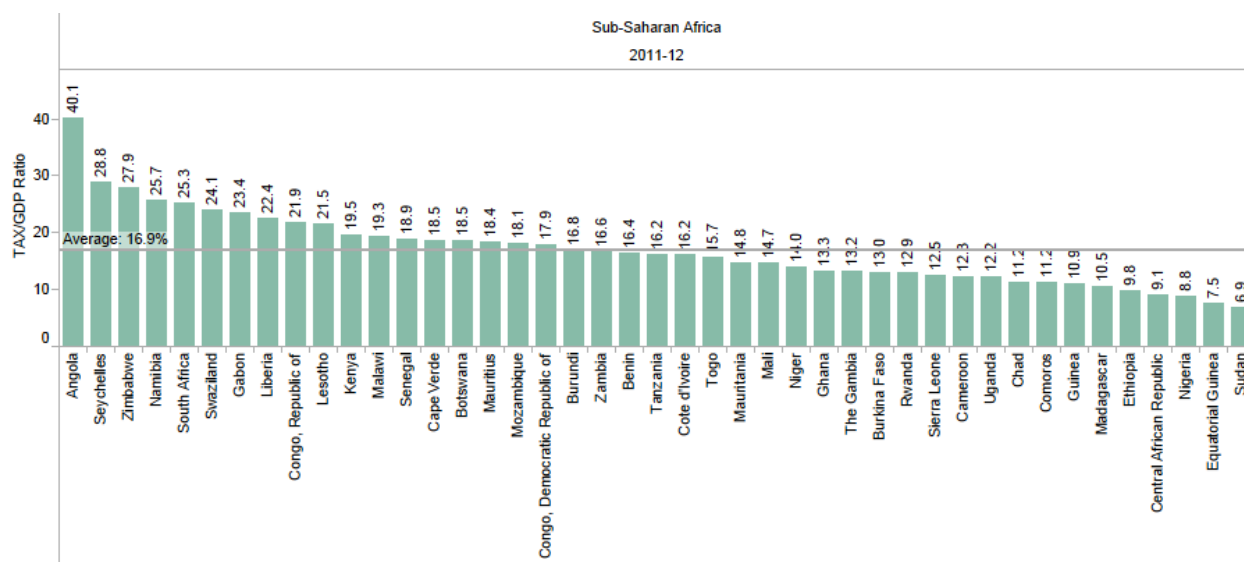
Figure 2. Tax-GDP ratio across income groups



Source: USAID Collecting Taxes database, via NSI (2013c)

Figure 3 provides further details on individual countries in the sub-Saharan African region. As can be seen, the regional average is driven up by a handful of countries. Most countries in the region have tax-GDP ratios below the regional average.¹²

Figure 3. Tax/GDP ratio across sub-Saharan Africa



Source: USAID Collecting Taxes database, via NSI (2013c)

The above data are useful in providing a general sense of recent trends in tax mobilization and how Africa compares with other regions, but they do not indicate which factors drive these trends. For this we turn to the AEO fiscal database. Figure 4 provides a sense of the dynamics underlying DRM performance across Africa over a 15-year period from 1996 to 2010. Two points are worth highlighting. First, revenue mobilization started to increase in the region in the early 2000s, which coincided with the point in time when growth started to pick up in many African countries. Total tax revenue mobilization was nearly stagnant from 1996 to 2002, but then it increased from around US\$137 billion in 2002 to a high of US\$497 billion in 2008, representing a compound annual growth rate of nearly 24 per cent.

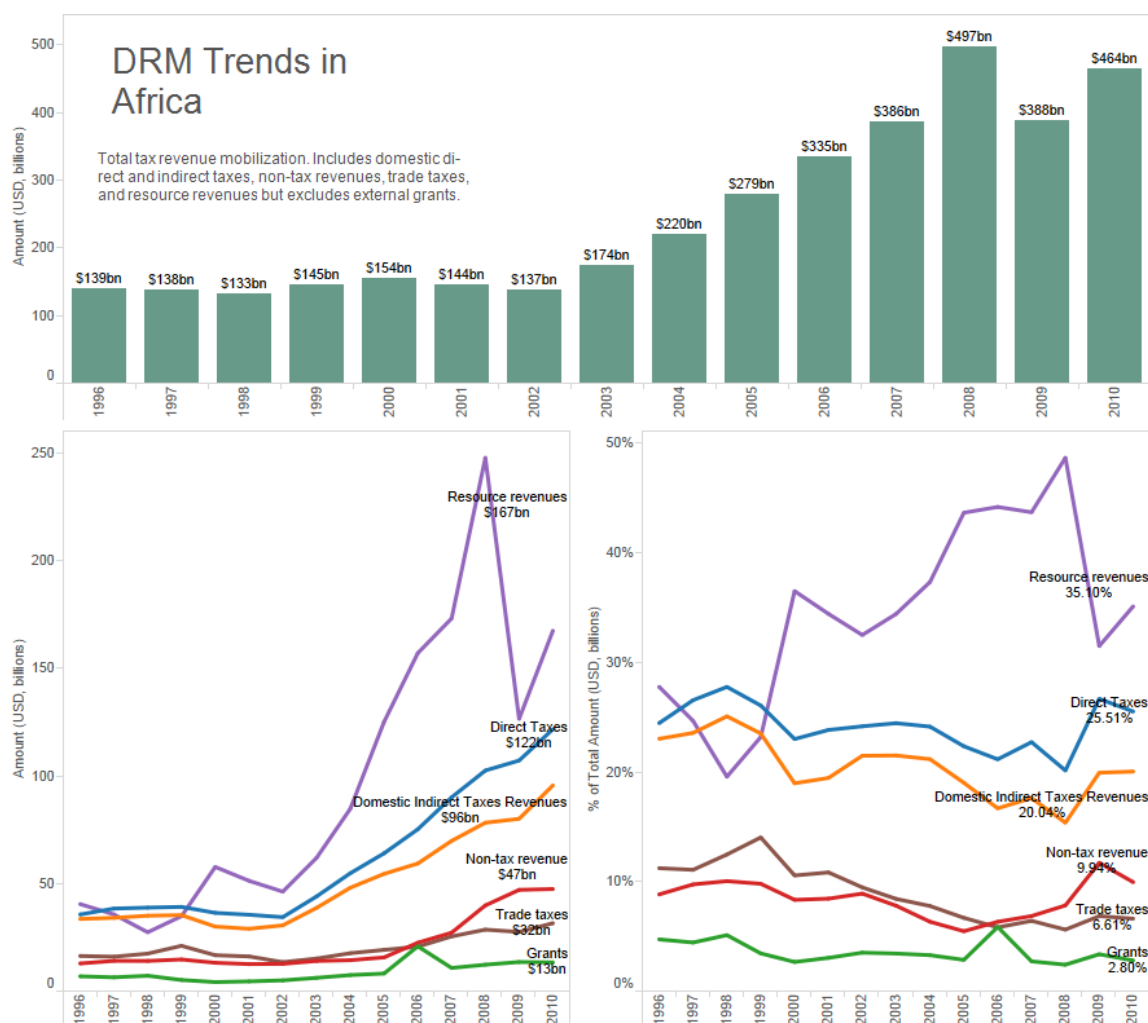
This performance also coincided to some extent with major reforms to tax policy, tax administration, and tax structures across many countries in Africa. The two main recent donor-supported tax reforms in the region have been the introduction of the value-added tax and establishment of autonomous revenue authorities (Bhushan and Samy 2012).¹³

¹² These data include, and so may be skewed, by resource-related revenues, which can be large, especially in smaller economies and low-income and low-middle-income countries as a share of their GDP.

¹³ The first experiments with the structure of autonomous revenue authorities go back to 1985 in Ghana, which established a revenue authority following a major economic crisis. The Uganda Revenue Authority was established in 1991, the Tanzania Revenue Authority in 1996, and others followed. Ghana, Uganda, and Tanzania, and Rwanda initially increased tax

Second, and more importantly, as can be seen in Figure 4, the majority of the increase in tax mobilization in Africa has been driven by revenue mobilized from the natural resources sector. Resource revenues made up nearly 49 per cent of Africa's tax mix in 2008, just before the impact of the global financial crisis took effect. The huge volatility experienced in the natural resources sector is also visible in the increased volatility of African governments' revenue bases, with resource-related revenues contracting sharply with the crisis. Notably, domestic direct and indirect taxes are also increasing at a rapid rate and with much less volatility, while trade taxes continue to decline (in percentage terms) as a source of revenue as countries further liberalize trade.

Figure 4. Composition of domestic revenue mobilization in Africa (1996–2010)



Source: AEO Database on African Fiscal Performance, via NSI (2013c)

mobilization substantially, but from low bases. With the exception of South Africa and more recently Ghana, countries have found it difficult to sustain initial performance. For more information, see Bhushan and Samy (2012) and Köhnen, Kundt, and Schuppert (2010).

While there is significant variation across countries, domestic tax revenue is collectively already more than 10 times the size of total foreign aid to the region. It is thus helpful to remember that even in the world's poorest region the majority of development financing is already mobilized domestically.

However, the factors driving revenue mobilization in Africa are causing a split between countries. On the one hand, there are those countries that are mobilizing sufficient tax revenues, mainly driven by the presence of natural resources (see Figure 5), but on the other hand there are countries that, despite significant tax efforts (including donor support), are simply working from tax bases that are too shallow (see Figure 6). These countries and their development partners face a double-edged sword. They not only have the weakest DRM capacities and shallowest tax bases but also the weakest aid absorptive capacities.¹⁴ Many of these countries are fragile states. Aid is already highly concentrated among fragile states—around 38 per cent of global aid goes to them.¹⁵ Strikingly, despite this, in recent years domestic revenue has been as much as five times as large as aid even in fragile states. This demonstrates the important role that domestic revenue plays, though—even in fragile states—it should not lead to the conclusion that aid is not important. Aid plays an important role in these countries, and it is reasonable to expect that most non-resource-rich fragile states will remain highly reliant on aid for years to come (Bhushan 2013).

14 Research shows that when aid reaches between 15 per cent and 45 per cent of GDP, its effectiveness tends to decline through effects on the exchange rate, inflation, interest rates, and other channels that can heighten macroeconomic volatility (Clemens and Radelet 2003). There are several African countries that would fall within this group, including Liberia, Burundi, Mozambique, Malawi, Rwanda, Sierra Leone, and the Democratic Republic of the Congo.

15 Half of this goes to just seven recipients: Afghanistan, the Democratic Republic of the Congo, Ethiopia, Haiti, Pakistan, West Bank and Gaza, and Iraq.

Figure 5. Countries where natural resource-related taxes dominate the resource mix

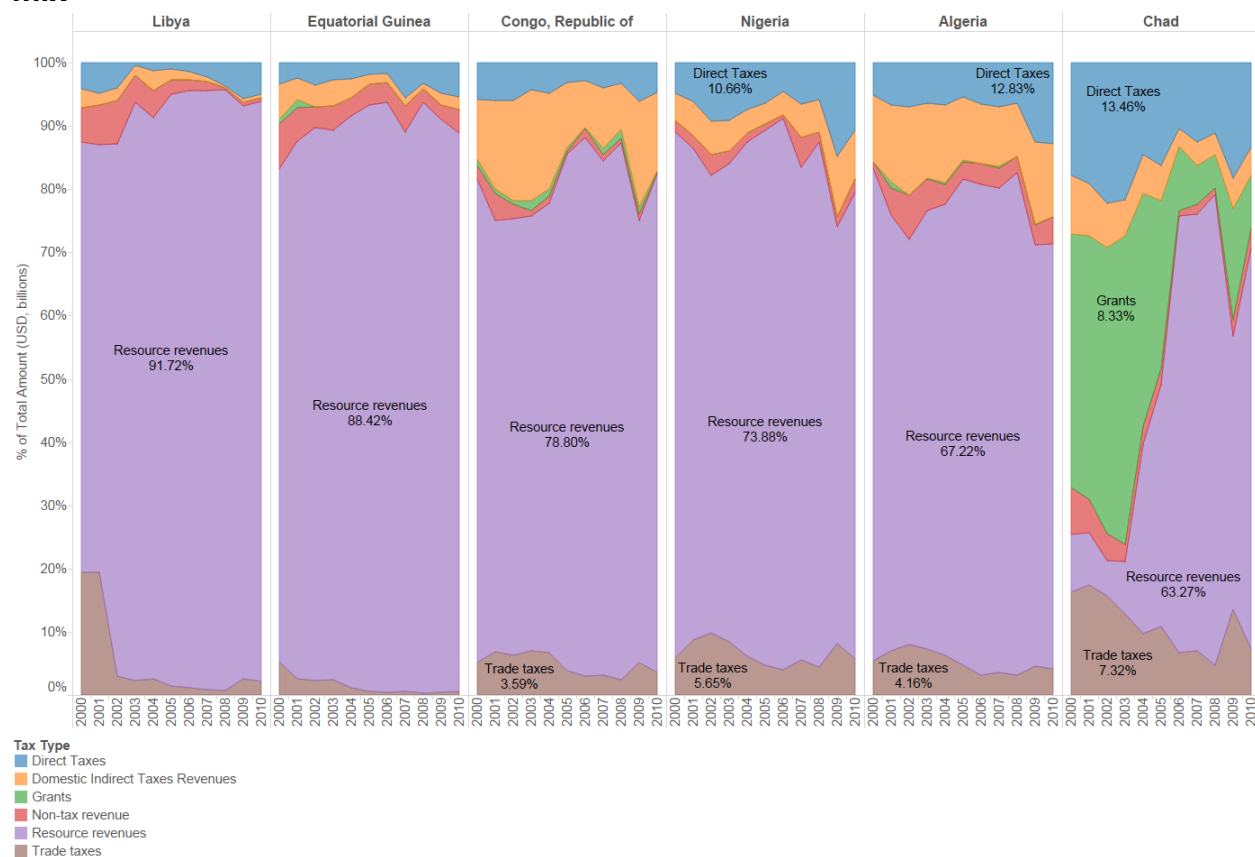
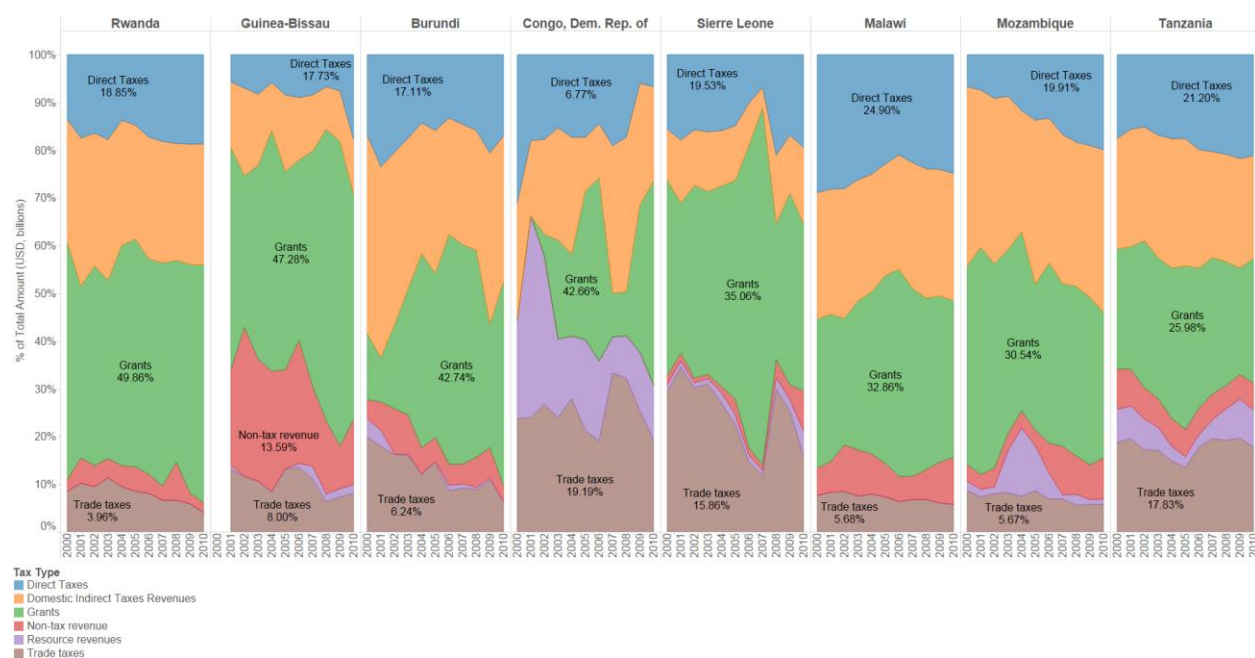


Figure 6. Countries where grants dominate the resource mix



Source: AEO Database on African Fiscal Performance, via NSI (2013c)

Tax performance, administration, and utilization of tax bases

How does sub-Saharan Africa compare with other regions on tax performance metrics? This question can be answered by looking at the cost of tax collection and the ratio of tax authority staff to the overall population. These metrics provide a sense of the efficiency of the tax collection system. In addition, the question can be answered by assessing whether African countries are effectively utilizing their existing tax bases.

Figures 7 and 8 provide data on the average cost of tax collection and ratio of tax authority staff to overall population across regions and income groups. The average cost of tax collection (“Avg Cost” in Figures 7 and 8) is calculated as a ratio of the budget of the tax authority and the total revenue collected by the authority.¹⁶ Similarly, the tax authority staff ratio (“Avg Tax Staff”) is calculated as the number of tax authority staff members per 1,000 persons in the country.

Figure 7. Tax performance indicators across regions, 2011–12

	Avg Cost	Avg Tax Staff
East Asia and Pacific	1.19	0.45
Central Europe and Central Asia	1.13	0.99
Latin America and Caribbean	1.26	0.33
Middle East and North Africa	3.17	0.46
South Asia	1.83	0.27
Sub-Saharan Africa	2.93	0.32
Western Europe	0.93	1.19
US and Canada	1.53	0.69

Source: USAID (2013)

Figure 8. Tax performance indicators across income groups, 2011–12

	Avg Cost	Avg Tax Staff
Low Income	3.20	0.17
Lower Middle Income	1.54	0.43
Upper Middle Income	1.04	0.81
High Income	1.14	1.01

Source: USAID (2013)

The data for 2011–12 above show that sub-Saharan Africa has one of the most expensive tax collection systems of any region. The ratio of tax authority staff to

¹⁶ For instance, if the budget of a tax authority is US\$2 million and the tax authority collects US\$200 million, the cost ratio is 1 per cent. In other words, for every US\$1 spent, US\$100 is collected.

population is one of the lowest and, despite significant recent reforms, most countries in the region still have inefficient tax collection systems. In Figure 7, Latin America has almost the same average tax authority staff ratio but is more than twice as efficient as sub-Saharan Africa.

Research also shows that many African countries are not effectively utilizing their narrow tax bases. A key factor that prevents countries from maximizing their revenue potential is the proliferation of tax exemptions. The number of countries in sub-Saharan Africa that offer exemptions of some type (especially in the form of “free zones,” reduced corporate tax rates, tax holidays, and investment codes) has risen substantially from 1980 to 2005 (Keen and Mansour 2009). Exemptions contract the revenue base, complicate tax systems, and open the door to political capture (the party or group in power often uses discretionary exemptions to retain power or undermine businesses linked to the opposition). More importantly, exemptions have a ratcheting effect—once in place, they are hard to remove.

Recent research has found that revenues foregone due to exemptions, while hard to estimate, represent a significant share of the revenue base in sub-Saharan Africa. According to International Monetary Fund data, undue exemptions in Burundi cost the treasury up to 1.5 per cent of GDP in recent years. The highest level of exemptions was reached in 2006 when 60 per cent of imports entered the country with full or partial exemptions for a total of 10.7 per cent of GDP or 65.5 per cent of tax revenues. In Ethiopia (leaving aside tax holidays of five to seven years), total revenues foregone due to customs exemptions alone were in the range of between 3.7 per cent of GDP (2005) and 4.2 per cent of GDP (2008). Similarly, in Tanzania losses from customs and value-added tax exemptions range from between 4.5 per cent (2005) and 3.6 per cent (2007) of GDP. In Uganda, where select 10-year tax holidays were introduced in 2007–08, key informants suggest foregone revenues amount to at least 2 per cent of GDP. The level of exemptions on top of already low revenue bases in these countries suggests that revenue potential is not being maximized, while the impact on investment promotion and other considerations remains unclear (Bhushan and Samy 2012).

This analysis demonstrates that despite significant recent reforms and a favourable global economic climate (up until the economic crisis in 2008), tax performance in African countries leaves much to be desired. Tax systems remain inefficient, costly, and ineffective. Furthermore, revenue foregone due to tax exemptions (Gaddis 2013) and tax avoidance (Jordan 2013) is a significant drain on DRM for many countries in the region. This is often the result of lack of coordination between investment promotion objectives and resource mobilization needs. Foregone revenue, in addition to large estimates of capital flight from the region, suggest that greater DRM potential is possible, even in some of the poorest countries than is being realized (Boyce and Ndikumana 2012). Without increased alignment between investment promotion

objectives and resource mobilization needs, however, the outcomes of DRM will remain suboptimal.

Tax effort index for Africa

The tax-GDP ratio is the most widely used taxation indicator because it is easy to obtain and interpret and it provides a quick overview of trends across countries. This measure is often used to analyze tax trends across countries with similar economic structures. As discussed earlier, the tax-GDP ratio is influenced by structural factors such as income levels. Recent literature suggests that the tax-GDP ratio has several weaknesses, however. A low tax-GDP ratio does not necessarily mean bad performance and a high ratio does not necessarily mean good performance. For example, Lesotho and Swaziland report atypically high tax ratios that are related to a revenue sharing agreement with South Africa, which arguably has little to do with domestic fiscal capacities. Similarly, many oil-exporting countries report high tax ratios when resource-related revenues are included (von Haldenwang and Ivanyna 2011; OECD 2013).

Moreover, the literature indicates that the tax-GDP ratio can increase for all sorts of reasons, including reasons that have little to do with better performance or a better state-citizen compact. For instance, during the 1980s and 1990s, Uganda and Burundi experienced a marked reduction in donor aid due to conflict or embargo. Despite having been highly dependent on aid, both increased tax revenue during periods of reduced donor support. Instability created opportunities for the leadership in both countries to take whatever resources they could (Sennoga 2010). In such situations, the tax mobilization ratio may well rise, but mobilizing revenue by imposing punitive costs on the population is not what anyone is advocating. DRM is ultimately about building better state-citizen compacts than those that exist in most African countries today.

A more sophisticated yet easy-to-interpret approach is to calculate a *tax effort index* for African countries. While not perfect, this approach helps address some of the weaknesses associated with the tax-GDP ratio. We calculate the index as a ratio between the share of actual tax collection and taxable capacity. For this we first need to compute *taxable capacity*. Following Tuan Minh Le, Blanca Moreno-Dodson, and Nihal Bayraktar (2012), taxable capacity is estimated to be the predicted tax-GDP ratio calculated using the estimated coefficients of a regression specification, taking into account the country-specific characteristics that influence tax mobilization. In other words, we control for the factors that influence the tax-GDP ratio to predict what individual African countries *should* be collecting, given their structural characteristics.

Tax capacity in this analysis is estimated using a panel dataset of 49 African countries from 1996–2010. The adopted empirical specification is:

$$TAX/GDP = \beta_0 + \beta_1 GDP_{PC} + \beta_2 TRADE + \beta_3 AGRIC + \varepsilon$$

where: TAX/GDP is tax revenue as a percentage of GDP (tax revenue is the sum of direct, indirect, and trade taxes), GDPPC is constant GDP per capita (US\$2,000), TRADE is trade as a percentage of GDP, and AGRIC is agriculture value added as a percentage of GDP.

A key difference between this analysis and others, such as that by Le, Moreno-Dodson, and Bayraktar (2012), is the data source used for the taxation information. This analysis uses the AEO database. In order to get a more accurate estimate, revenue sources were limited to those that require significant domestic effort to secure revenue. In other words we exclude resource related revenues and aid grants, which may skew results. While Le, Moreno-Dodson, and Bayraktar (2012) are only able to report findings for 20 African countries, our analysis covers 49 African countries.¹⁷ Other variables are from the World Bank's World Development Indicator (WDI) Database. The above equation is estimated using ordinary least squares.

Tax effort for each country and year is estimated according to the methodology above and an average value is calculated over the whole selected period to derive a single value for each country in the sample.

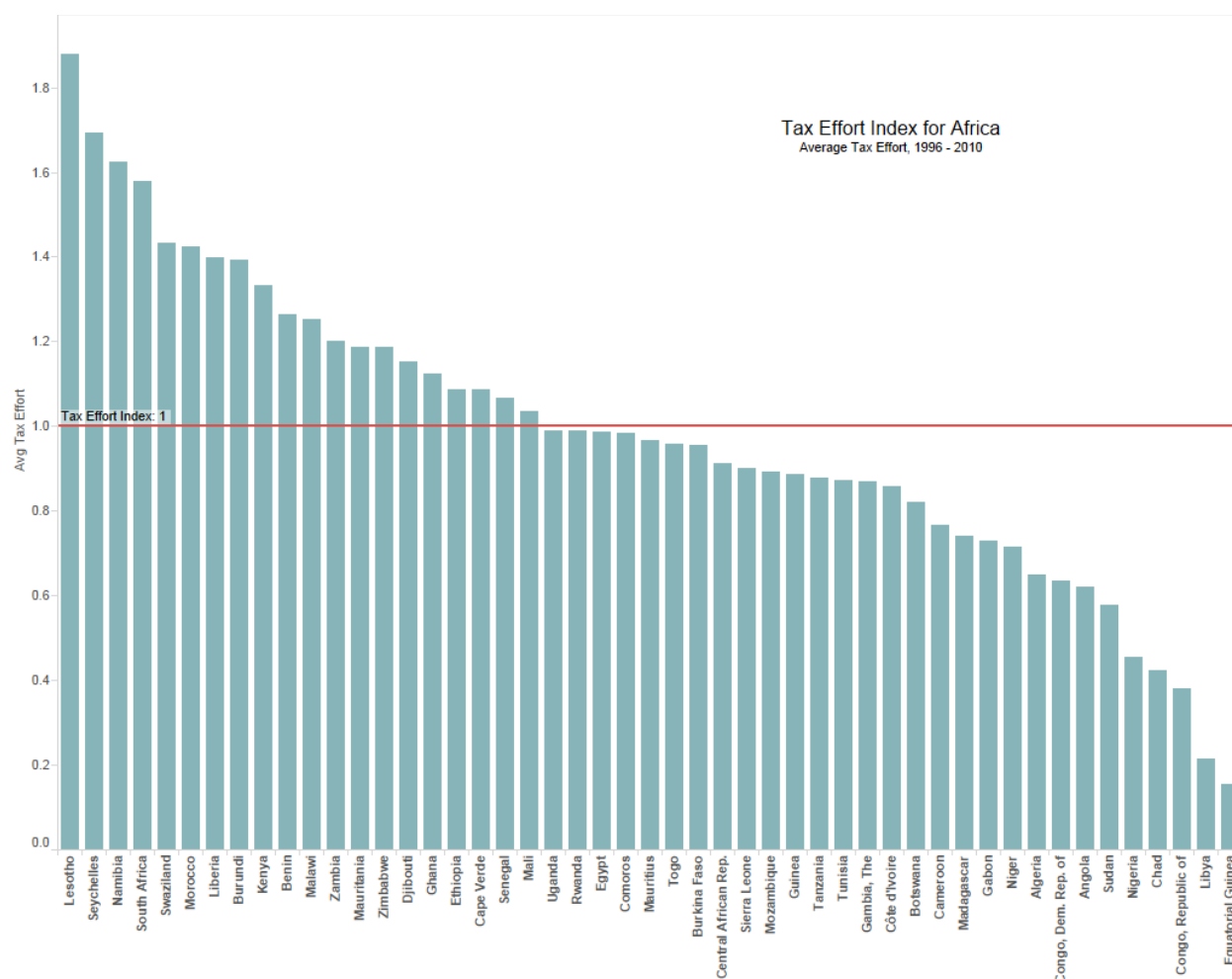
A tax effort index value above 1 indicates "high tax effort," whereas an index value below 1 indicates "low effort." The correct interpretation of the index is that high tax effort countries are utilizing their tax bases well to increase revenues, while low tax effort countries may have relatively substantial scope to increase revenue collection from existing tax bases. In other words, countries already showing high tax effort may not be able to increase revenue mobilization substantially without affecting other objectives (such as growth and investment).

Figure 9 graphs our results. Twenty-nine out of the 49 African countries have a tax effort index below 1. The lowest index values are for resource-rich countries. While these countries may have the potential to raise further revenue from domestic direct and indirect taxes, it is likely that the prevalence of natural resource-related revenue weakens the incentive to make greater effort in these areas.

Figure 9 also indicates that there is a diverse group of African countries that are already making substantial tax effort and are in fact collecting more revenue than would be expected given their structural characteristics. While many of these are small countries, the group includes more economically advanced countries such as South Africa, Morocco, Kenya, and Ghana, as well as poorer countries including Liberia, Burundi, Benin, and Malawi.

¹⁷ Notably, the findings of this analysis are entirely consistent with those by Le, Moreno-Dodson, and Bayraktar (2012).

Figure 9. Tax effort index for Africa

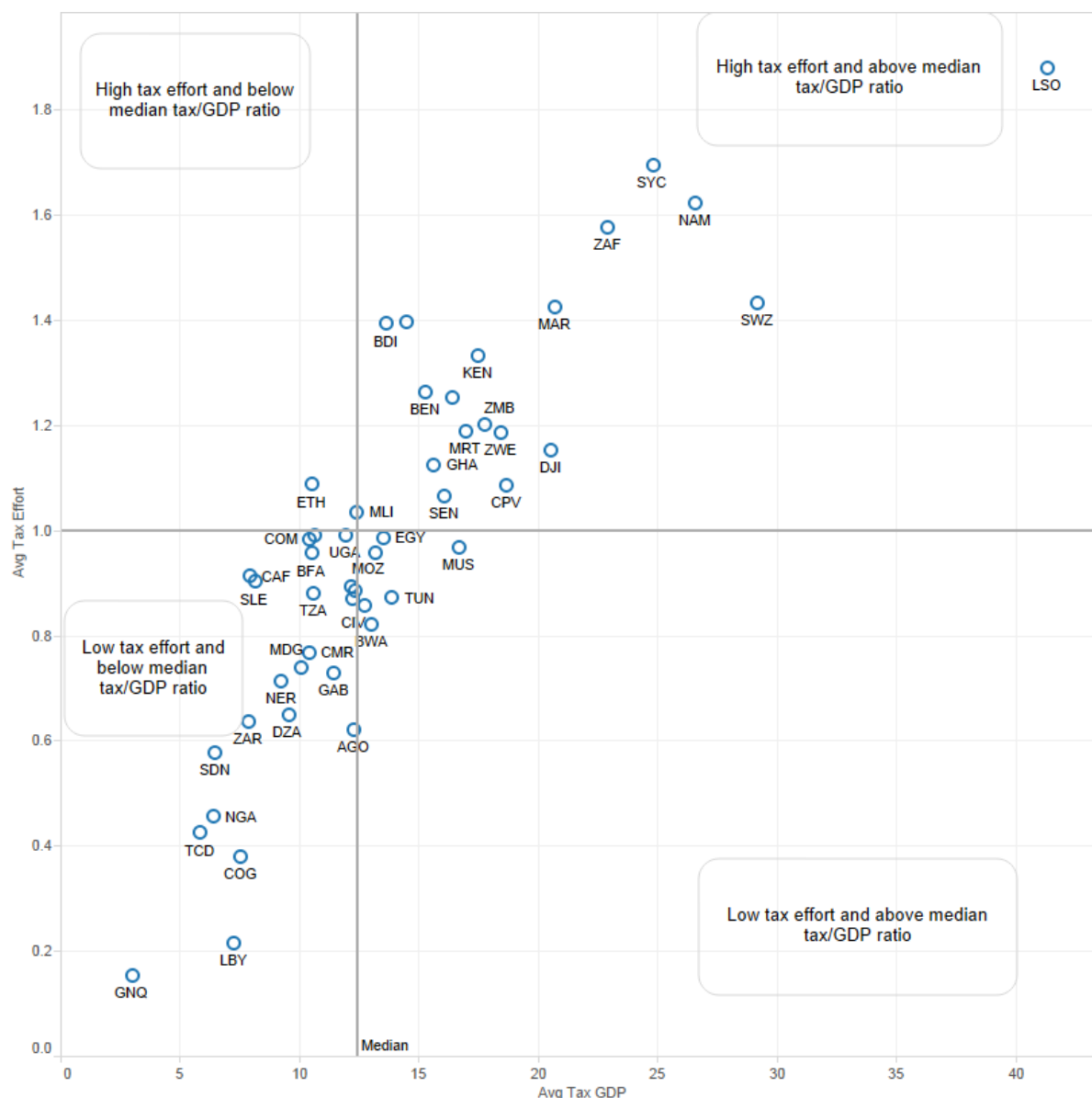


Sources: Authors' calculations, using AEO and WDI data

Figure 10 plots the tax effort index values for the 49 African countries alongside their tax-GDP ratios. The tax effort index values and tax-GDP ratios are averaged over the 1990–2010 period. Using this approach, countries can be divided into four groups: countries with high tax effort and above median tax mobilization, high tax effort and below median mobilization, low tax effort and below median mobilization, and low tax effort and above median mobilization. Twenty out of 29 countries are already making high tax effort. Tax mobilization is above the regional median for most of these countries. The tax-GDP ratio was below median in only two out of 20 countries. Twenty-nine out of 49 countries make low tax effort. The vast majority of these countries—all but six—have tax-GDP ratios below the regional median. Most of the low effort, low mobilization countries tend to be resource-rich countries.

The general conclusion that can be drawn from this analysis is that a number of countries in Africa are already making significant tax effort. Most of the low effort countries are rich in resources. These countries may have the potential to increase revenue mobilization but the prevalence of resource-related revenues may be weakening the incentive to make greater effort to capture their respective domestic tax bases.

Figure 10. Tax effort index for Africa and revenue mobilization, 1996–2010¹⁸



Sources: Authors' calculations, using AEO and WDI data

¹⁸ Results for countries such as Lesotho, Swaziland, and Namibia may be influenced by the inclusion of trade taxes in the equation. However, it can be argued that trade taxes also require collection effort. Results are not expected to change substantially if trade taxes are excluded, though the tax effort index value for some of these countries is expected to fall.

How does sub-Saharan Africa compare with other regions on tax effort? To address this question we estimated a tax effort index for all countries using WDI data. This approach is similar to Le, Moreno-Dodson, and Bayraktar (2012) and the results are consistent with their study.¹⁹ Tax collection in sub-Saharan Africa (at the regional level) is consistently above predicted tax collection or predicted tax capacity. The tax effort index is consistently above 1, especially since the early 2000s (up until the global financial crisis). On the other hand, tax effort is lower (below 1) in other developing regions, such as South Asia and East Asia. Tax effort has been increasing recently (since the mid-2000s) in Latin America and is nearly consistently at 1 for OECD countries (Le, Moreno-Dodson, and Bayraktar 2012).

The main finding from our analysis and that of others is that tax collection in Africa remains low despite significant effort in many countries. The region as a whole, and many countries within the region, are collecting more through taxes than would be expected given their structural characteristics. A key implication is that structural factors limit how much revenue countries can hope to mobilize before constraining growth, investment, and other objectives. Expectations regarding the extent to which domestic revenue can finance ambitious post-2015 goals in Africa, and address huge financing gaps may need to be tempered, especially given that domestic revenue is collectively already more than 10 times the size of total foreign aid to the region. While there is significant variation across countries, even in the world's poorest region, the majority of development financing is already mobilized domestically.

Conclusions: Investing in Responsible, Accountable Governments

This report analyzed the role of DRM in Africa in the emerging post-2015 development framework and the related FFD agenda. DRM is gaining prominence as the debate about how to finance an ambitious post-2015 agenda intensifies.

The emerging post-2015 FFD agenda has set high expectations surrounding developing country DRM efforts. While the role of aid is downplayed in the post-2015 FFD agenda, the roles of international private capital and domestic financing are being strongly emphasized. Such emphasis has important implications for poorer countries in Africa, many of which lack substantial experience attracting sustainable international private capital and have shallow tax bases. The HLP's proposal emphasizes big transformative shifts, but for all practical purposes the post-2015 FFD agenda may well be very similar to the Monterrey Consensus. Yet the emphasis on DRM is so far devoid of realistic

¹⁹ Le, Moreno-Dodson, and Bayraktar (2012) included additional independent variables on demographic characteristics and governance quality in some of their specifications. This analysis has not included those variables in the results reported here.

assessments of the financing potential of domestic taxation, non-tax revenue mobilization, and other alternative financing options as they relate to African countries.

We analyzed recent trends in DRM in Africa by focusing on taxation and revenue mobilization. The main finding is that while DRM is increasing in the region as a whole, this trend is driven by resource-rich countries and resource related revenue, which is now the largest component of Africa's revenue mix. Tax ratios for most African countries are below the regional average.

Despite significant recent reforms and a favourable global economic climate (up until the global financial crisis), tax performance in African countries leaves much to be desired. Tax systems remain inefficient, costly, and ineffective. Revenue foregone due to tax exemptions, tax avoidance, and capital flight is a significant drain on DRM in many countries in Africa.

Our analysis, based on a tax effort index that was calculated for African countries, shows that tax collection remains low despite significant effort. The region as a whole and many countries within the region are collecting more in taxes than would be expected given structural characteristics. A key implication is that structural factors limit how much additional revenue countries can hope to mobilize before constraining growth, investment, and other objectives. Most of the low tax effort countries in the region are rich in resources. These countries have the potential to increase revenue mobilization, but the prevalence of resource-related revenues may be weakening the incentive to make greater effort to capture the domestic tax base.

An important implication of this report's findings for African countries and their development partners is that tax issues cannot simply be reduced to goals and targets aimed at increasing tax-GDP ratios. Past research has shown that donors' contributions to building tax capacity in Africa remain relatively small and tend to be concentrated in a handful of countries (Bhushan and Samy 2012). From the perspective of development partners, DRM as it features in the post-2015 FFD agenda should not be seen as the panacea for post-2015 FFD. It should be repurposed to be singularly concerned with investing in responsible, accountable governments. Donors and African governments should not lose sight of the fact that DRM is ultimately about building better state-citizen compacts than those that exist in most African countries today.

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