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Domestic Resource Mobilisation (DRM): an overview of the diverse types of potential

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Author: Dr Sebastian Prediger

Editor: Karla Henning

The debate surrounding development finance has focused on increasing official development assistance and foreign direct investments for decades. But at the UN Conference on Financing for Development in Addis Ababa (2015), focus shifted to mobilising local public and private resources (domestic resource mobilisation, known as DRM) as a main source of development financing. Different approaches to generating or freeing up more local resources are currently under discussion. The most important are:

- Increasing efficiency in the public sector
- Increasing government revenue
- Promoting the private sector
- Developing financial systems
- Preventing capital outflow

Increasing efficiency in the public sector

The comparatively low rates of taxes and levies in developing countries (DCs), which are between 10% and 15% in many low-income countries, are often cited in the debate surrounding DRM. But before new tax-related circumstances can be created or tax rates can be increased, it is advisable to first ensure that the already available resources are used efficiently and effectively ("release effect"). There is enormous potential to increase efficiency and transparency in the public sector (registration systems, tax authorities, cadastral offices, e-procurement, etc.), primarily through the use of digital technologies. Further important measures include reducing unsustainable subsidies (particularly those with regressive effects), taking anti-corruption measures and improving public finance management (for example, by giving auditing offices more support).

Increasing government revenue

Measures aimed at increasing tax rates are under tight constraints in countries with widespread poverty and a high degree of informal economic activity. However, there are still substantial discrepancies between the actual and potential tax revenue in many DCs. One reason is the low collection rate, which could be improved in many places by simplifying tax laws, more carefully reviewing tax exemptions, and resolutely combating tax fraud and evasion. A higher collection rate is also desirable for reasons of fairness.

When creating a new state of affairs with regard to taxation, it is important to carefully assess the effects on poverty and wealth distribution. Experts see particular potential here in taxing the economic elite, especially with higher property taxes in rapidly growing urban areas. Collecting government levies for specific purposes, such as in the form of appropriate user fees for water or waste disposal, is also a way to increase local revenue. Compared to general tax increases, charges for specific purposes represent a direct service, which is often perceived as fairer ("costs-by-cause principle") and can increase willingness to pay.

Promoting the private sector

A flourishing private sector not only expands the tax base; it can also lessen the government's burden on the expenditure side (e.g. through lower social spending). Many tasks that the government performs in DCs could be more efficiently performed by an effective private sector. The government can promote private sector involvement with intelligent economic policy, directing local private funds into sectors identified as a priority in terms of development policy (e.g. also by directly promoting companies in ways that are in line with the market, or by launching funds oriented towards development policy).

Developing financial systems

A functional financial sector is of critical importance for economic development and DRM, promoting savings and generation of money while ensuring that savings are used in the most efficient way possible (investments). It facilitates access to (long-term) loans, which is a key constraint for private sector development, and thus also mobilises private (equity) capital for local investments. Promoting local capital markets (stock exchanges, corporate and government bonds) is also a way to mobilise additional funds from private and institutional investors. Possible approaches lie in expanding offers for financial products, improving access to the financial sector and improving regulation.

Preventing capital outflow

A major challenge for many DCs is that a significant portion of locally generated funds are not even used within the country and are instead transferred abroad. The exact extent of legal and illegal capital flight cannot be reliably determined. For example, experts estimate that at least 30% of African assets are parked in off-continent "safe havens" – money that could facilitate substantial developmental effects if it were to be invested in the domestic economy. Another problem is the (usually legal) "tax optimisation" on the part of multinational corporations (base erosion and profit shifting, or BEPS), which also causes countries to lose billions in tax revenue each year. Harmonising tax laws internationally is the only thing that will be able to remedy this in the long term. Improving the general economic and political conditions and thus the conditions for capital expenditures and investments is the most effective instrument to combat legal capital flight. At the same time, stricter measures must be taken against illegal forms of tax evasion.

Conclusion: much potential remains unexploited

Financing sustainable development goals requires much stronger mobilisation of national resources in DCs than has been achieved to date. Numerous places have not exploited this potential. There are many options that international development cooperation can pursue to help DCs unlock this potential. ■

Note: This paper reflects the opinion of the authors and does not necessarily represent the position of KfW.