



United Nations  
Economic Commission for Africa



Ninth  
African  
Development  
Forum

# Domestic resource mobilization

Issues paper







United Nations  
Economic Commission for Africa



## **Ninth African Development Forum**

Innovative Financing  
for Africa's  
Transformation

Marrakech, Morocco  
12-16 October 2014

Distr.: General  
ECA/ADF/9/2  
19 September 2014  
Original: English

# **Domestic resource mobilization**

---

Issues paper



## I. Introduction

1. Africa has experienced remarkable economic growth over the past decade. Sustaining such growth will require increased reliance on domestic resources in order to increase national ownership of public policy, ensure accountability to citizens and reduce the risk of volatility associated with external funding (North-South Institute, 2010). Awareness of the importance of domestic resources is not a new development: back in 2001, the framework document of the New Partnership for Africa's Development (NEPAD) emphasized the need for Africa to strengthen domestic resource mobilization, and this was reaffirmed at the global level in 2002 by the Monterrey Consensus on Financing for Development, which made improved domestic resource mobilization the first of its six leading actions and stressed the importance of establishing the necessary internal conditions for mobilizing domestic savings to sustain adequate levels of productive investment. Indeed, the need for Africa to explore different sources of financing to meet its development needs and transform its economies into middle-income countries has been reiterated at various forums over the past decade.

2. Enhanced domestic resource mobilization increases the ability of Governments to achieve long-term development objectives. Until now, however, African countries have had difficulty in mobilizing adequate domestic resources to meet their investment needs. Although there has been some progress in mobilizing domestic resources since the adoption of the NEPAD framework document and the Monterrey Consensus, the ratio of savings to gross domestic product (GDP) has fallen, from 24.3 per cent of GDP in 2008 to 16 per cent in 2011. Moreover, since 2008, the gross domestic savings rate has been consistently lower than the gross domestic investment rate. With current estimates of the financing gap standing at approximately 6 per cent of African GDP, it is clear that mobilizing sufficient, stable and predictable resources still remains a real concern for the continent.

## II. Objectives

3. The overall objective of the present paper is to provide background material for the Ninth African Development Forum, the theme of which is "Innovative financing for Africa's transformation". The paper will discuss the key issues, opportunities and challenges regarding domestic resource mobilization in Africa, with a view to providing guidance on policy options and mechanisms for fully exploiting sources of finance for economic development. The present paper should be read in conjunction with the concept note, which takes a broader look at Africa's challenges in accessing and utilizing innovative sources of financing, and covers issues such as illicit financial flows, private equity, new forms of partnerships and climate financing.

4. The present paper is also intended to provide a critical perspective on the secondary factors that impact the policy discussion on domestic resource mobilization: governance (policies, laws and regulations); environmental sustainability and stewardship issues; and the knowledge base, including human and institutional capabilities. This will be followed by a section on cross-cutting issues. The paper will conclude by highlighting a number of options for improving domestic resource mobilization in Africa.

## III. Broad issues

5. Research on the nature and scale of Africa's financing needs consistently demonstrates that financing remains a huge obstacle to achieving sustainable economic transformation. The

estimates of the continent's financing needs are indeed staggering, with some \$90 billion needed to plug the infrastructure gap; \$30-\$50 billion annually to meet the cost of climate adaptation; and \$25 billion annually to achieve universal access to modern forms of energy. Within the next few years, the cost implications of the post-2015 development agenda will become clearer; nonetheless, it is already certain that they will be comparable to those of the Millennium Development Goals (\$40-\$60 billion per year).

6. Although taxes are the largest source of domestic revenue, tax collection as a share of GDP has increased only marginally over recent years, from 26.6 per cent in 2009 to 27.0 per cent in 2011, and many countries are still recording tax ratios of less than 10 per cent. As a result, African countries are increasingly turning to external borrowing to bridge the financing gap and fund domestic investment, despite the positive growth of foreign direct investment, remittances and official development assistance.

7. The bulk of existing research on development finance has focused on identifying the key challenges that Africa faces in mobilizing and retaining resources (both domestic and external) and potential policy solutions. These challenges include low savings rates, poor tax administration and a limited tax base, often dominated by practices that restrict the growth of intra-African trade and provide opportunities for large-scale commercial tax evasion. Despite the reforms adopted across Africa, there is still much to be done to expand and exploit the fiscal potential of the informal sector, amend tax laws to combat profit-shifting by multinational companies through transfer pricing, and tackle high capital flows to tax havens. Domestic resource mobilization in the form of private savings is mainly hampered by low income levels and a lack of access to financial services in rural areas.

8. There are also challenges stemming from poor public sector governance and planning. Although many African countries have made huge strides over the past decade to improve their macroeconomic management, the same cannot be said for public financial management. There is still a pervasive disconnect between public financial management and national budgets and planning, which makes it difficult for countries to identify funding gaps and channel existing funds into priority development areas. Official development assistance is often used to support the delivery of public services, which in turn exacerbates aid dependency and reinforces the culture of poor public financial management.

9. Furthermore, financial systems in many African countries are currently ill-equipped to mobilize capital in ways that help individuals and the private sector. In the early 2000s, a number of African countries undertook banking reforms to curb the widespread proliferation of unregulated banks, improve prudential requirements (and therefore improve risk management) and encourage competition to increase access to financial services. Despite such improvements, many banks are still wary of offering credit to small and medium enterprises (even if the enterprises are prepared to pay a premium), fail to provide services that are accessible to the large informal sector and rural communities, and are timid when it comes to funding large-scale infrastructure projects due to the low capacity to assess risk, poor management of cost recovery and lack of guarantees.

10. The development of capital markets has been slow and has failed to provide an efficient conduit for capital for a number of reasons, including: scale; low capacity; stifling regulatory

frameworks; poor technological infrastructure; and legal frameworks that are incapable of providing sufficient protection to investors through contract enforcement.

11. Lastly, the pervasiveness of illicit financial flows should also be noted. It is estimated that such flows cost the continent about \$854 billion between 1970 and 2008, and the problem is becoming more marked: between 2000 and 2008, Africa lost an average of \$50 billion per year. The amount that Africa has lost to date could wipe out the continent's total outstanding external debt and still leave \$600 billion for poverty reduction efforts (Economic Commission for Africa, 2012a).

## IV. Specific issues

### A. Domestic savings

12. In Africa, the ratio of gross domestic savings to GDP is still below the average of middle-income economies and the average of the fast-growing economies in East Asia (Economic Commission for Africa, 2012b). The key challenges relate to the removal of savings barriers, the strengthening of the main drivers of savings, the effective mobilization of revenues from natural resources without hampering investment, and the creation of a fair and efficient system of taxation. With Africa's domestic revenue reaching \$520 billion in 2012, against less than \$50 billion in foreign aid received, the potential for increased domestic revenue mobilization is enormous, especially considering the current low levels of taxation.

### B. Financial markets

13. While banking is at the heart of Africa's formal financial systems, it faces many problems, including scale, large interest margins (lending and borrowing rates), high overhead costs and a low penetration rate. The latter is a key issue as limited access to the banking system by ordinary people and too few bank deposits inevitably lead to a dearth of credit to extend.<sup>1</sup> Inefficiencies in the banking sector arising from a lack of competitive pressure on existing banks has led to extremely expensive banking services, characterized by huge banking spreads, overheads and profits. This is compounded by weak regulatory structures that do not support robust risk management systems.

14. Stock market capitalization in Africa rose from \$300 billion in 1996 to \$1.2 trillion in 2007, but secondary financial markets on the continent remain largely underdeveloped, with scarcely one in three African countries having an organized capital market. In 2012, 9 of the 17<sup>2</sup> countries for which recent disaggregated data is available had market capitalization ranging from 6 to 30 per cent of GDP; 6 had between 30 to 70 per cent; while Zimbabwe and South Africa had 109 per cent and 159 per cent respectively. With the exception of South Africa and some North African exchanges, African exchanges are considered "frontier markets", typically characterized by low

<sup>1</sup> Access to long-term financing in Africa is constrained by, among other things, the short-term nature of African bank assets and the liability structure. Some 80 per cent of deposits in Africa are so-called sight deposits (less than 1 year maturity), with fewer than 10 per cent of deposits having a maturity of more than 2 years. Furthermore, more than 60 per cent of loans in Africa are extended for less than 1 year. Fewer than 2 per cent of loans are extended for more than 10 years.

<sup>2</sup> Benin, Burkina Faso, Côte d'Ivoire, the Democratic Republic of the Congo, Egypt, Ethiopia, Ghana, Kenya, Mali, Morocco, Seychelles, Sierra Leone, South Africa, Togo, Tunisia, Uganda and Zambia.

capitalization and liquidity levels. Issues of capacity (human, technological and institutional) are persistent, and management of risk and regulation are still issues that limit portfolio inflows.

### **C. Contractual savings**

15. Being typically long term by nature, pension funds can provide reliable financing for long-term development projects that would normally face difficulty attracting suitable investment. The insurance sector has similar potential, with the added benefit of providing an income safety net for businesses and individuals. However, these options are not without challenges: relatively high mortality rates in many African countries not only tend to reduce the take-up of life insurance policies, but also make the pricing of such products more difficult and less attractive for consumers. In this regard, the small number of consumers in most countries means that the pooling and diversification of risks becomes more difficult. Low savings rates, a general lack of awareness and financial literacy, and inadequate consumer protection also limit growth in these sectors. All these factors are compounded by a lack of effective investment guidelines as well as limited capacity to implement investment strategies. Moreover, as with most investments, there are prudential, investor and performance risks associated with investing certain assets in capital markets. Owing to these risks, most African countries have restrictions on how and where funds can be invested, which ultimately limits investment returns.

### **D. Public financial management**

16. It could also be argued that failures in public financial management contribute to inadequate domestic resource mobilization. Sound public financial management is characterized by aggregate fiscal discipline; resource allocation and use based on strategic priorities; and efficiency and effectiveness of programme and service delivery. Although steps have been taken to improve public financial management, many African countries still struggle to tackle endemic weaknesses such as unauthorized expenditures, committing unavailable funds to projects, poor reporting and accounting practices, and long delays in auditing and preparing annual national accounts. These weaknesses have led to poor budget performances, fiscal imbalances and the exacerbation of national deficit levels. Resolving fiscal fundamentals alone may not necessarily enhance domestic resource mobilization if national public financial management is lacking. African countries will need to engage in fiscal reforms that contribute to, among other things, the maintenance of budgetary discipline; the equity of public resource use; the efficiency of revenue mobilization; and general fiscal transparency (Economic Commission for Africa, 2002).

### **E. Sovereign wealth funds**

17. A sovereign wealth fund is a non-traditional form of savings that can be used to fund development projects or for future generations. More than 10 African countries already have sovereign wealth funds, including Algeria, Angola, Equatorial Guinea, Gabon, Ghana, Libya, Nigeria, the Sudan and Sao Tome and Principe. The establishment of such funds should be given particular priority in countries with plentiful natural resources and in middle-income countries, with a view to harnessing surpluses from such resources and economic activity, and effectively converting them into viable development projects. Countries that have successfully established sovereign wealth funds should be encouraged to share best practices with other countries. How-



ever, it is important not to deprive the current generation of Africans from benefiting from such funds, particularly where existing public service provision is inadequate.

## F. Remittances

18. Remittances are an important source of foreign exchange and they enable countries to import vital goods and pay off external debt. Remittance flows to Africa quadrupled between 1990 and 2010, reaching nearly \$40 billion in 2010 and some \$62 billion by 2012 (Economic Commission for Africa and African Union Commission, 2014). At a cost of 12.4 per cent per transaction, Africa is the most expensive continent to send money to. If this could be reduced to 5 per cent – the target set by the Group of 8 and the Group of 20 – it could save \$4 billion a year (World Bank and European Commission, 2013). Governments need to provide incentives to lower the cost of sending money to Africa and shift remittance expenditure from consumption to productive investments, as seen in Senegal, the Philippines and Bangladesh.<sup>3</sup>

## G. Diaspora bonds

19. In 2008, Ethiopia was the first country in Africa to introduce diaspora bonds. Called “Millennium Corporate Bonds”, they were issued by the Ethiopian electric power authority to finance national projects. Although the bonds were not as successful as had been hoped, the Ethiopian Government tried again in 2011, with a second bond issuance, to secure financing for the Grand Renaissance Dam project. Efforts were made to improve the marketing campaign vis-à-vis diaspora Ethiopians and to date \$400 million has been raised, although much of this has come from within the country. Drawing from Ethiopia’s experience, it is clear that there are important conditions that countries considering issuing bonds must consider if the process is to be effective and cost efficient. Governments must, first, ensure that the bonds are marketable and will appeal to the diaspora; second, be able to identify and locate nationals living abroad; third, establish an entity that will attract and maintain ties with the diaspora; fourth, improve financial literacy among members of the diaspora to help them to become active investors; and lastly, demonstrate good governance, transparency and political stability.

## H. Public-private partnerships

20. Public-private partnerships have been widely used in both developed and developing countries since the 1970s. In essence, public-private partnerships are risk-sharing mechanisms or relationships in which a legal contract assigns public service delivery responsibilities to a private entity. Public-private partnership investment in developing countries across different sectors – water, energy, telecommunications and transport – grew from about \$30 billion in 1995 to \$140 billion by 2009. Despite the huge potential of such partnerships, the implementation of public-private partnership investments in Africa is hampered by a number of factors, including:

- a. Small markets and un-creditworthy players (in public services delivery)
- b. Large investment relative to the expected revenue, and front loaded cost
- c. Unliberalized African public entities, tight government regulation and low-tariff requirements

<sup>3</sup> For further discussion on remittances, expenditure patterns and impact, see Maximizing the Development Impact of Remittances, United Nations Conference on Trade and Development, 2013.

- d. Difficulties managing the various risks, including legal, regulatory and government risks, project and technical risks, and taxation and economic risks.

## **I. Illicit financial flows**

21. Illicit financial flows impact all facets of the economy in affected countries. Such flows have been a huge drain on Africa's resources, preventing access to these funds for productive investments and undermining the economic governance of the continent. African Governments will need to address the issue of illicit financial flows as part of their efforts to mobilize both domestic and external resources.

## **J. Governance: policy, legal and regulatory issues**

22. Sound public financial management is integral to the process of improving domestic resource mobilization and ensuring that domestic resources are used to boost inclusive growth, create jobs and improve social welfare. Reforms in the areas of taxation, banking and capital markets, and efforts to access non-traditional sources of finance, need to be supported by a fair and robust public financial management framework to ensure that the most vulnerable and marginalized groups are not unnecessarily burdened by such reforms. It is therefore crucial that resource mobilization and spending processes are linked to core national development objectives and are underpinned by strong coordination and planning. There is also a need for mandatory impact assessments to determine to what extent such actions are achieving their stated objectives.

23. As taxation is the biggest source of domestic revenue for African countries, it is imperative that policymakers across the continent do more to address the constraints currently hampering the implementation of tax reforms and to maximize the contribution of taxes to domestic revenue. Reforms to tax policy and administration seem technical, but the real constraints are often political will and leadership. Indeed, African policymakers must convince their citizens that tax reforms are part and parcel of wider reforms to improve the business and investment environment of their countries. In simplifying the tax system, a comprehensive review of the tax exemption regime and investment codes could also help to broaden the tax base. Tax exemptions and holidays should only be granted where appropriate, and even then they should be granted sparingly and be time bound. Governments could also consider limiting such tax breaks to public-private partnership projects or entities that are willing to invest in infrastructure development and corporate social responsibility schemes.

## **K. Environmental sustainability and stewardship issues**

24. Climate change and adaptation issues are at the forefront of sustainable development in Africa, and managing the impact on financing priorities will be a challenge for most countries as they strive to advance their industrialization agendas. Improving domestic resource mobilization will empower countries to raise and allocate funds for future climate-related endeavours, including providing incentives for private sector management of negative externalities and establishing endowment funds for adaptation purposes and reconstruction in the event of climate-related crises. Countries will need to find ways of tapping into streams of capital to better accommodate their sustainability agendas without compromising on the delivery of immediate to medium-term development objectives.

## L. Knowledge base and human and institutional capabilities

25. Advances in public financial management, taxation, capital markets and other areas cannot occur in a vacuum of human and institutional capacity. Governments pursuing reforms with a view to improving domestic resource mobilization have generally had to invest in improving human capacity and/or acquiring such skills from outside their countries. Increasingly, and particularly since the introduction of the Busan Partnership for Effective Development Co-operation, there has been a call for technical assistance efforts to be strengthened to enhance the capacities of developing countries. Governments should use this opportunity to negotiate assistance that incorporates the provision of technical capacity and technology in areas where human and institutional capacity is lacking. This has huge potential for developing and retaining such skills domestically, thereby improving self-reliance and ownership of long-term national planning and reducing the risk of becoming dependent on foreign aid.

## V. Cross-cutting issues

26. The high levels of informality in most African countries, especially in the agricultural sector and in rural areas, mean that a considerable proportion of resources cannot be mobilized and used to finance productive investments. Indeed, countries that depend heavily on agriculture tend to have lower savings rates as percentage of national GDP. Moreover, in Africa, many economic activities take place in the informal sector and many households hold their savings in a non-financial form, such as livestock, grain or stockpiles of goods for trading. In other words, the issue of how to mobilize informal savings and channel them towards productive investment applies across sectors.

27. As well as providing a degree of financial flexibility and independence, women who are economically empowered have been found to save more, take less risky investment decisions, and make spending decisions that positively impact the whole household by expanding economic opportunities and improving the welfare of children in the areas of health, nutrition and education. It can therefore be deduced that initiatives that improve women's access to financial services and infrastructure can have a positive multiplier effect on the economy, so it is extremely important that policies aimed at enhancing domestic resource mobilization also reflect the unique and important role of women.<sup>4</sup>

## VI. Conclusion

28. Improving domestic resource management in Africa is no easy feat. Governments need to commit to taking action on a broad range of areas, including a targeted overhaul of taxation frameworks and fiscal policy, and a strengthening and deepening of financial markets, to better respond to the needs of individuals and private enterprises. At the most basic level, low-income countries need to improve access to bank-based finance by increasing competition, and pay due attention to effective regulation that deters monopolistic practices, encourages innovation and provides incentives for banks to provide cheap credit to small and medium enterprises and wider, more appropriate financial services to women. Consideration could be given to tapping into more developed financial markets to access services that cannot be provided domestically. Middle-income countries could focus heavily on regulation and improving business environments,

---

<sup>4</sup> For further discussion on the impact of women's economic empowerment, see Fletschner, D. and L. Kenney, Rural women's access to financial services: credit, savings and insurance. ESA Working Paper No. 11-07, March 2011.

with a view to attracting foreign capital, boosting growth and promoting long-term stability. In addition, greater efforts need to be made to establish the necessary regulatory and enforcement frameworks to better exploit non-traditional forms of financing and to ensure discipline in public financial management, to ensure that any resource gains achieved are channelled into specific national priorities that will advance inclusive and sustainable economic growth.

## References

29. African Development Bank (2012). *Diaspora Bonds: Some Lessons for African Countries*. *Africa Economic Brief*, vol. 3, issue 13, December 2012. Available from: [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Economic\\_Brief\\_-\\_Diaspora\\_Bonds\\_Some\\_Lessons\\_for\\_African\\_Countries.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Economic_Brief_-_Diaspora_Bonds_Some_Lessons_for_African_Countries.pdf).

Beck, T. and others (2011). *Financing Africa: Through the Crisis and Beyond*. African Development Bank, BMZ and the World Bank. Available from: <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Financing%20Africa%20Through%20the%20Crisis%20and%20Beyond.pdf>.

Economic Commission for Africa (2002). *Guidelines for Enhancing Good Economic and Corporate Governance in Africa*. Available from: <http://repository.uneca.org/bitstream/handle/10855/5544/Bib-39457.pdf?sequence=1>.

Economic Commission for Africa (2011). *Public-Private Partnerships in Africa's Energy Sector: Challenges, Best Practices and Emerging Trends*. Available from: <http://repository.uneca.org/bitstream/handle/123456789/17787/bib.%2067948.pdf?sequence=1>.

Economic Commission for Africa (2012a). *Illicit Financial Flows from Africa: Scale and Development Challenges*. Addis Ababa.

Economic Commission for Africa (2012b). *Finance and Investment: Mobilizing Resources for Financing African Union/New Partnership for Africa's Development Projects*. Policy Research Paper No. 3. Available from: <http://www.uneca.org/sites/default/files/publications/eca-policy-research-paper-no-3.pdf>.

Economic Commission for Africa and African Union Commission (2013). *Making the Most of Africa's Commodities: Industrializing for Growth, Jobs, and Economic Transformation*. Economic Report on Africa 2013. Available from: <http://www.uneca.org/publications/economic-report-africa-2013>.

Economic Commission for Africa and African Union Commission (2014). *Dynamic Industrial Policy in Africa: Innovative Institutions, Effective Processes and Flexible Mechanisms*. Economic Report on Africa 2014. Available from: <http://www.uneca.org/publications/economic-report-africa-2014>.

Economic Commission for Africa and the New Partnership for Africa's Development (2013). *Mobilizing Domestic Financial Resources for Implementing NEPAD National and Regional Programmes and Projects – Africa Looks Within*. Available from: <http://www.africanbondmar>

kets.org/fileadmin/pdf/Publications/Domestic%20Resource%20Mobilisation%20Study%20May%202013-NEPAD.pdf.

Fletschner, D. and L. Kenney (2011). *Rural women's access to financial services: credit, savings and insurance*. ESA Working Paper No. 11-07. Available from: <http://www.fao.org/3/a-am312e.pdf>.

North-South Institute (2010). *Domestic Resource Mobilization in Africa: An Overview*. Available from: <http://www.nsi-ins.ca/wp-content/uploads/2012/10/2010-Domestic-Resource-Mobilization-in-Africa-An-Overview.pdf>.

Swiss Re (2010). *Insurance in Sub-Saharan Africa: Gearing up for Strong Growth*. Zurich.

United Nations Conference on Trade and Development (2013). *Maximizing the Development Impact of Remittances*. Available from: [http://unctad.org/en/docs/ditctnkd2011d8\\_en.pdf](http://unctad.org/en/docs/ditctnkd2011d8_en.pdf).

World Bank (2013). *World Development Indicators Online Database*, Accessed on 15 November 2013.

World Bank and European Commission (2013). *Send Money Africa Report*. Available from: [https://sendmoneyafrica.worldbank.org/sites/default/files/SMA\\_Report\\_Jan2014.pdf](https://sendmoneyafrica.worldbank.org/sites/default/files/SMA_Report_Jan2014.pdf).

