Center for Global Development

ACET African Center for Economic Transformation

Africa Taking Charge of its Future

Increasing Domestic Revenue Mobilization

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When world leaders adopted the Sustainable Development Goals (SDGs) in 2015, there was broad recognition that most developing countries would need to step up their efforts to raise domestic resources to finance domestic investments; support from development partners and private sector investors would not be enough. For low-income countries, the IMF subsequently estimated that on average, domestic taxes would have to increase by about 5 percentage points if they were to meet the SDGs in five key areas (education, health, roads, electricity, and water). Sub-Saharan African countries would need even more financing given their development level.

Some progress has been made in increasing tax revenues. Between 2000 and 2018, average tax-to-GDP ratios in sub-Saharan Africa increased from 12 to 15 percent of GDP, peaking in 2015 at 16 percent of GDP. But this is not enough, and partners and developing countries will need to make a concerted effort to increase domestic resource mobilization (DRM). A financing strategy was laid out at the Addis Ababa Financing for Sustainable Development Conference, including the Addis Tax Initiative to accelerate progress on increasing DRM.

Progress on increasing tax revenue has been slow since 2015. And the dual health and economic crises stemming from the COVID-19 pandemic have worsened the situation markedly: economic activity has fallen, resulting in lower tax revenues, and countries have adopted fiscal policies both to support crisis spending on health and social safety nets, and to provide fiscal stimulus to businesses, straining government finances. Many African governments are also facing increasing debt service payments despite relatively low global interest rates, and an increasing number of countries are in debt distress.

Recovery from the COVID-19 crisis presents both a challenge and an opportunity. In due course countries will need to reestablish pre-crisis revenue levels and accelerate DRM so they can invest in a sustainable future. In regaining their revenue footing, countries have an opportunity to use the greater political cohesiveness around the COVID-19 response to take on difficult tax policy choices. These should be done with a view not just to increasing revenues, but also to raising revenues in a more equitable and sustainable manner—eschewing taxes that put an undue burden on the poor and ensuring government expenditures provide basic services and support those most in need of assistance.

The technical means of increasing DRM are well established. Elimination of tax exemptions (so-called tax expenditures) will make the tax system both more efficient and more equitable. Efforts to enlarge the tax base could spread the tax burden more evenly across the population, allowing counties to lower marginal rates and disincentives to productive activity. And improved mechanisms to capture the rents from natural resource extraction can provide resources for the budget while creating incentives to increase exports.

But as experience has proved, technical know-how is not enough. Revenue increases come about slowly and require sustained political commitment and technical work over years, if not decades. And it requires strong and consistent communication: the public needs to see a connection between paying taxes and receiving government services if the government is to garner their support to raise revenues. And too often, special interests (both politically powerful individuals and economically powerful corporations) have undue influence in the determination of tax policies, seeking "temporary" exceptions for business or personal reasons that then become entrenched in the tax code and prove politically difficult to dislodge. Thus the "low-hanging fruit" from a technical standpoint are the most difficult gains to harvest from a political point of view. And the more fragile the economy is, either because of conflict or political strife, the more difficult it may be to garner the political will and muscle to push reforms forward. Electoral cycles also complicate the task of enacting reforms that endure over time.

And the near future is likely to produce even more impediments to increasing DRM. The full impact of the global recession, particularly on global trade and commodity prices, has not yet fully played out as economic recovery is still uncertain in the world's largest economies. While there was hope that the COVID-19 health crisis in Africa would be less severe than in North America or Europe, there has been a resurgence of the virus in many parts of the continent that will require increased health spending, further restrictions on economic activity, and more subsidies to support people during the crisis. There will be continued and increased pressure to keep tax rates low and spending high. Even when economies begin to rebound, it will be difficult to claw back the tax breaks that have been given to ease the impact of the crisis. Debt levels are constraining the room for sovereign borrowing, and creditors are increasingly concerned about debt sustainability.

Another opportunity and challenge for 2021, apart from the global economic conjuncture, is the implementation of the African Continental Free Trade Area (AfCFTA), which commenced on January 1. Establishing Africa as a "single" market has huge potential to increase trade within and outside the continent, as business will be able to access a much larger customer base. But making tax regimes consistent across countries; avoiding competitive tax incentives; and putting in place the needed physical, regulatory, and human infrastructure to facilitate intracontinental trade will all present important challenges for country tax authorities over the next few years.

The question for African policymakers, businesspeople, and citizens in 2021 is how to take advantage of the new political impetus from the economic crisis and the AfCFTA rather

than let the "usual" impediments overwhelm tax reform efforts. Questions that panelists may wish to discuss include:

- What preparatory actions should governments take before beginning to emerge from the crisis?
- What opportunities and challenges does the crisis present for reform—for changing the way taxes have been traditionally collected?
- How can resistance from vested interests be overcome?
- What opportunities and challenges does AfCFTA present?
- How can the connection between taxes and government services be reinforced during and after the crisis?
- What are the roles for the private sector? Donors? Civil society?

Additional Reading

For further information, the following blogs and papers may be of interest:

G20 Compact with Africa Finance Ministers call for African ownership of CWA Press Release

G20 Compact with Africa Ministers' Consensus Statement

COVID-19: Ten Policy Priorities for Africa's Recovery, Growth, and Transformation

Fiscal Social Contracts and Domestic Resource Mobilization in Sub-Saharan Africa

On the Political Economy Determinants of Tax Reforms: Evidence from Developing Countries

Domestic Revenue in Low-Income Countries: Where to from Here?

Institutional and Political Determinants of Statutory Tax Rates: Empirical Evidence from Sub-Saharan Africa

Tax Revenue Reforms and Income Distribution in Developing Countries

Can Tax Buoyancy in Sub-Saharan Africa Help Finance the Sustainable Development Goals?

Scope for a Grand Bargain to Reduce Tax Exemptions?

Many more papers on DRM can be found on the CGD DRM webpage.

Also see other relevant materials on the ACET website