POLICY BRIEF

ECA/IDEP/POL/TRD/2020/002

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African Institute for Economic Development and Planning

Mobilizing Domestic Resources for Sustainable Development in Africa Post COVID-19

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Abstract

Africa has been relying for decades on external aid to finance its development, yet it is still facing human development challenges. The encouraging results from these recent years in terms of economic growth contrast with rising of inequalities and difficult living conditions. This situation arouses the need to think to innovant means of mobilizing resources within Africa and fully harness its potential. In the wake of the COVID-19 crisis which further exposed fragile economies, raising funds are critical to first respond to the socio-economic impact of the crisis, but also to sustain financing development after the recovery.

This policy brief highlights key policy recommendations emerging from the webinar held on 12 May 2020, which addressed the topic of "Mobilizing Domestic Resources for Sustainable Development in Africa, post-COVID-19".

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A continent relying on external aid

The African continent has received over decades a huge amount of funds to support its development. Despite encouraging economic growth results these recent years, it is worth noting that the inequalities are still increasing in a society whereby poverty is still prevailing. The 2020 Africa Outlook report underscored that Africa GDP growth estimated at 3.4% was marginally above the world average of 3% in 2019 and well above the average for advanced economies at 1.7%. Nonetheless, the continent is not really on the right track to achieve the SDG1 target of eradicating extreme poverty as the extreme poverty rate (weighted by population) is expected to fall from 33.4 % in 2018 to 24.7% in 2030, which is far above the target of 3%. The Monterrey consensus (2002) classified the external resources in four groups: foreign direct investment and other forms of private foreign investment; Export earnings from international trade; Foreign aid and technical cooperation; and the proceeds of debts forgiven by international creditors. Foreign aid and technical cooperation appear to be the most visible funding resource over the continent. This can be explained by uncompetitive African exports, the dwindling of foreign direct investment and the unwillingness of African creditors to relieve their debt. During the period 2014 – 2018, The amount of net official development assistance from the OECD Development Assistance Committee benefited mainly to Africa region which received more than US$ 50 billion each year, yet the standard of living has not improved. Besides, the ongoing COVID pandemic has further exposed African economies which rely essentially on external partners to mobilize funds. The impact of the crisis linked to COVID-19 on Africa economy could worsen the existing challenges it faces both at the economic and social levels. ECA recently estimated that Africa economic growth would record a 1.8% loss in the best scenario. Regarding financial assistance to cope with the current crisis, AfDB estimated up to US$154 billion the financial gap on the continent. In the meantime, Africa funds providers are preoccupied by the response to COVID-19 as US$ billion have been sent by advanced economies as stimulus packages. According to IMF , the real GDP growth in USA is projected to suffer from a contraction of 5.9% as compared to 7.1% in the European Union (excluding United Kingdom). Hence, there is a need for Africa member states to think to a sustainable and endogenous approach for financing their development and avoid the over-reliance on foreign aid.

A great existing potential

Tax revenue are by far the main source of revenue in Africa. A study conducted by both NEPAD and ECA in 2014 revealed some findings on the potential of Africa for mobilizing resources. The continent raises annually more than US$ 520 billion from domestic taxes as against US$ 59 billion received in private flows and US$ 50 billion in Official Development Assistance. In addition, the continent earns more than US$ 168 billion each year from minerals and has international reserves amounting more than US$ 400 billion in its central/reserve banks. Another means of funding is the African diaspora remittances which climbed up to US$ 40 billion in 2012 over the total global remittances of US$ 351 billion. Africa could also leverage on the securitization of diaspora remittances amounting up to US$ 10 billion yearly. Furthermore, banking revenues could be harnessed to finance development, just as sovereign wealth funds, bonds issuance (worth US$ 206 billion in 2011) and private equity market worth about US$ 30 million. However, some constraints are preventing the continent to fully tap into the afore-mentioned potential.

Africa's Financial Resource Potential and Challenges

Source: NEPAD and ECA, 2014

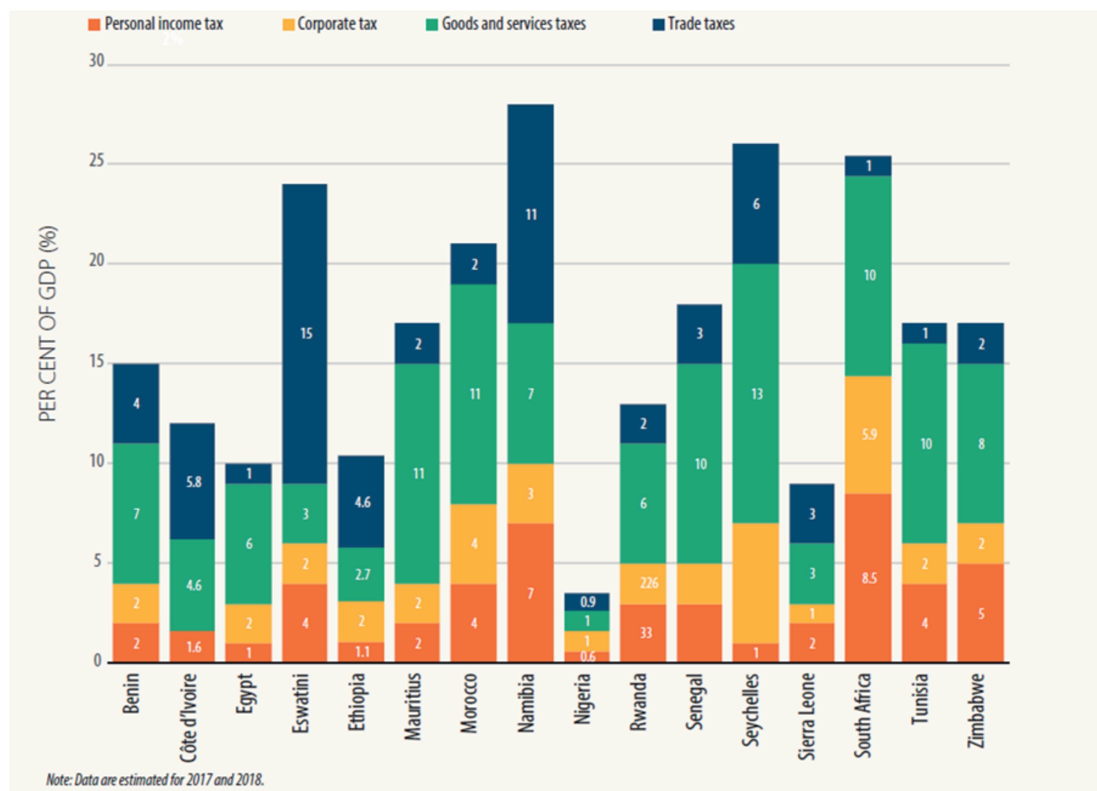
Challenges to harness the potential in mobilizing domestic resources

Some of the existing challenges in mobilizing domestic resources in Africa are related to tax administration. The ERA 2019 report highlighted the decline of the tax revenue to GDP ratio between 2000 and 2018 in several African countries including major economies. This indicator reveals the slower pace of tax growth than income growth across the continent. In terms of tax constituency, it is worth noting an imbalance between income (personal income and corporate taxes) and indirect taxes (good and services taxes). The latter dominate the former, suggesting therefore the possibility to improve the collection of income taxes. An overall tax reform could generate additional tax revenue of 3 per cent of GDP a year. All the sectors should be thoroughly covered by tax administration to avoid tax avoidance as observed in the informal sector which represents a big share in African economies, but it is not well monitored to harness its full potential.

On another hand, the rise of the debt burden in African member states could further fragilize and expose their economies to risks. In addition, the external debt of the continent is mostly denominated in foreign currencies, thus likely to suffer from tightening conditions of the global market. Illicit financial flows also reduce the revenue for financing development as Africa loses each year US$ 100 billion owing to these outflows.

Regarding diaspora remittances inflows, the COVID-19 is expected to shrink the volume of global remittances by 20% (World Bank, 2020) due to temporarily or permanent job losses of migrants in their host countries. In Sub-Saharan Africa. ECA formerly estimated up to $46 billion the amount of remittances to sub-Saharan Africa in 2019 and projected an increase to US$65 billion in 2021 (UNECA 2020b). However, with the undergoing COVID-19 crisis, a decline is projected by 23.1% in 2020. In addition, the cost of money transfer from African migrants to their home countries is quite high. For instance, a 200$US transfer requires a fees payment of 9% from an African as compared to 5% from a South-East Asia migrant. This is far from the 3% recommended by the SDGs. The issue of money transfer costs should be tackled as remittances are critical to mitigate the negative effects of the sanitary crisis across the continent by providing a lifeline for vulnerable groups. Corruption is also an impediment to an efficient tax governance which results in tax revenue collected under their real potential. To address the above-mentioned challenges effective policies should be designed and implemented.

Average tax structures in selected African countries, 2000-2018



Source: Based on data from ICTD and UNU-WIDER, 2018

Policy Recommandations

A set of policies could be adopted at both regional and national levels to enable the continent in the mobilization of required funds for financing SDGs.
As the COVID pandemic is squeezing the health system, the following actions could be taken to prevent the negative effects of similar shocks in the future:

- Undertake a tax policy reform that will benefit to the health system. As more than 38% of Africa health expenditures come from out-of-pocket money (WHO, 2016), these resources could be pooled through an efficient tax administration. However, recent studies concluded that increased govern ment revenue from tax administration reform do not systematically result in more funds allocated to the health sector unless this sector is prioritized by the public authorities and other accompanying measures are taken.

In addition, the institutional framework should be reinforced in African countries:

-Promotion of regional stock exchanges with strong and regulatory institutions to guarantee adequate safeguards against unwholesome practices and speculators;
-Development of requisite institutions and frameworks for safe and sound Securitization of Remit tances;
-Curtail of illicit financial flows and promotion of good governance.
Promote rural banking programmes to enable workers in sectors such as agriculture or SMEs having access to credit by better using mobile banking
-Improve the level of tax decentralization and making better use of ICTs.
-Adopt digital financial services to facilitate migrant remittances and reduce their costs upon the end of the sanitary crisis as prescribed by the World Bank .

Furthermore, the collaboration is crucial amongst African countries and/or institutions:

-Implement the African Continental Free Trade Area (AfCFTA) to boost intra-African trade, thus redu cing the bills of imports from outside the continent and eventually improving the trade revenue of member States. In order to compensate the tariff loss due to the implementation of AfCFTA innovative approaches could be adopted such as levy on imported goods from outside the continent (excluding donations and exempted goods), tourism, international travel and premium insurance. The accrued funds will be collected through the channel of the collaboration between the African Union, Member states and attendant companies.

- Support initiatives to establish new funds to finance the development of Africa's infrastructure, notably the Africa 50.
- Collaboration with the African Credit Guarantee Facility (ACGF) as a credit enhancement mechanism to support financing projects
- Promotion of Africa-owned Private Equity Funds including diaspora bonds and infrastructure bonds
- Exploration of New Public-Private Partnership (PPPs) financing models
- Establishment of Strategic Development Sovereign Wealth Funds
- Foster the links between formal, semi-formal and informal financial institutions
- Strengthen the collaboration with the International Financial Credit (IFC) of the World Bank Group for financing the private sector, especially the SMEs. These latter could take advantage from the tools designed by IFC to assist SMEs such as : e-lending platforms, e-invoicing, supply chain financing, use of alternative data for decisions on credit, SME lines of credit designed for a longer period, IFC's "Early Stage Innovation Finance" and the "Partial Credit Guarantee Scheme".
- Explore a working relationship with global sports organizations to find ways to payback the funds invested in the training of African stars in their respective discipline.
- Create conditions towards the creation of the African Monetary Fund that will provide a quick finan cial support to member states and enable them to mitigate the negative effects of deeper regional integration through the AfCFTA on their balance of payment.

Last but not the least, relevant capacity development programmes should be implemented to strengthen the skills of different actors involved in resource mobilization in Africa.

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