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REPOA Brief

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Domestic Revenue Mobilisation (DRM) for Sustainable Development in Sub-Saharan Africa and the Contribution of IDA-20

By REPOA

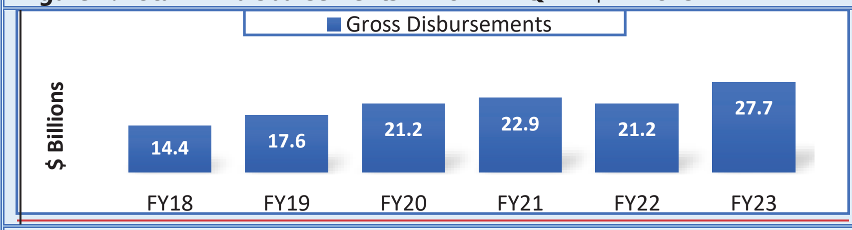
The Significance of DRM

DRM—increasing government revenues through taxation and other non-debt income sources—allows countries to own and flexibly chart policies that address their specific development challenges, while mitigating the risks of debt distress. Through DRM, countries accelerate their economic growth by raising and spending their own funds for public goods and services like schools, hospitals, clean water, electricity and infrastructure--all critical to helping people rise out of poverty and make sustained progress towards SDGs, and a critical step on the path out of aid dependence. Countries' investment in their own public goods and services, particularly infrastructure, is essential to attracting private investment and laying the foundation for long-term economic growth.

DRM in IDA-20 Recipient Sub-Saharan Countries

The twentieth instalment of the International Development Association (IDA-20) is a $93 billion three-year cycle for the period 2022-2025 that aims to support the world's poorest countries' recovery from COVID-19 by focusing on their sustainable development goals. DRM is a key feature of the **governance and institutions** component of IDA-20.

Figure 1: Total IDA disbursements FY18-FY24Q1 in $ Billions



Source: Development Finance, Corporate IDA & IBRD (DFCII) (2023)

Historically, IDA replenishment cycles have been instrumental in mobilising financial resources to support development efforts in some of the world's most vulnerable countries. To date, some $48.9 billion have been disbursed under IDA-20 with Tanzania having received $2.13 billion among its top five borrowers[1]. Figure 1 presents the trends in gross disbursements between 2018 and 2023.

The World Bank support for DRM under IDA-20 focuses on the following three sets of medium-to long-run interventions:

1. Efficient and Equitable Revenue Management

- First, countries need to ensure efficiency in revenue collection;
- Second, Governments need to make DRM more equitable;
- Third, Africa countries need to fully implement the legal reforms on natural resource governance which could lead to many benefits.

2. Beneficial Ownership

- Beneficial ownership transparency has emerged as an essential means of combating corruption, stemming illicit financial flows and tax evasion;
- 24 African governments have made commitments to beneficial ownership transparency in oil, gas, and mining to comply with the EITI Standards.

3. Tax Policy and Administration

- Improving governance around tax collection can help countries close gaps in DRM, and recover funds previously lost to tax evasion.
- Improving tax enforcement through transparency--beneficial ownership, government budgets, and tax audits--and strengthening judicial and executive oversight can help governments retain these funds.

Concerted IDA Action on DRM

DRM has been a focus of IDA action since the adoption of Country Policy and Institutional Assessment (CPIA) ratings in 1980. DRM is one of the 16 CPIA criteria, under the public sector management and institutions cluster, that determine the allocation of IDA resources and is used to evaluate the performance of IDA action. It is estimated that some 32 IDA countries received support for various aspects of DRM between 2005 and 2019 (IDA 17 and 18) through one or in combination of development policy operations (DPO), investment projects, or the IFC's advisory services on business taxation. IDA 20 continues the institutionalisation of policy commitments aimed at supporting DRM and broader Governance and Institutions.

SSA accounts for:

- 26 of the 36 countries in recipient of DRM support under IDA 20;
- More than half of SSA IDA recipients have tax yields of below the 15 percent threshold.

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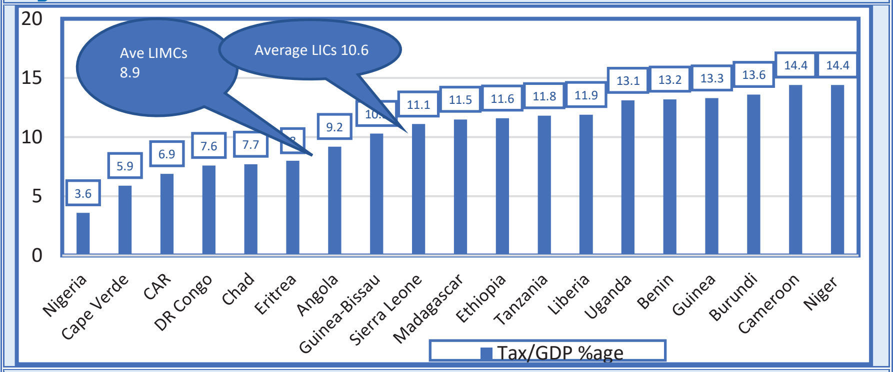
[1] Other leading borrowers under IDA 20 include Bangladesh ($3.2 bil), Ethiopia ($2.82 bil), Pakistan ($2.45 bil) and Nigeria ($2.25 bil). Source: International Development Association - World Bank (Accessed March 26, 2024)

IDA-20 SSA Countries with DRM Below 15% of GDP

Significant fiscal reforms, especially for countries with tax yield below 15% of GDP in Figure 2 below—are urgently needed to rebuild buffers and preserve the sustainability of public finances, while also achieving the region's development goals.

Figure 2: SSA LICs and LMICs with Tax/GDP Yields Below 15%, 2020



Source : OECD/AUC/ATAF, 2020

Although fiscal rules and medium-term budget frameworks are in place in most of these countries, their ability to steer fiscal policy remains limited. Evidence suggests that policy lacks an effective anchor and is excessively focused on short-term goals. Hence, two areas of concern are highlighted:

- Countries in SSA under this category have difficulty sustaining elevated primary surpluses.
- Compared to other regions, fiscal deficit ceilings are breached more frequently and by a larger margin.

Table 1: Tax Yields and Buoyancy Levels for Countries with less than 15% of Tax/GDP

Country	Tax % of GDP, 2020	Tax Buoyancy, 2021	CIT Buoyancy, 2021	PIT Buoyancy, 2021	Country	Tax % of GDP, 2020	Tax Buoyancy, 2021	CIT Buoyancy, 2021	PIT Buoyancy, 2021
Nigeria	3.6	-4.66	2.05	-0.05	Ethiopia	11.6	-0.56	-0.44	0.2
Cabo Verde	5.9	0.89	1.72	0.72	Tanzania	11.8	0.26	0.02	0.05
C A Republic	6.9	3.11	5.69	-9.0	Liberia	11.9	-0.29	0.69	0.97
D. R. Congo	7.6	--	--	--	Uganda	13.1	0.76	3.02	1.24
Chad	7.7	2.2	7.5	-0.24	Benin	13.2	0.22	0.10	-0.53
Eritrea	8.0	-0.25	-2.99	-2.19	Guinea	13.3	-0.2	--	1.25
Angola	9.2	0.25	-2.38	2.18	Burundi	13.6	3.9	0.57	0.67
G-Bissau	10.3	0.76	4.36	10.2	Cameroon	14.4	0.08	-1.39	-0.15
Sierra Leone	11.1	0.12	1.08	-0.64	Niger	14.4	-042	-2.31	-0.13
Madagascar	11.5	1.23	1.89	1.0					

Notes:
- **Tax buoyancy**—Tax buoyancy is an important measurement of tax revenue's sensitivity to changes in GDP. The sign of tax buoyancy is expected to be +ve.
- **CIT Buoyancy—** Corporate Income Tax buoyancy is an important measurement of the CIT revenue's sensitivity to changes in GDP.
- **PIT Buoyancy**— Personal Income Tax buoyancy is an important measurement of the PIT revenue's sensitivity to changes in GDP.

Source: OECD/AUC/ATAF, 2020; and USAID Country Dashboard for Respective Countries, March 2024

Policymakers in these countries face a fundamental tension between elevated development needs and low DRM—this creates difficult policy trade-offs and may lead to excessive indebtedness. As per table 1 above, about a quarter of these economies—especially those with positive tax buoyancy indicators—still have some fiscal space and can use it to continue making vital investments in human and physical capital.

Table 2: Resource-Intensive Countries in SSA / IDA-20 Recipients

Tax/GDP Yields	Country categories	Number of Countries
Below 15%	**Oil Exporters** LMICs Average Tax/GDP—8.7%	4 LMICs—Angola, Chad, Cameroon, Nigeria
	Non-Oil Exporters	2 LMICs—Benin, Tanzania
	LMICs Average Tax/GDP—12.5% LICs Average Tax/GDP—10.3%	8 LICs—C.A.R., D.R.C., Eritrea, Guinea, Guinea-Bissau, Liberia, Niger, Sierra Leone

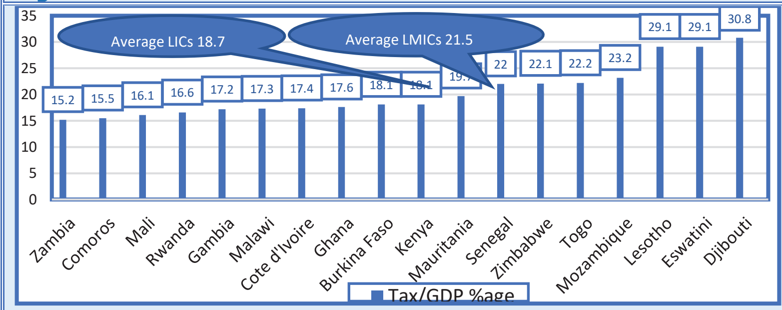
Source: IMF-REO SSA, April 2024

The majority of **resource-intensive economies** in SSA are in this category of countries as per Table 2. While international tax issues are not unique to the extractives sector, the inherently weak capacity and revenue-raising potential of the sector make the issues more pertinent in these SSA countries. The dominant role of MNEs in the extractives sector increases the prospects of transfer pricing and other aggressive tax planning and tax minimization schemes such as trade mis-invoicing, trade-in intangibles, and thin capitalization. The prevalence of tax incentives for mining investments also constitutes a significant challenge.

IDA-20 SSA Countries with DRM above 15% of GDP

The SSA and IDA recipient countries in this category have a much higher revenue buffer than the earlier category of countries—as per Figure 3 and Table 3 below. An interesting element is that a good number of countries under this category are ***Low-Income Countries***. The best case, hence, is that of Mozambique which has a high tax/GDP ratio of 23.2 (Figure 3 below) despite its per capita GDP level of $440—the lowest in the category of SSA countries under consideration. It is, therefore, interesting to briefly view the IDA experience with Mozambique.

Figure 3: SSA LICs and LMICs with Tax/GDP Yields Above 15%



Source : OECD/AUC/ATAF, 2020

Enhancing revenue generation capacity was a sub-objective of Mozambique's second PRSC series (PRSC 3-5). Project development objective indicators (Creation of the Central Revenue Authority and increase revenue as a share of GDP) were met; the revenue-to-GDP ratio reached 17.8 percent in 2009 against a target of 16.8 percent.

Tax reform implementation was good and characterized by continuous efforts to improve the efficiency of the tax administration, consolidation of taxes, and modernization of customs procedures to facilitate trade.

Table 3: Tax Yields and Buoyancy Levels for Countries with more than 15% of Tax/*GDP*

Country	Tax % of GDP	Tax Buoyancy	CIT Buoyancy	PIT Buoyancy	Country	Tax % of GDP	Tax Buoyancy	CIT Buoyancy	PIT Buoyancy
Zambia	15.2	0.54	3.15	0.92	Kenya	18.1	-0.08	-0.38	-0.21
Comoros	15.5	0.69	1.12	-1.12	Mauritania	19.7	-0.11	-0.65	-0.21
Mali	16.1	0.33	0,43	0.71	Senegal	22.0	0.43	1.56	0.6
Rwanda	16.6	-0.44	-0.42	0.64	Zimbabwe	22.1	1.52	-0.29	0.6
Gambia	17.2	-0.18	-1.49	2.09	Togo	22.2	0.29	1.88	1.87
Malawi	17.3	-0.21	-0.2	1.32	Mozambique	1.87	0.12	-0.19	1.0
Cote d'Ivoire	17.4	0.35	0.55	-8.36	Lesotho	29.1	-2.07	2.22	-0.28
Ghana	17.6	0.42	1.64	0.18	Eswatini	29.1	-0.5	-0.59	1.49
Burkina Faso	18.1	0.24	-0.06	1.31	Djibouti	30.8	-0.51	--	--

Source: OECD/AUC/ATAF, 2020; and USAID Country Dashboard for Respective Countries, March 2024

Notes:

- **Tax buoyancy**—Tax buoyancy is an important measurement of tax revenue's sensitivity to changes in GDP. The sign of tax buoyancy is expected to be **+ve**.
- **CIT Buoyancy**—Corporate Income Tax buoyancy is an important measurement of the CIT revenue's sensitivity to changes in GDP,
- **PIT Buoyancy**—Personal Income Tax buoyancy is an important measurement of the PIT revenue's sensitivity to changes in GDP.

IDA Initiatives and Commitments Made for DRM

DRM and IDA Initiatives and Commitments

IDA-20 builds on its previous two predecessors to streamline the operational target for DRM, by retaining the targeted improvements of the unweighted tax-to-GDP ratios of 1 percentage point over the three-year IDA cycle. IDA-20 also extends support for two complementary reforms aimed at enabling digital government services and combating illicit financial flows (IFF), both of which have the potential to spur the effectiveness and accountability of DRM initiatives as well as mitigate against practices that erode the tax base through among others, tax evasion. Continued support for DRM under IDA-20 signals a realization for sustained efforts to address historical and institutional deficiencies that have given rise to persistently low tax yields in some IDA countries.

Table 4: Source and Volume of World Bank Support to DRM

Instrument	Commitments Approved During FY12-15		Commitments Approved During FY16-19	
	Number	*US$ Millions*	*Number*	*US$ Millions*
Investment projects focused on DRM	20	1020	31	1488
DPOs with one prior action on DRM	65	n/a	84	n/a
Trust-funded projects	8	128	9	68.5
Advisory services and analytics	425	47	322	88

Source: World Bank (2023)

A combination of lessons from reforms discontinuity and optimistic forecasting of long-term success of IDA-19's DRM reforms saw a consolidation of DRM reforms in IDA-20. The latter initially aimed to achieve a tax-GDP ratio of at least 15% in the medium term in some 15 IDA countries through support for equitable (fair and progressive) revenue policies. A midterm appraisal of IDA-20 in November 2023, found the coverage of DRM support to have extended to 21 countries, with recipients who had been receiving support since IDA-18 finally recording nominal improvements in their DRM. IDA-20 continues the institutionalisation of policy commitments aimed at supporting DRM and broader Governance.

Attainment of IDA Commitments in SSA

Table 6: Disbursement – Commitment Ratio in SSA, IDA17 - 20

	IDA-17	IDA-18	IDA-19	IDA-20
Eastern and Southern Africa	65%	288%	52%	73%
Western and Central Africa	74%	273%	54%	70%
Africa Regional	78%			
Total Africa	68%	281%	53%	71%

Source: Computed from World Bank (2024)

Sub-Saharan Africa collectively accounts for 77 percent of the US$34.2 billion committed by IDA-20 in 2023. The region was also the recipient of two-thirds of all total IDA-20 disbursements worth US$27.7 billion during the same period. Further, the region accounts for 26 of the 36 countries' recipients of DRM support under IDA-20.

Collectively, the below frontier allocation and disbursement figures make it unlikely that IDA-20 will meet its DRM targets by 2025. Not only do these figures pose risks to the attainment many of the operational targets but the historically low tax yields, creeping reforms fatigue, a stuttering global economic recovery, and the short implementation cycle of IDA-20 further undermine the likelihood of attaining DRM targets in SSA. These challenges are inherently more pronounced in the current context as at least half of SSA IDA recipients face general elections during the replenishment cycle.

Conclusions

a. Countries' Low Tax-to-GDP-Ratio	➢ Many SSA countries are lagging behind their counterparts in Asia and the Pacific, Latin America and the Caribbean, and the OECD.
b. Large Informal Sector	➢ The informal sector is hardly taxed because it is too expansive; players in the sector are not organized and difficult to locate administratively; and cumbersome tax procedures make compliance costs high.
c. The Countries' Resource-Rich Status	➢ Most of the SSA countries with tax to GDP of less than 15% are among the resource-intensive countries, with abundant of mineral resources and others with oil and gas. Despite endowment of huge natural resources, the countries have not been able to collect enough taxes from this sector.
d. High Prospects for DRM Going Forward	➢ Some of the SSA countries are among the countries with big economies in the region with high growth rates over time. It implies that they have strong bases that need to have proper mechanisms to enhance their DRM.
e. Contribution of IDA	➢ In partnership with other MDBs—in particular the IMF and AfDB—and key development partners, the IDA-20 has made valuable contributions to enhance the countries' DRM.

Recommendations

- ✓ **Maximizing Revenue from the countries' natural resources; in particular full Use of Government Audit Rights.**
- ✓ **For improving both the efficiency and equity of the countries' tax system, the following four priorities are recommended**:
  - ➢ *Improving tax policy design to broaden the tax base and increase progressivity and redistributive capacity*.
  - ➢ *Strengthening revenue administration to improve compliance*.
  - ➢ *Implementing structural reforms to incentivize tax compliance, formalization, and economic diversification*.
  - ➢ *Sustained efforts are needed for successful reforms to mobilise domestic revenues in SSA.*
- ✓ **Policy action is needed in three key areas:**
  - ➢ Strengthen the tax policy and institutional framework to broaden the tax base and increase progressivity and redistributive capacity.
  - ➢ Strengthen the adoption, integration, harmonization, and institutionalisation of financial management information systems.
  - ➢ Structural reforms should improve incentives for tax compliance, formalization, and economic diversification.
- ✓ **IDA 21—Targeted Recommendations:**
  - ➢ *Elevate DRM to a standalone thematic policy commitment.*
  - ➢ *Integrate DRM support to complement expenditure management for a balanced approach to public finances.*

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