THE IMPERATIVES FOR DOMESTIC RESOURCE MOBILIZATION FOR SUSTAINED POST-CRISIS RECOVERY AND GROWTH IN SUB-SAHARAN AFRICA

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And

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Abstract

The recent global financial and economic crisis has demonstrated the futility of continued dependence on foreign aid for financing economic growth in Sub-Saharan Africa (SSA). Genuine drive toward sustained post-crisis recovery growth, development and transformation will remain elusive if special efforts are not directed at improving domestic resource mobilization (DRM) and utilization. This paper articulates the imperative for DRM by analyzing the gamut of issues surrounding it in SSA. Employing Arellano-Bond GMM technique on a panel of 38 SSA countries, savings and investment turn out to be the only DRM variables that contribute positively and significantly to economic growth while all the tax revenue variables are insignificant, suggesting the need for improving the DRM process. For sustained post-crisis recovery, economic growth, development and transformation of SSA countries, emphasis should be placed on developing the local revenue mobilization and management process, reforming the tax system to promote harmonization and a shift away from tax exemptions, concessions and holidays, developing incentive schemes for punishing corrupt tax officials and rewarding upright ones, reforming the financial sector, leveraging IT to improve savings mobilization, reforming the global aid architecture with clear path for African countries to exit aid dependency and improve the business environment.

Key words: Domestic Resource Mobilization, post-crisis recovery, sustained growth, sub-Sahara Africa.

JEL Classification: E21, E22, E6, H2

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1. Introduction

Domestic resource mobilization is the only real key to sustained economic growth, development and transformation in all economies and this is even more so in Sub-Saharan Africa (SSA). The advent of the global financial and economic crisis has further reinforced the need for African countries to intensify efforts aimed at developing strategic policies for mobilizing domestic resources for long-term economic growth, especially at this recovery stage (AfDB 2010). This is imperative because the crisis has revealed the futility of continued dependence on aid from donor countries and development partners as the source for required financial resources to finance sustained economic growth. The crisis caught almost all the developed countries off-guard as their economies sank into recession. Thus, to some extent, aid pledges were not delivered because the donor countries were concerned with rescuing their battered economies, with limited attention to the plight of developing countries – the innocent victims of the crisis.

While foreign aid has its own place in financing economic growth in African countries and this should be a supplement to domestic resources, it should not be relied upon as a means for sustained, long-term financing because it rather deepens the dependency of African countries on the aid-giving countries and institutions. It also reduces the policy space available to African countries given the aid conditionality that are usually attached to the aid extended. Furthermore foreign aid as a means of financing sustained growth and development blinds some African countries to their domestic wealth potentials that could be harnessed for financing long-term growth and transformation. On the other hand, domestic resource mobilization is advantageous on several grounds. It remains the biggest source of long term financing for sustained growth, development and provision of public goods and services for the teeming population. In addition, domestic resources and use strengthens the governance, fiscal and capital market institutions and further fortifies the social and fiscal contract between the government and its citizens. Furthermore, it reduces aid dependency. In fact, the Monterrey Consensus in Financing for Development (UN, 2003) emphasizes that aid should be provided as a short-term financing strategy while developing aid-dependent countries should commit to enhancing domestic resource mobilization in the long term.

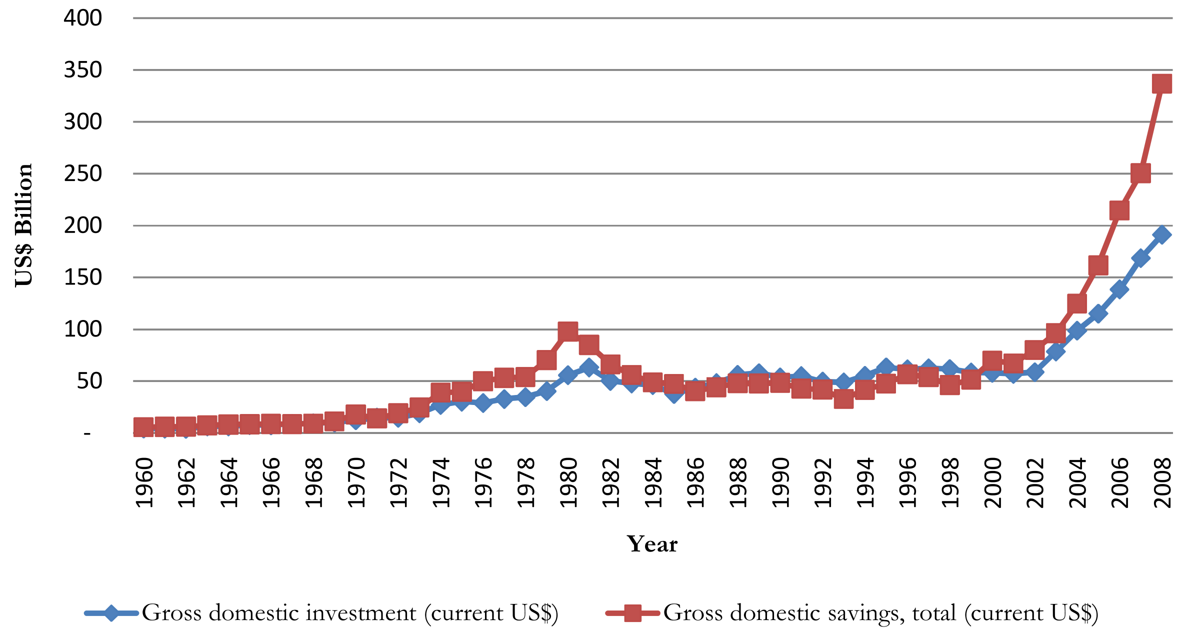
This paper argues that while domestic resource mobilization is long acknowledged as the key to sustained long-term economic growth in African countries, the recent global financial and economic crisis has made this even more imperative. The paper reviews the historical data on domestic resource mobilization in African countries. Relying on both general and country-specific and stylized facts on domestic resource mobilization and empirical assessment of the effects of domestic resources on economic growth in SSA countries, the paper articulates the challenges facing African countries in their domestic resource mobilization efforts. The paper ends on a positive note by providing innovative, country-specific, regional and continental initiatives for improving domestic resource mobilization in SSA countries. These include specific policy prescriptions on strengthening the domestic institutions (governance, tax, trade, legal, etc.); broadening the tax base; tackling tax flight, tax evasion tax avoidance and corruption; and transparency.

Following this introduction, section 2 provides a synthesis of the stylized facts on domestic resource mobilization in SSA countries using historical general and country-specific data. Section 3 provide empirical evidence on the effects of domestic resource mobilization on economic growth in a panel of selected 38 SSA countries. Section 4 articulates the real and potential challenges to successful drive toward domestic resource mobilization in SSA. Specific policy actions for improving the domestic resource mobilization drive in SSA is the focus of section 5 while section 6 concludes the paper.

2. Stylized Facts on Domestic Resource Mobilization in Sub-Saharan Africa

Contrary to general belief, domestic savings and investment is high in most SSA countries. Several efforts have been made by SSA countries to improve domestic savings and investment in the region. These include fiscal restraint, financial sector reform that has strengthened financial institutions and made them more vibrant, political and macroeconomic stability, reduced armed conflict and civil strife and engagement of new economic actors such as China and India. In addition, several exogenous factors appear to be working in favor of the region to promote domestic investment and savings. Some of these are international commodity price boom, widespread bilateral and multilateral debt reliefs, especially the Highly Indebted Poor Countries initiative and Multilateral Debt Relief Initiative, and growing domestic market. These factors have improved domestic savings and investment, especially in recent times.

Figure 1: Current Domestic Savings and Investment in SSA, 1960-2008



Source: Based on Africa Development Indicators 2010 Database

Table 1: Average Domestic Investment and Savings in Selected SSA Countries, 1960-2008 (% GDP)

	1960-69	1970-79	1980-89	1990-99	2000-08	1960-69	1970-79	1980-89	1990-99	2000-08
	Savings					**Investment**				
Benin	2.52	0.86	-2.49	3.41	5.64	10.87	15.53	15.13	16.32	17.82
Botswana	-3.91	21.12	35.27	39.68	52.08	18.64	42.82	29.96	30.02	38.75
Cameroon	11.33	18.28	24.16	18.48	18.82	12.74	21.37	23.80	14.76	18.34
Cote d'Ivoire	28.39	27.36	19.63	17.81	19.01	19.35	24.09	16.46	11.31	10.08
Ghana	11.35	10.15	4.75	7.53	6.46	15.49	10.20	7.81	19.94	27.55
Kenya	17.91	20.20	18.32	14.61	9.35	16.48	23.21	23.17	18.31	18.29
South Africa	25.92	29.07	28.48	19.44	18.38	22.98	27.64	23.43	16.66	18.22
Uganda	14.75	9.96	2.31	4.32	7.73	12.17	9.73	8.52	16.05	21.04
Zambia	39.56	33.19	14.05	8.96	17.22	24.68	30.20	16.11	14.56	22.35
Zimbabwe	16.81	19.19	16.50	16.90	7.16	15.88	18.89	17.27	19.47	12.37
SSA	**19.31**	**28.77**	**22.17**	**14.49**	**24.72**	**16.79**	**20.12**	**19.30**	**17.85**	**17.81**
East Asia & Pacific	19.77	28.63	33.3	36.27	36.10	N/A	28.59	32.89	37.82	40.97
Latin America& Caribbean	20.19	23.29	21.0	20.23	20.23	20.03	22.23	23.07	19.33	21.38
Middle East& North Africa	21.18	26.64	26.9	26.28	25.69	20.23	23.23	18.03	20.89	28.17
South Asia	15.13	16.98	21.2	22.75	29.09	12.87	15.31	17.31	20.76	25.85

Source: Africa Development Indicators 2010 Database

Figure 1 presents the historical trend in domestic investment and savings in SSA. A major observation is that they both remain relatively low until very recently, specifically in 2000 with a rise in domestic savings to almost $70 billion from the previous year that stood at $51 billion. From that point onward, the figure has been rising steadily to peak at about $337 billion in 2008, with an annual average of about $156 billion between 2000 and 2008. Similar trend is observable for domestic investment that rose steadily to peak at $191 billion in 2008. Referring to Table 1, it is clear that several SSA countries are working very hard to improve domestic savings and investment. However, the basic trend is a reduction in domestic savings in all the representative countries except Benin, Botswana and Cameroon. With respect to investment, most of the countries experienced improved performance with Botswana topping the chart with over 100% increase on annual average between the 1960s and 2000s followed by Uganda that almost attained this feat. Another good performer is Ghana with a rise in annual average investment from 15.5% in the 1960s to 27.6% in the 2000s.

Resource mobilization through tax and financial instruments are poor in most SSA countries. While the general picture suggests some improvements in tax revenues in SSA countries, a closer look shows poor performance across countries (See Table 2). There are perceptions that the variance is most observable between the resource rich and non-resource rich group of countries (Keen and Mansour 2009). On average, total tax revenues per GDP was 16%, with company income and personal income tax yielding the lowest tax revenues. One trend that cuts across most SSA countries in their tax revenue mobilization efforts is that tax revenues are dominated by trade tax.

In particular, trade tax far exceeds company and personal tax revenues by multiples in many cases. The only exception being South Africa and Tanzania. It is noteworthy that countries with relatively more developed economies appear to be mobilizing more tax revenues through personal income tax as opposed to less developed countries. Thus, South Africa is leading in this respect, with 6.8% personal income tax as percentage of GDP, while Nigeria and Ethiopia recorded one of the least with less than 1%. Indeed, most African countries need to do more in this respect as the personal income tax mobilized was less than 2% of GDP. While it does not appear true that resource rich SSA countries are able to mobilize more revenues compared to their resource poor counterparts, what is indeed true is that resource rich countries are able to raise more revenues from resource taxes, explaining the high tax revenues of 29.7%, 26.2% and 25.2% in Botswana, Gabon and Nigeria, respectively. Apart from Cameroon, South Africa and a few other resource rich countries, other countries in this class raise double digit resource tax revenues as a percentage of GDP. Another interesting observation about tax revenues in SSA is the structural differences across countries. South Africa, Burundi, Ghana and Tanzania are leading the chart in mobilizing indirect taxes, while Botswana and Nigeria are seriously lagging.

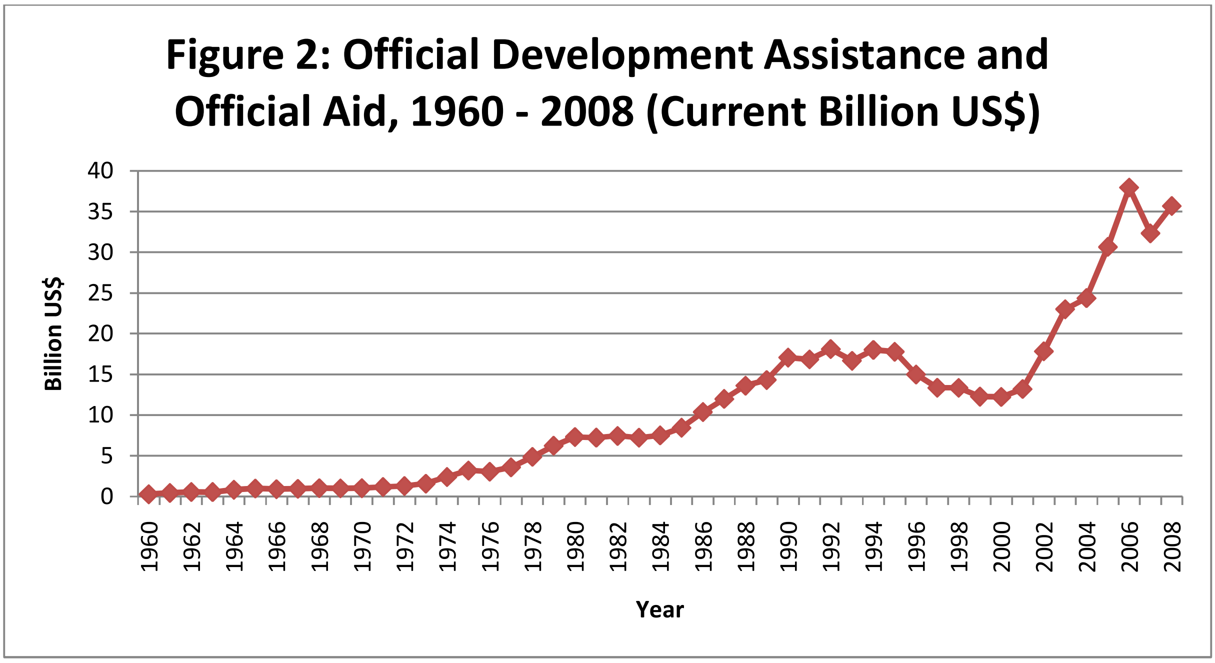
This tends to justify the view that resource rich countries are less vigorous in mobilizing non-resource tax revenues. Large informal sector with activities that go unaccounted for is a major determining factor in the low revenue mobilization in most SSA countries. In some of these countries, informal sector activities account for almost 50% of economic activities go untaxed. In addition, many SSA countries have very porous borders where smuggling and underground activities thrive. Since these activities are illegal, they remain untaxed, thereby denying the government of a huge tax revenue income.

Table 2: Tax Revenues in Selected SSA Countries, 1980 – 2005

Country	Total Taxes / GDP	Trade Tax Revenue / GDP	Indirect Taxes / GDP	Income Taxes / GDP	Company Tax / GDP	Personal Tax / GDP	Resource Revenue/ GDP
Benin	11.9	4.5	3.6	3.2	1.3	1.0	
Botswana	29.7	6.6	1.2	3.7	2.0	1.7	17.6
Burundi	15.0	4.2	6.5	3.8	1.9	1.7	
Cameroon	13.9	2.5	3.7	2.6	1.2	1.1	4.2
Ethiopia	9.5	2.0	3.7	3.3	2.0	0.9	
Gabon	26.2	4.7	3.5	3.3	1.8	1.3	13.9
Ghana	12.8	3.7	5.6	3.5	1.8	1.3	
Nigeria	25.2	2.5	1.5	1.9	1.2	0.8	17.6
South Africa	19.5	0.8	6.6	9.9	3.2	6.8	1.1
Tanzania	11.4	1.4	5.6	3.3	1.6	1.1	
SSA	16.1	5.1	4.1	3.9	1.7	1.8	

Source: Keen and Mansour 2009.

SSA countries are highly aid-dependent, undermining and stifling domestic resource mobilization efforts and further blinding several SSA countries to their domestic revenue potentials. Africa is a substantial recipient of all forms of aid, ranging from humanitarian to food, project and budget support. Since 1966 to date, SSA has consistently received a higher percentage of the total volume of world aid flow compared to other developing regions of the world (see Figure 2 and Table 3). In 2003, for instance, Sub-Saharan Africa received a total share of 31.2 percent of world aid, just a little below what was received by East Asia, Latin America, Middle East and North Africa and South Asia put together. Between 2006 and 2008, cumulative increase in ODA was almost 50% in nominal terms and 30% in real terms (Africa Partnership Forum 2010). In 2008 alone, SSA countries received $22.5 billion out of the total $26 billion net bilateral ODA from DAC donors to Africa. A critical factor that may be responsible for the large inflow of aid to Sub-Saharan African are the series of wars, conflicts and natural disasters that have ravaged the region in recent times. Thus, a greater portion of aid to the region may at best have been targeted at disaster control and humanitarian relief rather than growth. Even more recently, the food and oil crisis and ultimately the global financial crisis have all worsened the fiscal positions of most governments of SSA countries, thus necessitating the need for more foreign assistance. While aid has brought a great relief to poor SSA countries and has financed very useful development and poverty reducing projects, it tends to instill in many countries the feeling of complacency with respect to domestic resource mobilization, thus seriously limiting the revenue potential from these sources. Moreover, steady aid inflows tend to distort the original role of aid in economic growth, namely, supplementing domestic resources.



Source: Africa Development Indicators, 2010.

Table 3: Regional Distribution of Foreign Bilateral Aid, 1986 – 2007.

Region	1986-1987	1996-1997	2006-2007
Sub-Saharan Africa	26.6	23.4	31.3
South and Central Asia	12.9	10.2	10.5
Other Asia and Oceania	18.2	21.4	12.7
Middle East and North Africa	16.0	12.7	16.1
Latin America and Caribbean	11.5	13.3	7.4
Europe	2.5	3.4	3.6
Unspecified	12.3	15.6	18.4

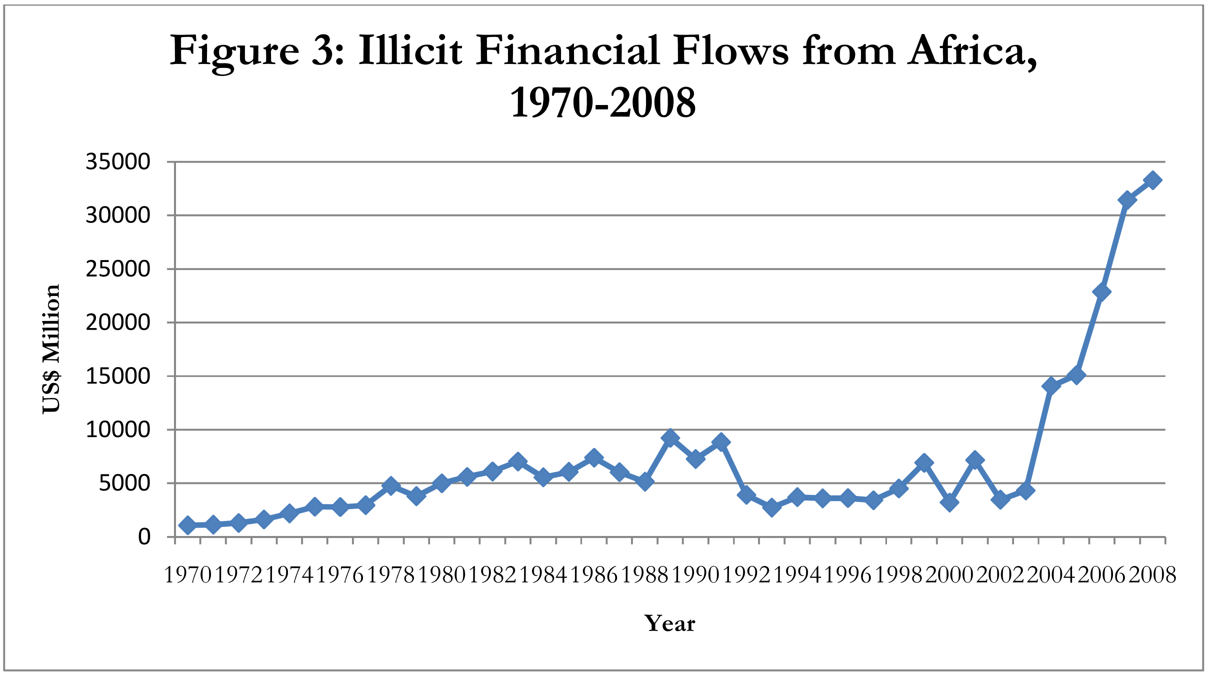
Total Bilateral	**100**	**100**	**100**

Source: OECD 2009

Domestic revenue remains the most important source of development finance in SSA. There has been significant increase in domestic revenue mobilization for development financing in most SSA countries beginning from the late 1990s and continued despite the negative effects of the recent global financial crisis. For instance, between 2007 and 2008, domestic revenue for development finance in SSA countries increased from 70% to 76% (Africa Partnership Forum 2010). It is true, however, that there exists a large variation across countries in the region given their different characteristics that include net oil importing, net oil exporting, middle income and low income status. A very important observation, is that the rise in domestic revenue for development finance is cross-cutting, largely driven by the substantial increase in commodity prices in the period preceding the global economic recession. However, challenges remain for domestic revenue mobilization in Africa as billions of dollars are lost annually from unscrupulous sources.

Capital flight is rife. The issue of capital flight as a constraint to domestic resource mobilization has been long recognized (Ajayi and Khan 2000; and Boyce and Ndikumana 2001). A recent estimate submits that illicit financial flows from Africa totaled $854 billion between 1970 and 2008 (GFI 2009). This estimate can be adjudged to be conservative since it focuses only on one form of trade mispricing without consideration for smuggling and services mispricing. When these other sources of illicit capital flows were included, the estimate is believed to worth $1.8 trillion. This is ludicrous and even preposterous when one observes that total ODA flows from all donors was $144.7 billion during the same period. This implies that Africa has lost more capital than it had received from all donors over time.

Commercial tax evasion, mainly trade mispricing is by far the largest component of illicit capital flight, accounting for between 60 and 65% of total leakages. This is followed at a very far distance by criminal activities such as drug trafficking, racketeering and counterfeiting that accounted for between 30 and 35% while corruption by government officials took 3% of the total flows. In many cases, these invaluable social capital is lost through several sources, prominent among which are corruption, direct theft, bribery by top leaders, government officials and their cronies. The underlining root causes of capital flight in SSA can be broadly classified into push and pull factors. The push factors are risk of confiscation resulting from the illegitimate wealth acquisition, attempt to circumvent domestic regulations such as foreign exchange restrictions or sheer reluctance to pay tax on legitimate wealth. Similarly, the pull factors include weak international regulatory system, low risk of detection, lax regulation, and low risk of prosecution as a result of lack of co-operation between countries.



Source: Based on GFI 2009.

Table 4: Illicit Financial Flows in Selected SSA Countries, 1970 – 2008 (US$ Million)

	1970-79	1980-89	1990-99	2000-08	2006	2007	2008	Total
Angola	0.0	0.0	538.2	2643.9	2707.0	7416.9	2458.4	29178.0
Benin	0.7	53.6	8.6	13.3	0.0	0.0	0.0	873.0
Botswana	0.0	31.7	77.2	385.8	655.1	243.7	0.0	4530.0
Cameroon	75.1	77.3	478.4	131.8	0.0	0.0	0.0	7938.0
CAR	1.0	18.6	5.2	0.0	0.0	0.0	0.0	253.0
Congo Republic	3.3	282.5	57.0	678.0	1829.3	0.0	0.0	9238.0
Equatorial Guinea	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ethiopia	12.6	543.3	181.4	234.0	0.0	277.8	0.0	9508.0
Gabon	16.5	151.6	190.4	596.0	0.0	0.0	0.0	9445.0
Ghana	33.2	135.1	129.0	96.8	0.0	0.0	17.7	3939.0
Kenya	14.1	183.1	99.6	116.4	0.0	0.0	0.0	4002.0
Nigeria	283.7	2504.0	1568.8	15837.7	18739.8	28597.5	43638.0	185821.0
Senegal	27.1	67.2	27.2	8.3	0.0	0.0	0.0	1262.0
Sierra Leone	0.8	42.5	37.5	21.6	0.0	0.0	0.0	1002.0
South Africa	0.0	0.0	54.3	1844.4	0.0	0.0	0.0	17143.0
Tanzania	161.8	293.6	0.0	178.6	0.0	0.0	0.0	6000.0
Uganda	0.0	108.9	26.0	161.7	0.0	0.0	583.1	2804.0
Zambia	0.5	195.8	3.2	162.4	0.0	756.1	94.2	4046.0

Zimbabwe	32.1	100.0	27.6	0.0	0.0	0.0	0.0	1564.0
Total SSA	1164.9	6859.7	4734.0	25826.3	25988.6	39654.4	48715.1	352,985
Total Africa	2413.3	11255.7	6178.5	30537.3	38258.8	53466.4	52906.3	476480.0

Source: GFI 2010.

Table 4 shows that while illicit capital flows from SSA countries date back to the 1970s, the magnitude being experienced today is a recent experience. Nigeria by far account for the total illicit capital flows from SSA countries amounting to a cumulative value of about $190 billion between 1970 and 2008. This is followed by Angola with total illicit capital flows of about $30 billion during the same period. While it remains true that illicit capital flows are also pervasive in resource poor countries like Ethiopia, resource rich countries are dominant drivers of illicit capital flows in the region. While Africans engaged in these heinous activities that significantly starve the continent of the much needed resources for development are culpable, the international community is equally blamable for the development of and encouraging money laundering systems such as trade mispricing, anonymous trust accounts, tax havens, disguised corporations, and fake foundations.

Widespread Tax flight. A very important direct consequence of capital flight is tax flight involving both individuals and multilateral corporations. Capital flight induces a loss in wealth that otherwise would have been subject to tax in the domestic economy. Several types of actions resulting in tax flight in SSA countries are: trade mis-invoicing (over-pricing imports and under-pricing exports); outright smuggling of valuable items such as diamond, gold, illegal drugs, cash, antiques, etc; disguising and mis-reporting bank wire transfers through illicit means that involve distorting information about its source, ownership, destination and purpose; mis-pricing financial transfers that involve payments for foreign purchases, royalties, interests, and fees; and transfer mis-pricing between affiliates of a multi-national corporation or between the affiliate in a host country and head office in the home country.

The stylized facts on domestic resource mobilization, use and management in SSA countries reveal serious need for reforms and policies aimed at correcting the current lopsidedness. It has shown the progress made and where the weaknesses lie. It is also shown the role of the international community in stifling domestic resource mobilization, thus indicating that concerted efforts are required to correct the observed anomaly.

3. Evidence on the Effects of Domestic Resources on Economic Growth in SSA

3.1 Theoretical and Empirical methodology and data description

The goal of this section is to provide empirical evidence on the contributions and importance of domestic resources to economic growth in selected SSA countries. The sample consists of a balanced panel dataset comprising 38 countries over the period 1980-2007. We follow the conventional specification and methodology used in the growth literature, though rarely used for studies based on SSA countries.

The standard growth regression usually estimated in the growth literature which we estimate for the selected SSA countries is as follows:

$$\ln Y_{i,t} = a_0 + \partial \ln Y_{i,t-1} + \beta' X_{i,t} + \lambda_i + \lambda_t + \varepsilon_{i,t} \quad (1)$$

The dependent variable (Y_{it}) is per capita real GDP of SSA country i at time t. The explanatory variables are the initial per capita GDP (Y_{it-1}) and a set of other explanatory variables (X_{it}) that vary across both countries and years. The term λ_i represents the unobserved country-specific effects such as policies and institutions that may be important determinants of growth. On the other hand, λ_t is an unobserved time-specific effect while ε_{it} is the time-varying regression residual. The subscripts i and t denote SSA country and time period respectively, while $\ln$ symbolize logarithm.

The presence of the lagged dependent variable (Y_{it-1}) combined with that of the fixed effects (λ_i) renders the OLS estimator inconsistent, given that λ_i is by construction correlated with the error term (ε_{it}). There is also the high likelihood that other explanatory variables might be correlated with the fixed effects. Thus, every coefficient has the potential of being biased. The challenge, therefore, is to estimate a consistent and unbiased dynamic growth model for the selected countries. The first step in achieving this is to eliminate the fixed effects. But then, the Within OLS estimator which could do this is no better technique since the equation is in differenced form, implying that the new error term ($\varepsilon_{it} - \varepsilon_{it-1}$) is by construction correlated with the lagged dependent variable $Y_{it-1} - Y_{it-2}$ (see equation 3). Thus, neither the OLS estimator nor the Within estimator are appropriate for estimating dynamic growth equations. Another problem we have to grapple with is omitted variables, which could be variant or invariant. The inclusion of the fixed effects λ_i allows us to control for invariant omitted variables. There is also the probability of endogeneity of some of the explanatory variables. For instance, faster growing SSA countries might adopt technologies and innovations that would induce increased productivity growth in sectors and activities that contribute to the GDP.

Many studies in the empirical growth literature address all these issues by relying on the Arellano-Bond Generalized Method of Moments (GMM) estimator proposed by Arellano and Bond (1991). This estimator technique controls for omitted invariant variables and corrects for the potential endogeneity of some explanatory variables by using internal instruments. In addition, the procedure controls and eliminates the unobserved individual-specific effects λ_i by first-differencing the growth equation.

The Arellano-Bond Generalized Method of Moments (GMM) estimated growth equation is of this form:

$$\ln y_{i,t} - \ln y_{i,t-1} = a_0 + \alpha(\ln y_{i,t-1} - \ln y_{i,t-2}) + \beta'(X_{i,t} - X_{i,t-1}) + (\lambda_i - \lambda_i) + (\lambda_t - \lambda_{t-1}) + (\varepsilon_{i,t} - \varepsilon_{i,t-1}) \quad (2)$$

In this framework, the explanatory variables that are assumed endogenous or predetermined can be instrumented and the validity of such instruments can be tested. To correct for the endogeneity problem, the Arellano-Bond GMM procedure employs lagged values of the corresponding endogenous variables as internal instruments. More specifically, endogenous variables are instrumented by lags from at least two periods and deeper and a pre-determined variable is instrumented by lags from at least one period and deeper. This demands some assumptions on the endogeneity or exogeneity of the explanatory variables included in the growth model. The explanatory variables can be strictly exogenous to growth or predetermined or endogenous.

For the purpose of this study, the following differenced GMM model is specified for estimation:

$$\ln Y_{i,t} = a_0 + \partial \ln Y_{i,t-1} + \beta' X_{i,t} + \lambda_i + \lambda_t + \varepsilon_{i,t} \quad (3)$$

It is pertinent at this juncture to elucidate on the explanatory variables contained in the row vector of explanatory variables (X). These are domestic resources (savings, investment, indirect tax on goods and services and tax on production), labour measured as the economically active population, institution, governance, infrastructure measured as the number of both mainlines and mobile lines per 100 persons, human capital denoted by the secondary school enrolment rate, urbanization and trade openness. The model is estimated with the robust option to correct for heteroscedasticity.

The consistency of GMM estimation holds only if lagged values of explanatory variables are valid instruments. To ascertain this, two post-estimation diagnostic tests are provided. The Sargan test for the overall validity of the instruments is reported to determine whether lagged and first-differenced values of endogenous or predetermined explanatory variables are valid instruments. Another specification test examines whether the residual of the regression in differences is second-order serially correlated. While first-order serial correlation is expected, second-order serial correlation must be rejected to confirm the correctness of our model specification.

For the empirical purpose of this paper, thirty-eight (38) SSA countries[1] are chosen based purely on data availability. All data are annual across the selected countries, spanning 1980-2007. Effects of domestic resources on growth is the central focus of this section. As earlier, indicated domestic resources are represented by domestic savings, domestic investment, domestic tax on goods and services and domestic tax on production. All these variables are in real terms. Growth is measured as

[1] Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Cote d'Ivoire, Ethiopia, Gabon, The Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Senegal, South Africa, Sudan, Swaziland, Togo, Uganda, Zambia and Zimbabwe.

annual per capita GDP growth in percentage. Domestic resources are expected to exert positive influence on growth. There is no final word on the best proxy for infrastructure in a study of this nature. However, we are constrained by data availability to use the number of telephone lines available, measured as both mainlines and mobile telephone subscribers per 100 persons. In our measure of human capital, we use education attainment, namely, the gross total secondary school enrolment ratio expressed in percentage. A positive relationship is expected between human capital and economic growth. Similarly, a positive sign indicates that governance makes a positive contribution to economic growth. To capture issues of governance and institutions, we employ the Polity IV Project Database. The Revised Combined Polity Score otherwise known as Polity 2 is employed as a measure of governance. This score is computed by subtracting the institutionalized autocracy indicator from the institutionalized democracy value indicator. The score ranges from -10 to 10 where higher score implies better governance. To capture the effects of institutions, we follow Tabellini (2005) in using constraints on the Executive, as defined in the Polity IV Database. According to this criterion, better political institutions means that the holder of executive powers is accountable to bodies of political representatives, and government authority is constrained by checks and balances and by the rule of law. The value varies from 1 (= unlimited authority) to 7 (= accountable executives constrained by checks and balances). Higher values thus correspond to better institutions. For details on the governance and institution data, its components and computations, please see Marshall and Jaggers (2009).

3.2 Empirical Results and Discussion

The estimated results on the effects of domestic resources on economic growth in the selected SSA countries are reported in Table 5. The Sargan tests conducted on each model are reported with a view to assessing the validity of the over-identifying restrictions. The results reveal a failure to reject the null hypothesis that the over-identifying restrictions are valid in all cases. All the results confirm the absence of second-order autocorrelation. Consequently, the estimated coefficients reflect the true (efficient and unbiased) relationship between domestic resources (our variables of interest) and the traditional pre-determined and endogenous determinants of growth, on the one hand, and per capita GDP growth, on the other.

It is interesting to note that our domestic resources variables have the right sign in the growth models except for tax on goods and services. However, only investment and savings are exerting significant positive effects on growth, with respective estimated coefficients of 0.45 and 0.36.

A possible explanation for the insignificant effects of tax revenues on economic growth in SSA countries is the low tax revenue yield and mobilization in the countries. As earlier discussed several factors are responsible for this outcome. However, one of the most challenging of these is singled out for emphasis here: corruption. Evidence abounds that corruption reduces tax revenues in the long run (Tanzi 1991; Fjeldstad and Tungodden 2001). It is also noteworthy that corruption is an important determinant of the large shadow economy in SSA countries, the growth of which has further reduced tax revenues accruable to the countries. Other channels through which corruption reduces tax revenues and growth are that it discourages both local and foreign investors, reduces the productivity of social investment on growth enhancing infrastructure such as roads, railways, health, water and electricity. Thus, the long-recognized fact that reducing corruption will have significant positive impact on tax revenues mobilization and ultimately on economic growth in SSA countries has never been more imperative than now (Ghura 1998; and Tanzi and Davoodi 2000).

Table 5: Panel data estimation of the effects of DRM on growth in SSA countries for 1980-2007 using the Arellano-Bond GMM estimator.

Explanatory Variables	Models: Dependent variable is Y_{it}, per capita GDP Growth			
	(Investment)	(Savings)	(Tax G&S)	(Tax Prod)
Y_{it-1}	-0.0517 (0.0786)	-0.1520* (0.0840)	-0.0224 (0.0936)	0.0172 (0.0767)
Labor	-0.2267* (0.1364)	-0.1732 (0.1637)	-0.0306 (0.1527)	-0.2134 (0.1403)
Domestic Resources	0.4493** (0.1516)	0.3601*** (0.1057)	-0.2201 (0.3951)	0.2694 (0.1743)
Governance	0.6114 (0.5886)	0.2153 (0.6156)	-0.6425 (0.7775)	0.6563 (0.6153)
Institution	-0.2252 (1.5636)	0.9920 (1.5963)	3.8448* (2.1432)	-0.3210 (1.6276)
Infrastructure	-0.0057 (0.1303)	0.0830 (0.1412)	0.3659** (0.1674)	0.0672 (0.1268)
Human Capital	-1.1039** (0.4313)	-1.1259* (0.4248)	-1.3392* (0.7220)	-0.6884* (0.3720)
Urbanization	0.4718** (0.2333)	0.1888 (0.2324)	0.1346 (0.2794)	0.4612* (0.2382)
Openness	0.5231 (0.5093)	0.8807 (0.5134)	0.1683 (0.6529)	0.5191 (0.5337)
Life Expectancy	-5.3056** (1.7201)	-5.1079*** (1.8459)	-11.6929*** (2.8647)	-5.2797*** (1.7784)
Sargan test, p-level	0.314	0.278	0.178	0.286
Observations	1,064	1,064	1,064	1,064
AR(1) test, p-level	0.0010	0.0030	0.0051	0.0004
AR(2) test, p-level	0.4915	0.5064	0.5857	0.6433

Note: Standard errors are in parentheses. ***, ** and * represent respectively statistical significance at the 1%, 5% and 10% levels.

4. Challenges of Effective Domestic Resource Mobilization in SSA

SSA countries face several daunting challenges in the efforts to improve domestic resource mobilization. Some of these challenges are briefly examined here. SSA countries are faced with economic and financial vulnerability resulting from high dependence on resource exports, official development assistance, bilateral and multilateral aid, foreign private capital flows and other forms of external finance. In addition, the economies are highly susceptible to external fluctuations resulting from the high dependence on resource exports.

Domestic resource mobilization in SSA countries is also challenged by shallow domestic revenue base. In most African countries, the bulk of the population is engaged in the informal sector while several others are experiencing different forms of unemployment. Moreover, industrial, manufacturing and general corporate activities are very limited. In several SSA countries, the informal sector accounts for around 90 percent of employment and close to half of total economic activities. This suggests that the bulk of activities going on in these very important sectors are untaxed either through direct taxes or VAT. The current wave of Export Processing Zones in SSA countries with its accompanied tax exemptions and waivers tend to further reduce the tax base of the economies. The existence of these exemptions fuel corrupt, tax evasive and tax avoidance schemes that seriously minimize tax mobilization. To further worsen the situation is the widespread poverty that makes the potential income tax payers smaller.

Business environments are relatively harsh in many SSA countries. Generally, these countries are consistently at the bottom rung of the World Bank's Doing Business. Doing business can be very complicated in several SSA countries. This begins with the poor or absence of stable and transparent regulatory mechanisms for doing business. Property rights are not well defined and the legal and law enforcement institutions are limited in their abilities to provide redress in the case of perceived or real frictions. Furthermore, there is a high level of uncertainty with respect to what is required for starting and operating business. In many countries, the procedures for starting business are so cumbersome given the several activities involved, spanning across institutions that are geographically located and over a long period of time. In Cameroon, for instance, there are 12 procedures in starting business, costs about 18% of the value of a property to register such property, requires 800 days to enforce a contract and takes 1,400 hours to prepare, file and pay taxes. It is interesting to note, however, that several African countries have been undertaking reforms that have significantly improved the business climate. Some typical examples are Botswana, Rwanda and Ghana, with some of these countries ranking in the top ten of global reformers.

Weak domestic capacity in negotiating concessions and contracts in resource extraction with foreign and multinational corporations reduces the real and potential revenues from such deals. One noteworthy feature of resource extraction negotiations between SSA countries and multinational corporations is that the terms tend to tilt in favor of the foreign investors. This is usually the product of ineffective negotiation skills. In addition to directly reducing domestic revenues, such weak capacity reduces the possible local content in the terms of contract, the latter being aggravated by limited availability of domestic enterprises. It also limits the extent to which these countries can monitor the activities of the multinational institutions and prod them to comply with terms of the deals.

Weak domestic revenue and expenditure management mechanism. Several SSA countries do not have clear-cut strategy for domestic revenue mobilization and expenditure. Moreover, tax institutions and administrative capacity, especially enforcement is highly deficient in most SSA countries. In some instances, the cost of collecting tax revenues is higher than the total tax revenues collected. While the structure of the economy is usually the problem, institutional deficiencies are at the epicenter of such failures.

Several SSA governments are characterized by weak political will and lack of moral justification for tax drive. It is a well known fact that in almost all countries of the world, tax imposition and collection is a strong political issues often met with resistance from the populace, especially in countries where the incentives for tax payment is weak due to poor social services from the government (Ogunleye 2008). This is worsened in SSA countries by the complaint often received from some tax payers that they cannot see the dividend of the tax being paid in form of basic social services and welfare improvement.

Domestic financial institutions and instruments are weak in most SSA countries. Financial markets have played a very limited role in mobilizing domestic resources in Africa, especially with respect to mobilizing savings for productive investment (Nissanke and Aryeetey 2008). This is due to the fact that several African countries are characterized by low number of quality and well geographically dispersed financial products. In contrast, the financial markets are largely fragmented. A great percentage of the population in this region is unbanked. This is especially so given that many people live in rural areas where banking infrastructure are in very short supply.

5. Imperative of DRM for Economic Recovery in SSA: Policy Reflections

The need for improved domestic resource mobilization in driving African recovery from the recent global economic and financial crisis has been well emphasized (see Aryeetey 2009). In what follows, we provide some policy prescriptions on specific actions required for this purpose.

Domestic resources provide a more stable, certain and sustainable means for development finance. Aid as opposed to domestic resources is not a sustainable mode of financing development as demonstrated by the global financial crisis. Though aid rose to a record high in 2008, it continues to fall significantly behind the pledged levels. The reason for this is well known: the global economic downturn that has led the advanced countries to re-direct their strengths and resources to rescuing their economies through economic stimulus packages. On the other hand, domestic resources provide a more reliable and less volatile revenues for fiscal finance.

Another imperative for domestic resource mobilization is the fact that domestic resources create a social contract between government and citizens, thereby strengthening citizens' oversight and supervision of the use of financial resources. Oversight of fiscal revenues is most crucial at this time of recovery from economic downturn in SSA countries given the very limited resources at the disposal of governments. Yet, several development projects are urgently required to further help in quickening the pace of recovery. One possible reason why oversight of fiscal activities by citizens is weak in Africa is the feeling that the fiscal revenues are not their taxpayer money. This is especially true in resource rich countries where the bulk of the fiscal revenues come from resource exports and tax. On the contrary, observation shows that in developed countries where most of fiscal revenues are derived from direct tax revenues, taxpaying public is very sensitive to the use of such revenues, knowing that it is a product of their hard work. This process makes the fiscal authorities more transparent in the use of fiscal revenues. This strengthens the citizens' overall supervision and monitoring of use of such resources by the fiscal authorities, thus improving political governance.

Also important is the improved policy space engendered by reliance on domestic resources. This is one of the most important factors that should drive improved domestic resource mobilization in SSA countries. The continued dependence on foreign aid limits the extent to which SSA countries can take ownership of their development policy and strategy. Most development assistance are tied and come with political and economic conditionality. These tie the hands of SSA countries in the design and implementation of own macroeconomic, sectoral, sub-regional and regional development policies. Reliance on own resources will give freedom from this bondage and free hand to design, develop and implement development policies perceived to be in the best interest of SSA countries.

There is need for enhanced political commitment in designing and implementing national, sub-regional and regional strategies for improving mobilization of domestic resources. This is especially important for African countries given the small size of some of them. Rather than doing it alone, it may be more economically rewarding to leverage on the existing sub-regional economic and political groupings currently in operation in SSA. This will make for risk sharing and broaden the tax revenue base over and above national levels to sub-regional levels and ultimately continent wide. SSA countries are also required to demonstrate commitment to reversing the current unfavorable trends in capital and tax flight. This could be done through the platform of the ECOWAS, SADC, EAC and AU.

Develop local capacity in all facets of domestic revenue collection and management. For tax, local capacities should be developed in the design of tax policy, tax administration and management. For instance, specific efforts could be made to train and retrain local experts in the art of understanding the *modus operandi* of multinational corporations and how to monitor their revenues, profits and accounting procedures with a view to auditing them efficiently and making them pay tax on all their taxable activities. For resource rich countries specific local capacity development is required in contract negotiations that will ensure the terms of the contracts are favorable to the host country. Some of the issues that require adequate attention in such negotiations are technology transfer, domestic value-addition through establishment of both upstream and downstream activities, and increased percentage of local content in employment and engagements of local people and enterprises.

Tax reforms that reduce complications in tax assessment, computation and collection and broaden the tax base to include the hard-to-tax informal sectors are germane. The current tax regimes in SSA countries are such that there is low level of compliance and limited administrative capacity. Reforms should ensure a broader tax base and better tax conditions that are capable of harnessing untapped tax potentials, especially through formalization of informal sector activities and a move away from the current concentration on large tax payers. Reforms should focus on improving tax administration and capacity. To facilitate assessment and collection, it is important to develop a system for Taxpayer Identification Number for all potential taxpayers in the countries for both individuals and institutions. The reform will remain incomplete if attention is not paid to existing tax legislation and regulations. The whole reform process can be effectively driven through the use of technology and other innovative techniques. It is interesting to note that some development partners are currently working with some African countries along this line, especially in Eastern Africa, especially on custom duty. This is a welcome development because custom duty is one of the major sources of tax revenues in SSA countries. Such reforms should be extended to the global landscape that gives room for tax harmonization and tax procedures to reduce distortions and more conscious effort to tackle tax flight.

Tax reforms should also foster a move away from the current trend of tax exemptions, concessions and holidays. Experiences in SSA countries and elsewhere have shown that, at best, time-bound tax holidays only succeed in attracting short-term investment. As soon as the tax holiday period is over, investors tend to shift production to new areas where they can enjoy this kind of incentive. Generally, tax holidays encourage tax fraud and tax avoidance through use of transfer pricing as taxable businesses shift their profits to those enjoying tax holidays thereby avoid payment of taxes. Required reforms in this respect will be those that eliminate such exemptions, concessions and holidays and consider replacing them with more transparent incentives of unlimited loss carry-over and accelerated depreciation. The advantage of the proposed tax system is that they are less distortionary and will increase access to the government of the much needed fiscal revenues.

It is worth emphasizing that the need for harmonization of tax policy and procedures will help avoid double taxation in SSA countries, especially for countries in the same regional and economic blocs. In Western Africa, for instance, countries in this region can be broadly categorized according to their inherited tax tradition: Anglo-Saxon and French systems. But for few exceptions, all the 15 countries in this bloc fall into either category. The same features are observable in Eastern Africa where Kenyan, Tanzanian and Ugandan tax systems are patterned after the Anglo-Saxon while Burundi and Rwanda have semblance to the French system. These diversities among these countries belonging to the same economic grouping tend to weaken regional integration and domestic resource mobilization, especially of customs duty. One possible option is to begin by creating sub-regional institutions that will manage and finally remove these diversities and gradually broaden this to the entire continent. Functional reforms are also imperative. Revenue collecting institutions in SSA countries should be made more independent through the creation of independent Revenue Authorities as opposed to the current practice where they are units or divisions within the Ministry of Finance. Such structural and functional review will help improve the capacity of the revenue authorities to mobilize domestic resources.

Provide sufficient incentives for tax collectors, higher level tax bureaucrats and institutions through rewards and punishments. One of the most common explanations of tax officials for engaging in corrupt practices in several SSA countries is poor pay, poor staff welfare and poor incentives. It becomes highly irresistible for a tax official that is poorly remunerated to repudiate bribes when offered by tax payers for the purpose of reducing tax obligations. To correct this marked disincentive, tax institutions and individuals should be well catered for through special salaries and benefits package. After all, they are the ones collecting the money. More is recommended to be done by way of developing special bonuses and additional incentives for tax officials and institutions that are outstanding in tax revenue collection. Such outstanding performance should be set and gauged through target setting and proper evaluation of results against the set targets. Furthermore, incentives schemes and mechanisms could be used to achieve this as has been attempted in Ghana (Chand and Moene, 1999).

SSA countries should vigorously pursue vigorous financial sector reforms that will ensure effective mobilization of savings and allocating them efficiently across the wider spectrum of economic agents. Many a time, financial sector savings mobilization is often focused on corporate activities and large tax payers both of which account for very small percentage of the entire economy. More reforms are required to ensure there are incentives for savings mobilization that extends to the rural areas, unbanked populace and the informal sector. Since these categories of people make up the dominant percentage of the population, it will not be surprising to note that more resources could be raised from these sectors compared to the formal corporate world. Many rural dwellers and recently urban dwellers keep their money under the mattresses and pillows because of loss of confidence in the financial system or high transaction costs. In Ghana, for instance, as in several other SSA countries, the large interest rate spread deserves immediate attention. One area the government can be helpful is in providing basic banking infrastructure in the rural areas. In addition, special incentive in form of tax rebate could be provided for financial institution based on the percentage of their domestic savings mobilized from the rural and informal sector. The overall reforms in the financial sector should target reducing information asymmetry and transaction costs and instill confidence in the financial system. Financial sector reform should be extended to the capital market. Apart from a few, several SSA countries either do not have an existing capital market or the existing ones are dysfunctional. Reforms are needed to ensure international best practice in the operation and management of capital market for those that have existing ones and pave way for the establishment of one for those that do not have any. Appealing for instance from countries like Nigeria and South Africa that are highly experienced in capital market operation and management could be a very useful and rewarding exercise.

The financial institutions should play an active role in harnessing IT to improve domestic savings in SSA. One possible option is the excellent and very innovative *M-PESA* introduced in Kenya, the first of its kind in the world. The success of this innovative resource mobilization strategy is unparalleled as evidence has shown that more than 10% of Kenya's GDP now pass through the mobile banking service[2]. It is interesting to note that some other African countries such as Tanzania and South Africa are copying this best practice. Other African countries should borrow from these examples and examine how it could be adapted and then adopted given their local situations. Another excellent international experience that could be adopted to the needs of SSA countries is the IT-based branchless banking. This has been instituted and with amazing success by the Integra Micro Solutions based in Bangalore, using village banker. The huge success of and benefits from this innovation was partly the result of government support by way of subsidy at the initial phase of the project. Such public-private partnership in such innovative schemes should be explored in SSA countries to improve domestic resource mobilization through financial services.

Improve the current global aid architecture to provide clear strategy for SSA countries to exit its current aid dependency. The current aid allocation technique tends to be based on identifying financial gap and aiming to close them. On the contrary, aid programme should be developed to improve the existing local capacity, especially in domestic revenue generation. Concerted efforts should be made at ensuring that aid is not provided to SSA countries as an end in itself but a means to the end of self-sufficiency on domestic resources. It is interesting to note that there a pockets of this type of aid initiatives going on in SSA countries. The recent global financial and economic crisis has demonstrated the unsustainability of reliance on foreign aid for development finance. Thus, exiting aid dependency and complete reliance on own resources should be the ultimate goal.

Policies aimed at promoting domestic investment should be pursued through improvement in the business climate. The one-stop shop for investment promotion and registration in operation in many SSA countries is a welcome development in improving the transparency of investment registration and operation process. It also helps in reducing the time spent in the business registration process. In addition, SSA countries need to strengthen their legal, law enforcement, regulatory and other business-related institutions to ensure they are efficient in their understanding and enforcement of the rules of the business game in their respective countries. Good education of the law enforcement agents in business matters is important. Independence of the judiciary should also be promoted because it will help instill confidence in the mind of the business community that they will be given a fair hearing should there arise a breach in business activities and relations.

The drive towards effective domestic resource mobilization policy in SSA countries must take cognizance of the important features of revenue mobilization in SSA economies, prominent among which is the very weak state of institutions and capacity for domestic revenue drive. Most especially, there is need to adopt international best practices in tax policy and administration and revenue management from resource exports. Some of the important features of such tax reforms should include simplifying the tax system through harmonization, and reduction in exemption and avoidance of double taxation. It is also important to build willing compliance from taxpayers through design and implementation of social policies and programmes financed by tax revenue.

[2] http://www.finextra.com/news/fullstory.aspx?newsitemid=21088

There should be s follow-up to this by public enlightenment and sensitization campaign aimed at changing the mindset of the people on the importance of paying taxes.

5. Conclusion

Improved domestic resource mobilization is not impossible in SSA countries. Our mission to elucidate on the imperatives for domestic resource mobilization has shown that SSA countries are making strenuous efforts to improve their domestic resource mobilization process. The recent global financial and economic crisis has demonstrated the need for African countries to look inwards for sustained economic growth financing. To drive the upturn in the region, even more efforts are required to improve the mobilization and management of domestic resources. However, challenges remain in these efforts. These include financial and economic vulnerability of most economies in the region, shallow revenue and tax base, uncertain and poor business environment, weak domestic capacities, poor revenue collection and management mechanisms, weak political will for tax drive and weak financial institutions and financial instruments.

In an attempt to demonstrate empirically the effects of domestic resources on economic growth, it is found that only domestic savings and investment are exerting positive statistically significant effects on growth. All the tax variables are not significantly impacting on growth. This finding tends to demonstrate the areas where more efforts are required, namely, tax revenues drive. To help improve domestic resource mobilization, SSA countries should be more pragmatic by doing the following: be more vigorous in developing local revenue collection and management capacity; work more on tax reforms that will ensure tax harmonization and a move away from tax exemptions, concessions and holidays; provide sufficient incentives for tax collecting agents and institutions to reward transparency and punish corrupt practices; reform the financial sector; leverage on IT to improve savings mobilization; work to improve global aid architecture to chart the course for SSA countries to exit aid dependency; and improve business climate to promote private investment.

There are claims on the complicity of some developed countries and their institutions in the wanton capital flight from SSA countries. For instance, they were said to have engaged in double-dealing, corruptly inflating credits extended to SSA countries, exploit the loans offered to SSA countries as the punitive basis for plundering their natural resources for debt repayments. As evidence has shown, illegal financial flows from SSA countries over the years exceed by multiples the sum of aid and assistance received by these countries. This is important because such illicit funds are stashed away in these foreign countries where there is some sense of security of the funds. To reverse this trend, the cooperation of the developed countries and international community is required in many critical ways. One is the demonstration of purpose and commitment by repatriating all illegal funds in developed countries to their SSA countries of origin. It is interesting to note that SSA countries have established institutions dedicated to fighting money laundering in the sub-region, namely, the Inter-Governmental Action Group against Money Laundering in West Africa and Eastern and South African Anti Money Laundering Group. It is recommended that other SSA sub-regions adopt similar stance by establishing this type of institutions. Most importantly, the cooperation of the international community is required to make these institutions succeed. Thus, cooperation with these institutions through disclosure of proven illegal funds and taking necessary steps to repatriate them will be most useful for SSA countries.

Concerted efforts are required to improve domestic resource mobilization in SSA countries. Success by SSA countries in their current efforts will be elusive if they are left to do it alone. Better results will be achieved through galvanized efforts at sub-regional and regional levels. Thus, cooperation among SSA countries and the support of the international community are important. The African Development Bank, ably supported by other International Financial Institutions is solicited in muting an African institutions dedicated to improving domestic resource mobilization in SSA. The expected improved resources from these efforts will help imbue SSA countries with freedom and policy space to take charge of developing, crafting, implementing and managing policies that will impact positively on their efforts to recover quickly from the negative effects of the global financial and economic crisis and ensure sustained economic growth, development and transformation.

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