

Domestic public resources

- National institutions are best placed to end poverty (in countries with functioning national governing institutions – the focus of this chapter); they can diagnose, prioritise and design investments to address domestic problems.
- For governments to set and drive the poverty reduction agenda, domestic resources must become the 'spine' around which other development finance flows are coordinated.
- The way governments mobilise and use their resources can have a significant impact on the poorest people living in poverty.
- Yet the countries facing the greatest challenge in ending poverty also:
 - Mobilise the fewest domestic resources and are projected to have slowest revenue growth
 - Rely more on particular taxes – such as indirect taxes, that can be regressive, imposing a greater relative burden on people in poverty – and on international grant funding
 - Can often have weak or no governing institutions, especially if they are emerging out of a conflict.
- Many countries facing the greatest challenge to ending poverty prioritise spending in key sectors such as health and education, although spending in absolute terms remains very low, and rely heavily on donor funding for key sectors such as agriculture, education and health, and on external financing to fund capital investment.
- Lower administrative levels of government will also play an important role in reducing poverty - their ability to raise revenues and the way they spend these resources can have a big impact on the poorest people.
- Ending poverty by 2030 requires a significant increase in the resources available to national institutions through sustainable, progressive mechanisms, and closer monitoring to ensure they are invested in a way that benefits the poorest people.

National institutions are the main drivers of poverty eradication.

They are best placed to diagnose, prioritise and design investments to address domestic problems.

But for governments to set and drive their own poverty reduction agenda, domestic resources must become the 'spine' around which other

development finance flows are coordinated.

Although domestic public resources in many developing countries have seen an increase since the start of the millennium development goals (MDGs), it is now recognised that there is both need and space for governments to significantly increase their own resources further. We must

strive for greater public resources, but to do this we need to understand the nature and impact of domestic public revenue, particularly on the people in the deepest poverty. The distribution of poverty is uneven at the sub-national level, so the ways in which governments allocate resources across thematic areas and geographic regions is also important to ensure development goals are implemented successfully.

Domestic resource mobilisation

Governments will play a central role in driving efforts to end poverty through development planning, policymaking and priority setting. Domestic public resources will be central to the success of nationally driven efforts to end poverty in the Sustainable Development Goal (SDG) era.

Although domestic public resources are the largest resource available to developing countries in aggregate (see Chapter 1), the volume of resources mobilised varies widely from country to country.

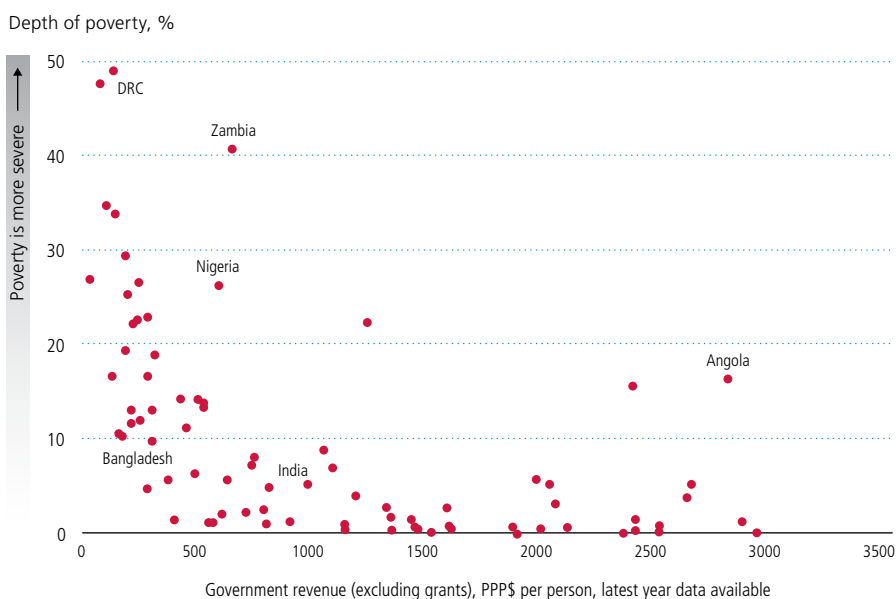
Governments in many developing countries raise low volumes of revenue that are not currently enough to implement the SDGs at the national level.

Revenue per person is lowest in countries where depth of poverty is highest (Figure 3.1). Revenue (excluding grants) is less than PPP\$500 per person per year in 24 of the 33 countries with a very high depth of poverty (above 10%),¹ and in 15 of these countries it is less than PPP\$250 per person. With such low levels of resources, governments are likely to face financial constraints in providing services and making investments that can reach the poorest people and reduce poverty.

Despite this, there is significant potential for these governments to increase revenue mobilisation, given that resources raised as a percentage of gross domestic product (GDP) are also the lowest globally (Figure 3.2). Many countries aim to mobilise resources equivalent to 20% of GDP as a minimum.² However, 20 countries mobilise resources equivalent to less than 15% of GDP – 11 of these are in sub-Saharan Africa, of which 10 have non-grant revenues of less than PPP\$500 per person. A further 32 countries mobilise resources equivalent to 15–20% of GDP.

FIGURE 3.1

The countries that face the greatest challenge in ending poverty have the fewest resources to address it



Notes: Depth of poverty estimates are for 2011 (the most recent country data available); government revenue per person shows the latest actual estimates available for each country (2014 data for 30 countries, 2013 for 50, 2012 for 22, 2011 or earlier for 5). 39 developing countries of 146 are excluded due to lack of data.

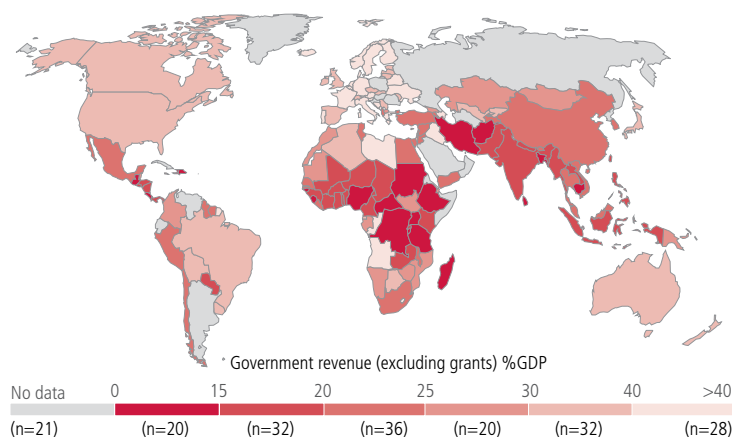
Source: Development Initiatives calculations based on IMF Article IV publications and PovcalNet.

Explore further: how domestic resources per person (<http://bit.ly/1EEV0Tu>) in comparison to depth of poverty (<http://bit.ly/1Vw3NAY>).

FIGURE 3.2

Revenue mobilisation is low in many developing countries, particularly in sub-Saharan Africa

Government revenue (excluding grants), % GDP, 2013 or latest actual data



Notes: This figure shows total revenue excluding grants as a proportion of GDP for each country (131 developing countries showing the latest actual estimates available and 37 developed countries showing 2013 data for comparison).

Source: Development Initiatives calculations based on IMF Article IV publications and PovcalNet.

Explore further: government revenue %GDP (<http://bit.ly/1Op4X02>) and how this has changed since 2005 (<http://bit.ly/1Op4ZVH>)

Reducing this gap between realised and potential revenue mobilisation provides a crucial opportunity to increase resources targeted at poverty alleviation, with

international support an important factor in achieving this.³ This need is exemplified by examining the future projected trends in government revenue.

Future trends

Whilst there is potential for government revenue growth in many of the poorest countries, projections show that the countries with the lowest current levels of domestic resource mobilisation are also those in which revenues are least likely to grow (see Figure 3.3). In some of the poorest countries governance systems are fragile and for them generating the resources to address poverty will be a major challenge.

In countries where the depth of poverty is greatest, real-term revenues over the next two to three years are projected to remain stagnant. In addition, countries where natural resources make up a significant proportion of the revenues are projected to see a decline in real terms, as a result of falling global commodity prices.

Despite low growth in revenue across many of the countries with the deepest poverty, there are examples of countries achieving significant growth in mobilising resources (see Box 3.1).

How resources are mobilised

While the volume of resources mobilised by governments varies from country to country, so does the way in which those resources are mobilised. Governments mobilise revenues in different ways; this can lead to very different impacts on the poorest people and has longer term implications for the sustainability of public financing, particularly where there is a heavy reliance on natural resource revenues.

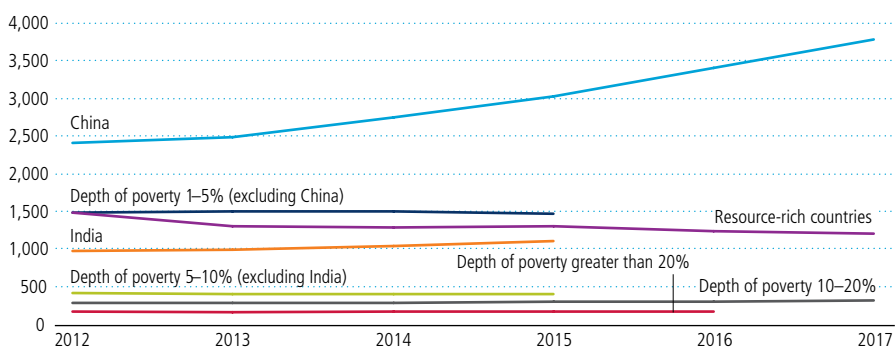
Indirect tax, direct tax and progressivity

A government's system of tax collection determines how progressive it is. Direct taxes are seen as more progressive as they are proportionate to income or profit levels, while indirect taxes may

FIGURE 3.3

Where poverty is greatest, revenues are projected to grow least

Government revenue (excluding grants) in countries grouped by depth of poverty, PPP\$ per person, constant 2012 prices



Notes: Includes 58 countries for which data is available; those with sparse data are excluded. China and India are shown individually as their large economies affect the average of the groups. The decrease among resource-rich countries is due to falling the falling price of oil and other commodities.

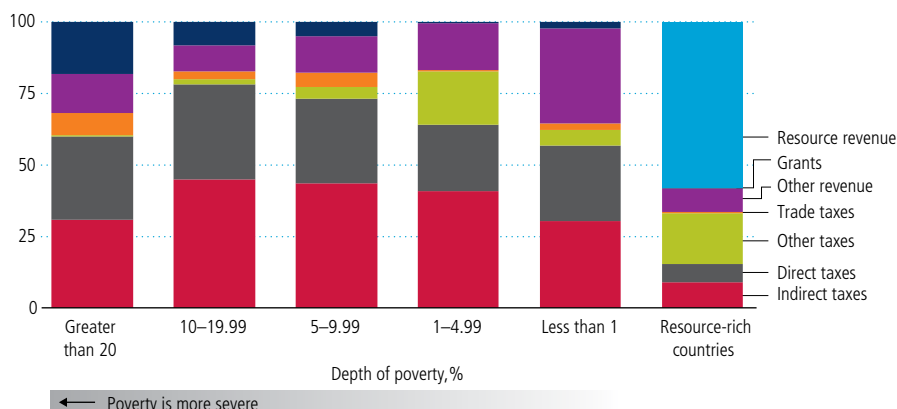
Source: Development Initiatives calculations based on data from IMF Article IV publications and PovcalNet.

Explore further: domestic revenue projections in China (<http://bit.ly/1Op5bEx>).

FIGURE 3.4

Many of the poorest countries rely heavily on indirect taxes and grant financing

Domestic public revenues, % of total, 2013



Notes: Includes 96 countries for which data is available. Countries where natural resources account for more than 10% of revenue are included in the 'resource-rich countries' group as they have a very different portfolios of revenue.⁴

Source: Development Initiatives calculations based on data extracted from IMF Article IV publications and PovcalNet.

Explore further: domestic public revenues in Ethiopia (<http://bit.ly/1V5quPB>), Côte d'Ivoire (<http://bit.ly/1V5qC1t>) or Central African Republic (<http://bit.ly/1V5qAGR>).

not take into account an individual's ability to pay. Indirect taxes can therefore place a heavier burden on people in poverty as they account for a higher proportion of their incomes and higher proportions of profits for small businesses than large businesses.⁵

Many of the poorest countries rely heavily on indirect taxes (Figure 3.4). Indirect taxes account for 41% of

revenue across countries with the highest depth of poverty (the left two columns in Figure 3.4), with ratios highest in Ethiopia (56% of total revenue), Cote d'Ivoire (54%) and Central African Republic (51%). Indirect taxes account for 30.5% of revenue in countries where the depth of poverty is less severe (less than 1%). Governments often find it easier to establish and collect indirect taxes as they do not

need as much institutional structure or as many processes as direct taxes, particularly where economies are largely informal. Therefore, it is essential that there is consideration of the impact of current and future tax regimes on the poorest and most vulnerable people.⁶

Natural resource revenues and sustainability

Seventeen resource-rich countries rely heavily on revenues from natural resources: including countries such as Nigeria, Chad and Republic of Congo, where the depth of poverty remains high.

Natural resources can offer a significant pool of finance for governments to invest in development and poverty reduction, although many countries have suffered the 'resource curse' where institutions struggle to manage and use this pool of funding effectively. Without safeguards or stabilisation mechanisms (see Box 3.1), relying on natural resources can also leave countries vulnerable to swings in international commodity prices and, as natural resources are finite in quantity, may not be sustainable over the long term.

Across the group of resource-rich countries, natural resources account for 58% of total revenue (Figure 3.4). In some countries it is much higher. In Timor-Leste and South Sudan natural resource revenues account for 91% and 83% respectively.⁷ In Equatorial Guinea, Republic of Congo and Angola natural resource revenues account for more than two-thirds of total revenues.

Grant financing

The countries that face the greatest challenge in ending poverty are also those that rely most heavily on international grant financing. In countries where the depth of poverty exceeds 20%, international grants comprise on average 18% of government revenue.⁸

BOX 3.1

Increasing revenues where poverty is high: Mozambique and Timor-Leste

Mozambique

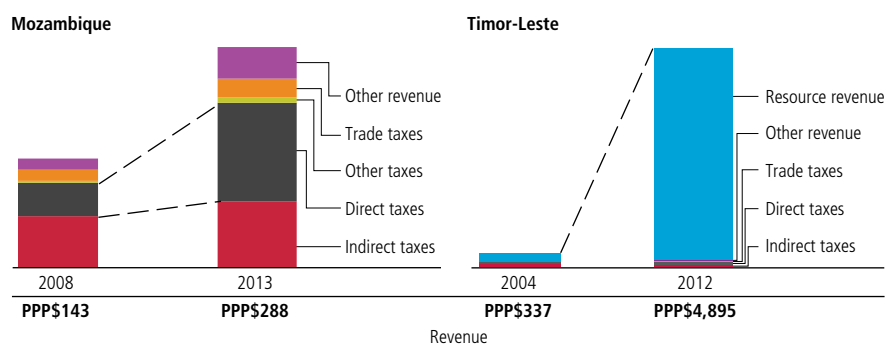
In Mozambique non-grant revenues per person more than doubled in five years, from PPP\$143 in 2008 to PPP\$288 in 2013. Direct taxes have grown thanks to successful tax administration reform, supported by the international community. The Mozambique Revenue Authority was established in 2006, and its reforms have modernised the country's tax administration, improving the efficiency of the tax system and broadening the tax base. Significant technical cooperation and other assistance from donors meant that Mozambique was the third largest recipient of aid for domestic resource mobilisation in 2013 (see also Chapter 4). A number of donors assisted Mozambique by using a tax-related common fund to coordinate assistance with a single process for dialogue, monitoring and quality control, considered one of the most successful uses of this approach.⁹ As revenues have grown, Mozambique relies less on grant financing, with grants to the government falling 40% between 2008 and 2014.

Timor-Leste

In 2005 Timor-Leste established a sovereign wealth fund (the Timor-Leste Petroleum Fund) to manage resources from the petroleum sector. As the sector grew it generated significant revenues for the Timorese government, and revenues per person grew almost 15-fold from less than PPP\$350 per person in 2004 to close to PPP\$5,000 per person in 2012. The Petroleum Fund manages revenues from the sector, investing and transferring a regular amount of finance to the government, thereby helping to stabilise government finances and shielding them from large swings in production or petroleum prices. Government revenues have since been less volatile than in many other resource-rich countries. While the government remains extremely reliant on these resource revenues, the Petroleum Fund has built up significant assets (equivalent to US\$10,700 per person) that can support government finance to be sustainable and diversify over the long term.¹⁰

FIGURE 3.5

Growing revenues in Mozambique and Timor-Leste



Source: Development Initiatives calculations based on data from IMF Article IV publications. Explore further: changing revenues in Mozambique (<http://bit.ly/1LL7oGI>) and Timor-Leste. (<http://bit.ly/1LL7w9g>)

For some countries in this group it is much higher. In Burundi, Malawi and Rwanda it accounts for 49%, 37% and 35% of total revenue respectively. Reliance on grant funding is falling in general – according to the latest data it is the single largest source of revenue for 8 countries, down from 16 in 2006 – though it remains a significant source of funding for spending in key sectors and on capital investment projects (see Figures 3.6 to 3.8 below).

Domestic public resource allocations

To increase resources, governments must first improve their domestic resource mobilisation through progressive, sustainable means – but how these resources then impact on poverty depends on how they are allocated. As well as raising revenue, governments use external funding in the form of grants or loans (concessional and non-concessional), alongside domestic borrowing.¹¹ Revenue and financing together determine the scale of government allocations and may have a bearing on their destination. Some external financing is conditional on being spent on a particular area (such as sector

budget support or project-specific funding) and both domestic and external finance result in debt servicing and repayment.

Allocating domestic public resources to key MDG sectors

Even though the initial focus of the MDGs was towards upscaling aid allocations, it has broadened over time to include domestic government allocations to particular sectors. Commitments have been established in the past 15 years to ensure governments allocate a minimum to core sectors crucial for meeting developmental goals. These include the Abuja Declaration (health), Maputo Declaration (agriculture), Education for All Initiative (education) and eThekweni Declaration (water, sanitation and hygiene), many of which have a regional focus. Although the targets themselves have been criticised,¹² they show that importance is being placed on increasing government resource allocations to these key sectors, resulting in some notable shifts.

Spending on health, for example, across all developing countries grew from 5.0% of government spending in 2000 to 5.7% in 2013, but varies considerably

between regions (see Figure 3.6). Sub-Saharan Africa, which committed to the Abuja Declaration target to spend 10% of government resources on healthcare, has moved towards this target: health spending increased from 7.4% of total spending in 2000 to 8.3% in 2013. This pattern is also reflected in education spending, which increased from 14.1% to 17.3% in sub-Saharan Africa within a similar time period.

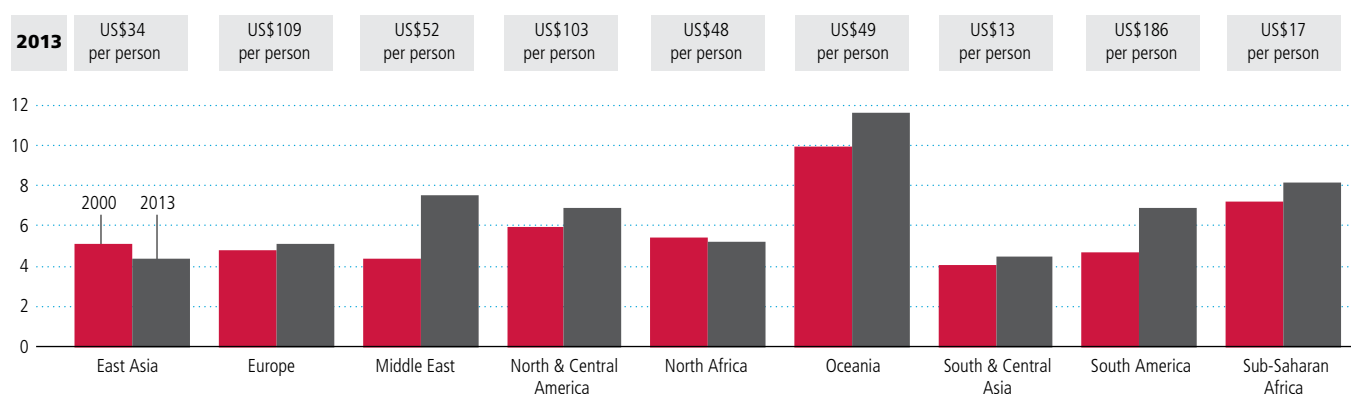
Although governments in many regions are placing a high priority on certain sectors, the limited resources available means that absolute levels of spending often remain very low. For example, in countries where depth of poverty is most severe (above 20%) spending in the health sectors in real terms was just US\$13.40 per person in 2013; in countries with depths of poverty between 10% and 20%, health spending was US\$17.30 per person. Geographically, spending per person is lowest in sub-Saharan Africa and South and Central Asia (Figure 3.6). To compare, the World Health Organization estimates that low-income countries should have spent US\$60 per person on healthcare by 2015 to meet the MDGs.¹³

While there has been a general upward trend in government expenditure

FIGURE 3.6

Sub-Saharan Africa is the second highest regional spender on health by proportion, but only the eighth per person

Health spending (minus social security funds), % of total spending in each region, 2000 and 2013



Note: The graph includes only developing countries. South Africa is excluded from the sub-Saharan Africa total because as the largest economy in the region it affects the trends and regional average. 2012 data used for countries in the Middle East region.

Source: Development initiatives calculations based on World Health Organization data.

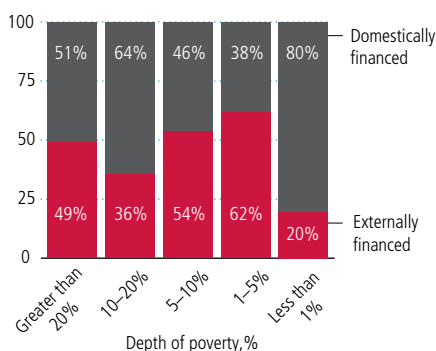
allocations, a significant proportion of funding still comes from donor funding (Figure 3.7), particularly in sectors focused on capital expenditure (such as health, water and agriculture). In Rwanda and Burundi, donor funding makes up over 80% of government allocations to agriculture, and 74% and 60% respectively to health. Even in countries where domestic public resources are growing such as Ghana, donor funding to sectors important for reducing poverty remains high, at 28% in agriculture and 22% in health.

In sectors central to efforts to end poverty, low levels of total spending combined with a reliance on external funding highlight the scale of the challenge ahead. Key sectors must see significant increases in the resources available to them if they are to make the investments needed.

Beyond these key sectors many governments rely on external financing for a significant proportion of their capital investment (Figure 3.8).¹⁴ In the countries with the most severe depth of poverty (over 20%) almost half of the capital investment made by governments is funded by donors.

FIGURE 3.8
Many countries rely on external financing to fund capital expenditure

Externally and domestically funded capital expenditure, % of total, latest actual data



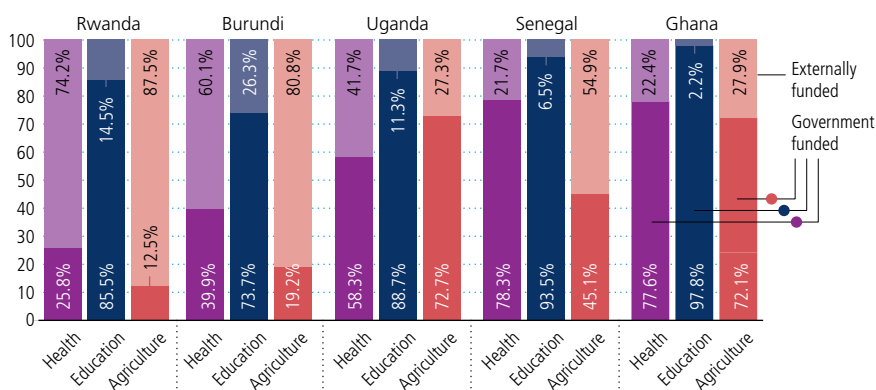
Notes: It is not possible to distinguish between concessional and non-concessional external financing here, but generally financing is more concessional in countries with greater depth of poverty (see also Chapter 4).

Source: Development Initiatives calculations based on IMF Article IV publications and PovcalNet

FIGURE 3.7

Donors' fund a significant portion of government spending in key sectors

Percentage of sector spending from government and donor resources, 2015 budget data



Notes: Rwanda budget data are for 2015–16 fiscal year and Uganda for 2014–15 fiscal year

Source: Latest available government budget documents

Explore further health spending in Senegal (<http://bit.ly/1PjfyHe>) or education spending in Uganda (<http://bit.ly/1Pjftn1>)

BOX 3.2

Subsidies

Debates on financing are increasingly focusing on subsidies; the Addis Ababa Action Agenda commits to rationalise fossil-fuel subsidies in particular.

Subsidies are designed to shield the poorest people in society from adverse price shocks, for example on energy, food and agricultural inputs (such as fertilisers) by artificially reducing the price to the consumer. But research into their effectiveness has shown that in many, though not all,¹⁶ cases they fail

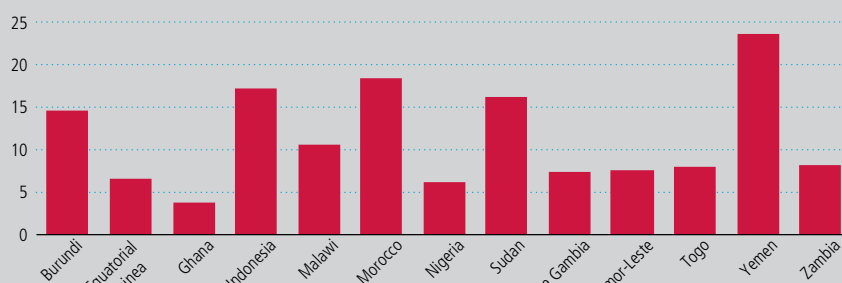
to target the poorest people and can actually benefit richer people far more.¹⁵

Government may spend substantial amounts on subsidies (Figure 3.9), consuming a significant amount of a government's resource envelope. Rationalising ineffective subsidies can therefore release significant additional resources for many countries, though must be done in a way that minimises the impact on the poorest people so not to undermine efforts to reduce poverty.¹⁷

FIGURE 3.9

Subsidies account for a large proportion of total spending in many countries

Subsidies, % of total spending, latest actual data



Notes: 13 countries for which data are available are included. Data for Malawi is for fertiliser and seed subsidies only; data for Nigeria, Togo and Indonesia is for fuel/oil subsidies only. Data is the latest actual estimates for each country, ranging between 2012 and 2014.

Source: Development Initiatives calculations based on data from IMF Article IV publications.

Explore further: subsidies as a proportion of total spending in Morocco (<http://bit.ly/1Pjeovk>), Burundi (<http://bit.ly/1Pjevaa>) or Indonesia (<http://bit.ly/1PjeGIW>)

Interest payments

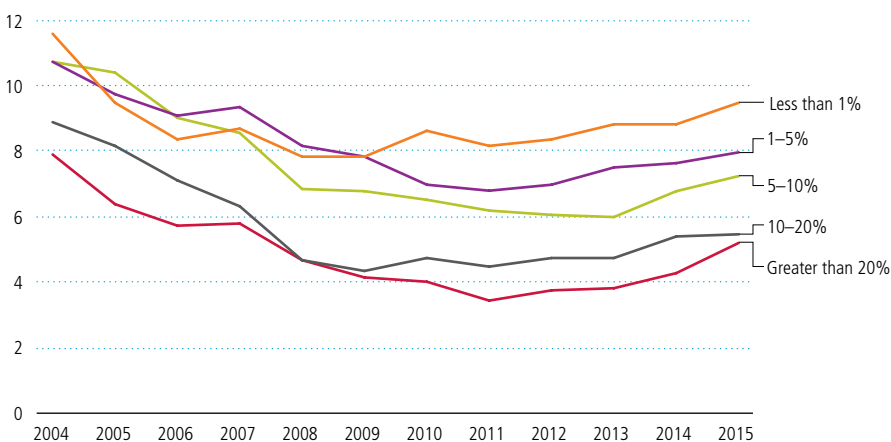
Interest payments can also form a significant component of government spending. While they are not directly related to development and reducing poverty, they can have strong indirect impact as they significantly constrain a government's ability to function effectively. Figure 3.10 shows that this was the case in many developing countries in the early 2000s, where a large debt burden meant interest payments were a significant proportion of total government spending. Since then, largely due to international debt relief initiatives, the proportion of government spending on interest payments has declined significantly, though there has been an upward trend since 2012. This is due to factors including increased borrowing following the global financial crisis; moves by some donors to provide loans instead of grants (see Chapter 4); increased use of maturing domestic financial systems; and increased private interest in lending to emerging economies in search of higher returns while interest rates in developed economies remain low.

The trend of increasing interest payments looks set to continue (Figure 3.11) as developing countries increasingly use alternative forms of finance, from both domestic and external sources. The availability and use of debt finance, therefore, needs to be carefully monitored to ensure interest payments do not impact on government allocations, particularly so in areas vital for development progress. Alternative forms of finance such as non-concessional borrowing, for example, should only be used in economically viable projects and not for general government functions.

FIGURE 3.10

Developing country interest payments fell through the 2000s, but are rising again

Average total interest payments as % of total spending for countries grouped by national depth of poverty



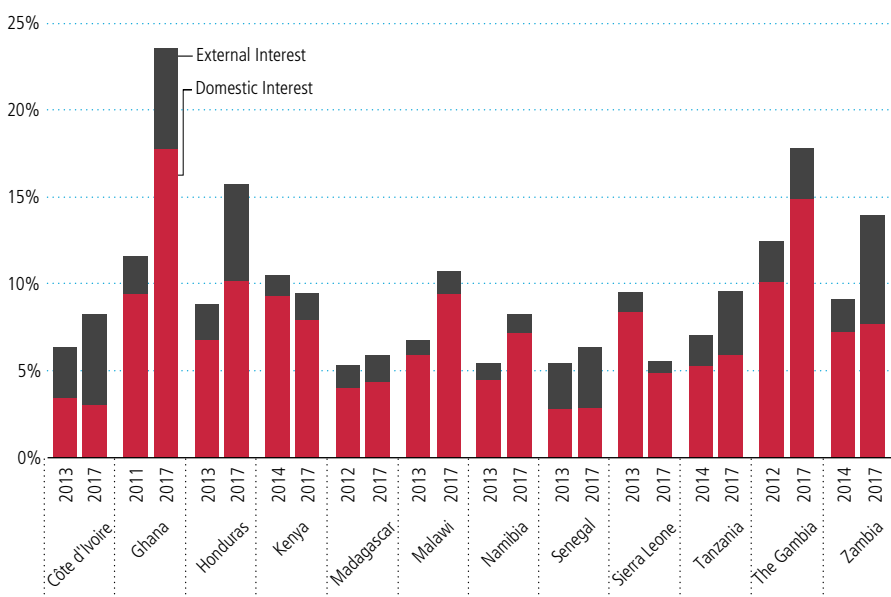
Notes: 61 countries with data available are included.

Source: Development Initiatives calculations based on data from IMF Article IV publications and PovcalNet

FIGURE 3.11

Interest payments will account for a growing proportion of total expenditure in many countries

Interest payments as % of total government expenditure, latest actual and 2017 projections



Notes: Includes 11 countries for which data is available after 2017, and which have both have poverty rates of more than 5% and interest rate payments of more than 5% of total spending.

Source: Development Initiatives calculations based on data from IMF Article IV publications

Explore further: interest payments as a proportion of total expenditure in Ghana (<http://bit.ly/1PjeZx2>), Honduras (<http://bit.ly/1Pjfffr>) or Zambia (<http://bit.ly/1Pjfkjk>)

Sub-national domestic public resources

- To end poverty we need disaggregated data on people and resources that unpacks national averages to show exactly who and how people are benefiting from investments, together with the inequalities in resource allocations and outcomes within a country. As we enter the SDG era, sub-national data on domestic public resources is increasingly both important and available, particularly because: A growing number of developing countries have devolved responsibility and decentralised fiscal powers to sub-national governments, enabling resource allocation mapping in key areas such as basic education, primary healthcare, agriculture and WASH.
- Information management systems have been improved, enabling more accurate and timely information to be published on sector performance.
- Government data is increasingly transparent and accessible.

To meet development goals both nationally and internationally, we must have and use sub-national data on resource allocations and outcomes.

Sub-national spending

Sub-national government spending varies within countries because different areas have different contexts and population needs. For most sub-national governments, financing comes from central government transfers. These are often calculated according to a needs-based formula, with conditions placed on how they can be spent (such as on teachers' wages). Donor funding can also be a significant resource for local government spending, and is also

often targeted to areas of need. Sub-national governments are able to raise their own revenue to finance aspects of their budgets that often otherwise go unfunded, although these usually make up smaller portions of the total resource bundle.

While we would expect some differences in funding levels in line with differing needs, in practice the resources available to sub-national governments often vary widely. While some localities have adequate resources to provide for effective service delivery, others are constrained in the level of service they can provide.

Uganda is leading efforts to publish detailed sub-national revenue and spending data, allowing detailed monitoring of investments and outcomes. District spending per person for primary health varies from US\$1 in Mukono District to US\$37 in Kalangala District (Figure 3.12). For primary education it varies from US\$10 per child in Zombo District to US\$217 in Kalangala.¹⁸ Donor funding of primary education and health also varies significantly between districts, although as Figure 3.12 shows it is seemingly well targeted to regions of most need. Certain districts rely heavily on donor financing, highlighting issues around sustainability and variability of financing. The data also exposes a number of districts, like Arua, that have intermediate needs that are neither a priority for government-allocated revenue or external finance.

Sub-national revenue

The extent to which sub-national development challenges can be addressed is influenced by the source of revenue funding as well as they way it is spent. Each source of revenue presents a set of challenges faced at the local level. For example, central government transfers can be delayed

and resources are often allocated conditionally, making them difficult to target other areas of need. Donor funding disbursements can also be unpredictable and while they may be on-budget, they may not go through government systems or be coordinated towards government development planning. Unpredictable financial disbursements to sub-national governments can have a severe impact on outcome performance as they engenders uncertainty, hampering the ability to plan for sustained activities.

Improving sub-national governments' own revenue mobilisation capacity is increasingly identified¹⁹ as a means of providing additional development finance and a funding reserve to compensate for the unpredictability of other resource flows.

While most tax is controlled by central governments, sub-national governments can use a number of revenue-raising measures such as fees, fines and property taxes. But because local institutions commonly have limited capacity to collect revenue and often lack formal record keeping,²⁰ sub-national governments normally have the potential to significantly increase revenue.

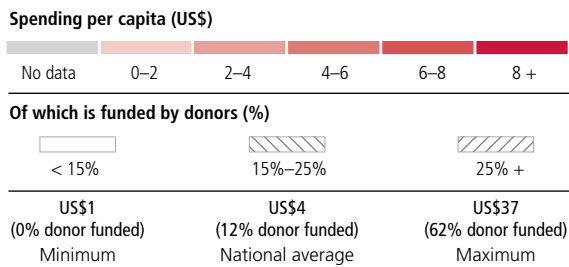
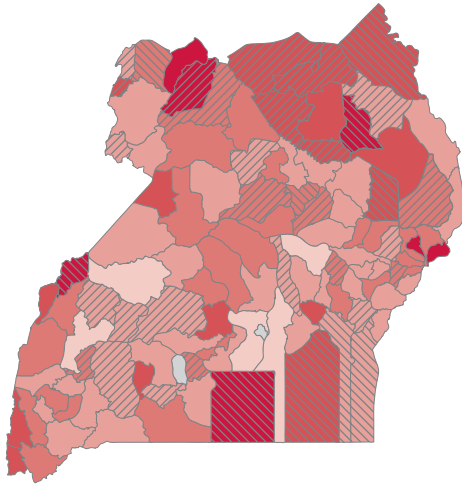
As with spending allocations, locally raised revenue collection also varies widely across sub-national governments, often because of differing contexts such as how urban or economically mature the region is. But there can still be clear differences in how areas that are similar in nature raise revenue, so it is important to understand why and learn lessons from these different approaches and experiences. Consistent, comparable sub-national data is the first step in identifying these issues.

This differential picture of local revenue raising is illustrated in Figure 3.13 by the case of Uganda. An average district raises only 4.2% of their own revenue

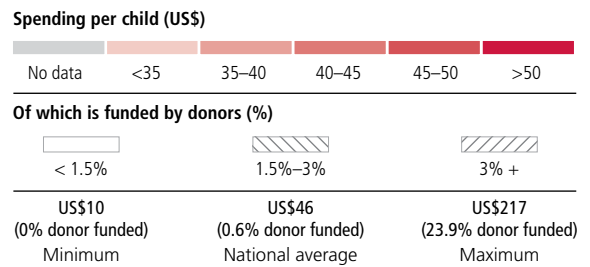
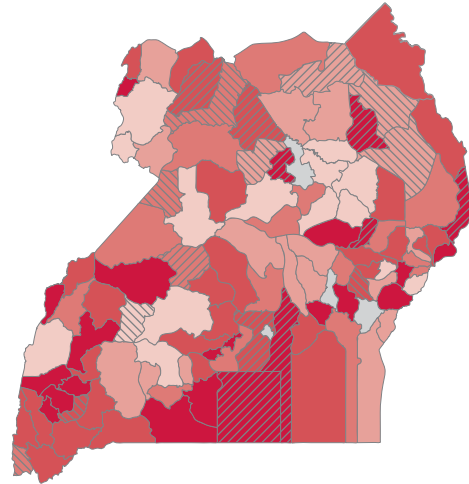
FIGURE 3.12

Spending and outcomes in health and education vary in Uganda

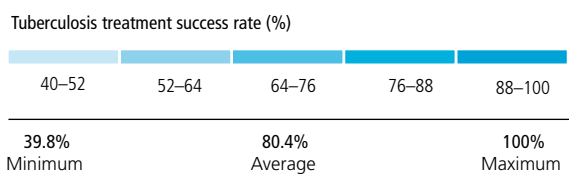
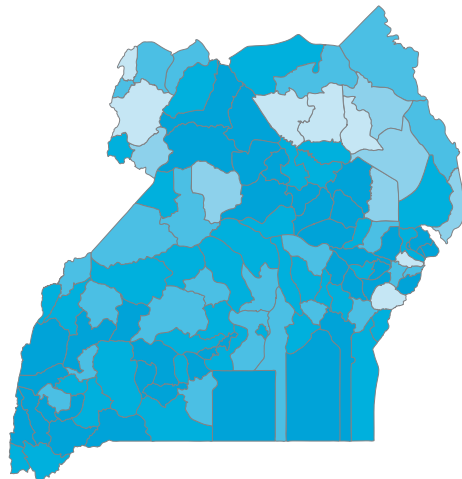
Planned per capita primary health spending, by district (2015–16, US\$)



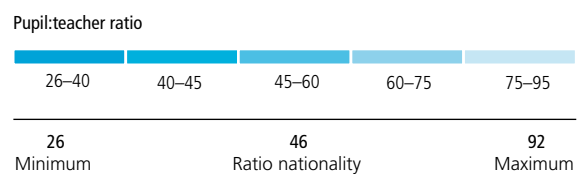
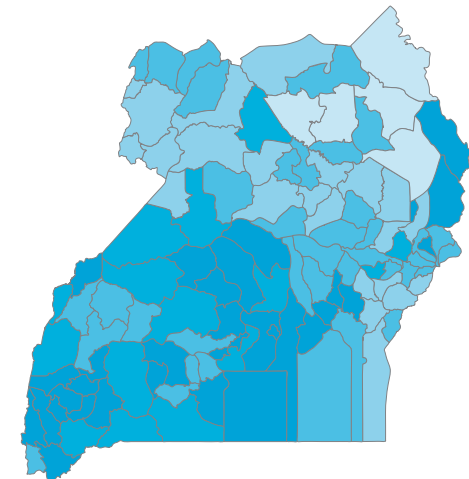
Planned primary education spending per child, by district (2015–16, US\$)



Tuberculosis treatment success rate, by district (2014)



Primary education pupil–teacher ratio, by district (2013)

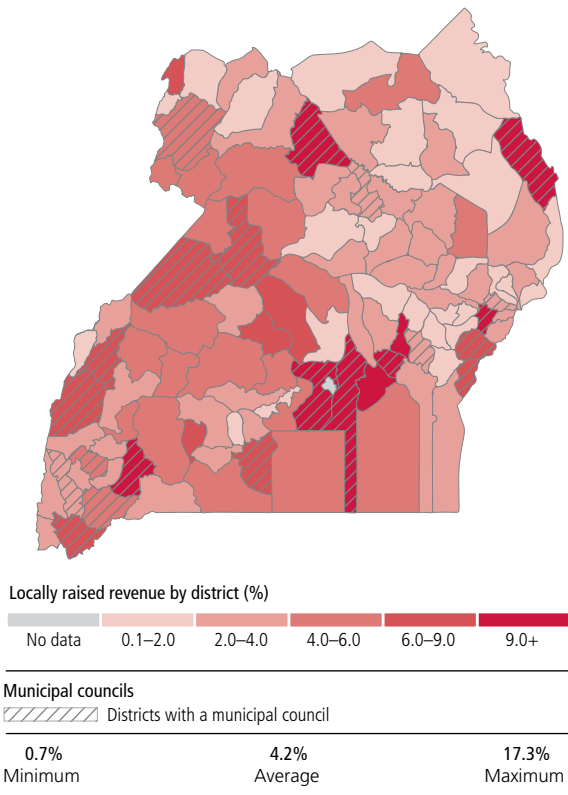


Source: Development Initiatives based on Ministry of Finance and Economic Planning 2015–16 draft budget estimates, Ministry of Education’s education abstract 2013 and Ministry of Health’s health sector performance report 2013–14.

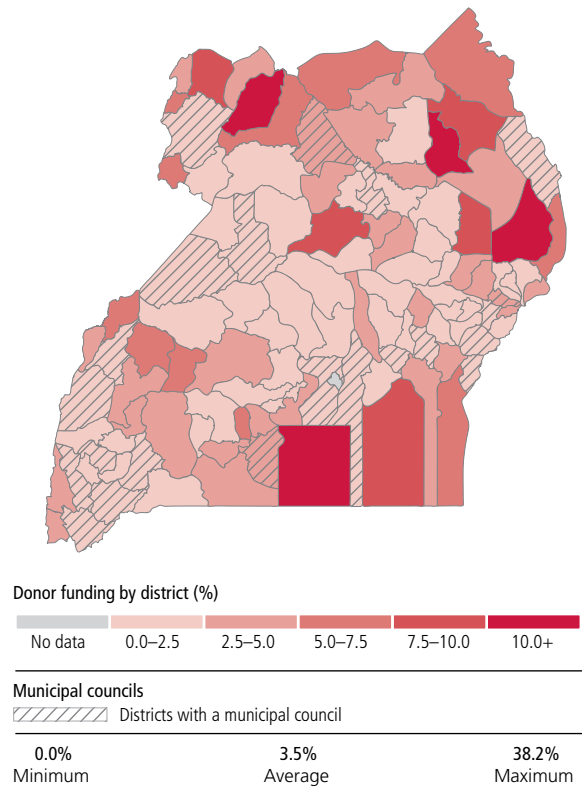
FIGURE 3.13

Locally raised revenues and donor funding trends vary widely at sub-national level

Percentage of revenue locally raised, by district (2015–16)



Percentage of district revenue from donor funding (2015–16)



Source: Development Initiatives-spotlight on Uganda

although this varies substantially, from the lowest at 0.7% to the highest at 17.3%. In general, and as would be expected, districts with municipal governments raise more revenue, yet there are clear differences between them. Jinja District, for example, raises 16% of its total revenue while Mukono District, while similar in nature, raises just 9%. There is also a clear inequality in revenue raising between Uganda’s south and west and its north and east; the latter two are typically the poorest regions with much more prevalent and higher levels of external financing.

The context and position of local governments is an important consideration when identifying the potential areas and means for increasing locally raised revenue. We also must understand the impact of

revenue collection on the poorest people. Sub-national governments are a microcosm of central governments, with some forms of revenue more progressive in nature than others.²¹ Ensuring sub-national governments

increase locally raised revenue in a progressive way can be a key component of increased finance for development in a way that does not adversely impact on the poorest and most vulnerable people.

Summary

National institutions are best placed to drive poverty reduction as they can diagnose, prioritise and design solutions to domestic challenges most effectively. Yet in the countries where the challenge of ending poverty is greatest, national institutions do not have enough resources to make these investments. To end poverty by 2030 national institutions in the poorest

countries need significant increases in the resources available to them. The international community, which already supports much investment in key sectors and sub-national regions in key countries, will continue to play an important role in the SDG era. We must ensure that international official finance is well targeted, and that appropriate instruments are used in each context.