May 2018

ODA for domestic resource mobilisation: is it working?

briefing

This briefing summarises the key findings of our research into ODA for domestic resource mobilisation to be published in June 2018 – please look out for it on our website at devinit.org.

We will continue to build on this work to inform more detailed analysis through our Investments to End Poverty project in 2018. Feedback, thoughts and comments are welcome.

key findings and questions

Domestic public resources are widely recognised as one of the most important sources of financing for developing countries to meet the Sustainable Development Goals (SDGs). Equally, the important part that official development assistance (ODA) can play in helping to strengthen and scale up domestic resource mobilisation (DRM) for development is well understood. This has led to significant political attention and action, most notably with development partners committing in the Addis Tax Initiative (ATI) to double ODA support to DRM and improve policy coherence. However, these commitments – that political consensus – have failed to realise substantial progress at the country level. Why is this, and what can be done about it?

In looking at this question, particularly through the lens of the ATI, two key findings emerge:

1. While providers are on track to meet the ATI commitment of doubling ODA, the data shows that this is largely down to a small number of donor countries increasing their disbursements significantly.
2. The data also shows that the countries receiving support are limited. While the absolute number of countries is relatively large and the rate of increase has been fairly significant, a large proportion of ODA for DRM is going to a very small group of countries and the absolute amount remains small.

In turn, this raises key questions for discussion:

- Is the scale of ambition on the ATI financing targets high enough, when evidence suggests that doubling will still be insufficient to meet need?
- Beyond financing levels, how important are aspects such as planning, strategy and effectiveness, and should there be further commitments in these areas?

background

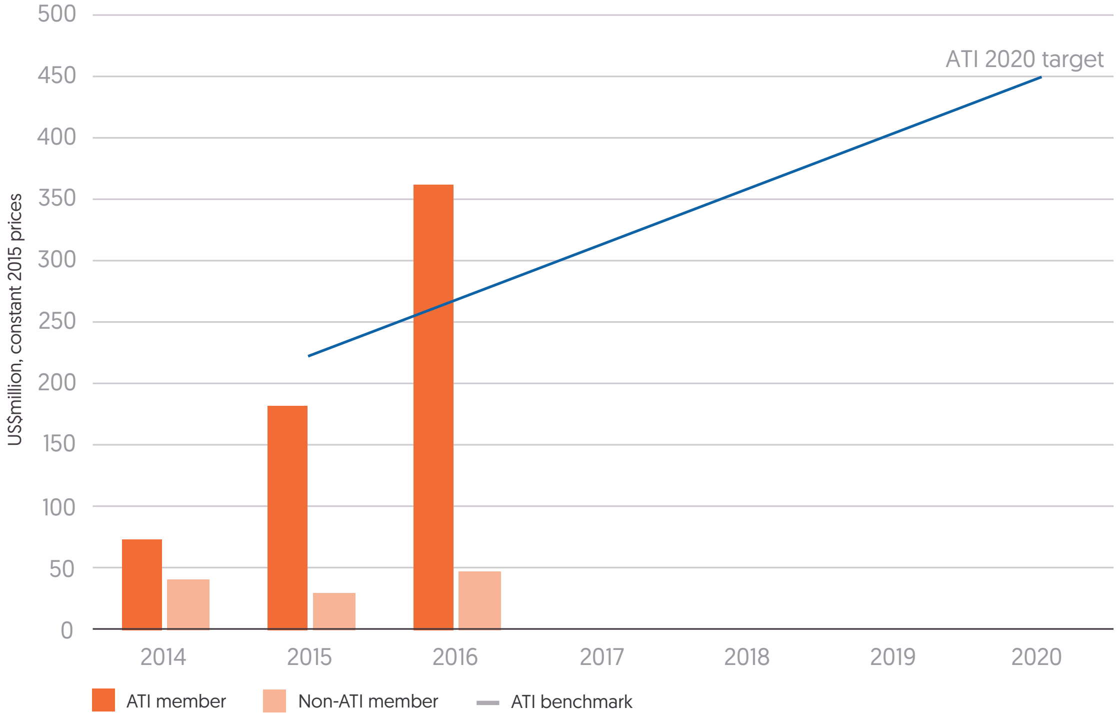
Domestic public resources are widely acknowledged – in the Addis Ababa Action Agenda on financing for development[1] not least – as one of the most important sources of finance for developing countries. While a wide variety of financial flows from ODA to international private finance are critical to achieving the ambitions of the 2030 Agenda for Sustainable Development (Agenda 2030), domestic resources are perhaps one of the most important. They form a spine around which other resources should be coordinated. Domestic resources can not only finance pro-poor development but also strengthen countries' ownership and control of their own development. There is also arguably substantial potential for an increase in domestic resources whether through economic growth or by supporting the strengthening of domestic resource mobilisation (DRM). And there is also broad consensus that increasing DRM will be fundamental to delivering on Agenda 2030 and meeting the SDGs.

But progress has been mixed in achieving this goal. On the global level, there is significant agreement on the importance of better support for DRM and the catalytic role ODA can play in it – which has been clearly illustrated in the creation of the Addis Tax Initiative (ATI)[2] and other similar initiatives. Yet this has seemingly failed to translate into real progress at the country level, with median tax revenue for least developed countries declining to 13.3% in 2016, and growth in tax-to-GDP ratios slowing in middle income countries.[3] Other factors such as low commodity prices and weak global growth have depressed progress on DRM, but despite the consensus and commitments made, ambition seems not to have been met with action and real progress. Understanding why that consensus has not translated into progress is critical.

financing DRM – on track but off target

While donors are collectively on track to meet if not exceed their target, agreed in the ATI, of doubling ODA for DRM, the question remains of whether this is the right target. Given the relatively low level of aid spent on DRM, doubling does not equate to a significant amount of resources (Figure 1) and can be easily distorted by a one-off significant increase from one country. One such example is France, which increased disbursements from US$5.7 million in 2015 to US$154.2 million in 2016 – primarily due to a large disbursement to Indonesia – and thus represented a significant proportion of the 2016 uplift.

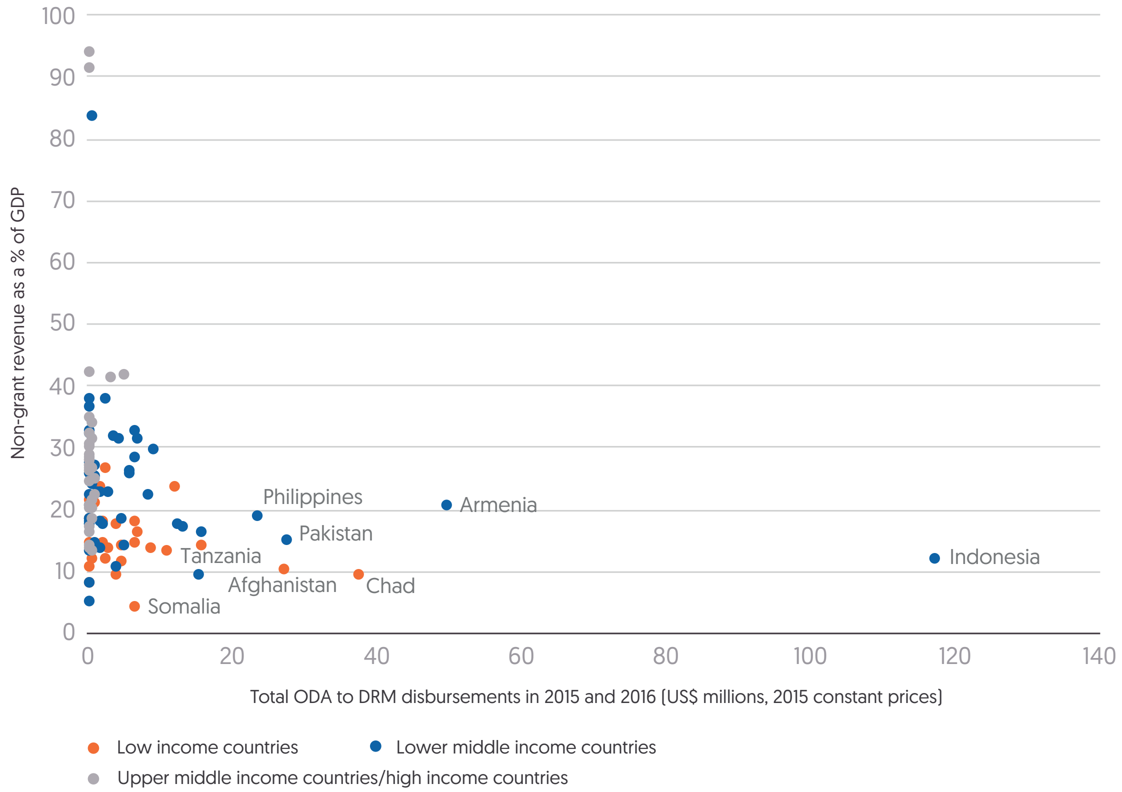
Figure 1
ODA for DRM from ATI and non-ATI members



Source: OECD Development Assistance Committee Creditor Reporting System (CRS), ATI monitoring report 2015
Note: ODA to DRM comprises all projects reported to the DRM code and those with a major component targeting DRM.
Abbreviations: ATI: Addis Tax Initiative; DRM: domestic resource mobilisation; ODA: official development assistance.

In addition, these resources are targeting a relatively small number of countries. While analysis shows that over 116 countries receive some ODA specifically targeted at DRM, a significant proportion of this is focused on a much smaller group. The six countries receiving the most accounted for around 45% and Indonesia alone represented 18.9% of total disbursements for 2015–2016. And interestingly, though all the largest recipients have low revenue-to-GDP ratios, four of those are lower middle income countries. But from a demand perspective, many countries have sizeable funding gaps in their national revenue authority plans.[4] Given the evident scale of the need for financial support to build DRM capacity in some countries, the aggregate need – particularly for low or lower middle income countries – for concessional finance like ODA will clearly be significantly higher than the US$447.52 million in disbursements committed to in the ATI or from providers outside the ATI.

Figure 2
DRM support to countries by income classification



Source: OECD Development Assistance Committee Creditor Reporting System (CRS), International Monetary Fund (IMF)
Note: ODA to DRM comprises all projects from all donors reported to the DRM code or with a major component targeting DRM.
Abbreviations: DRM: domestic resource mobilisation; ODA: official development assistance.

beyond the money – making aid for DRM more effective

Creating an enabling environment

The evidence outlined in the first section suggests a need for a more demand-oriented, context-specific approach to ODA for DRM tailored to needs as defined by countries themselves. And a strong enabling environment is fundamentally important to both ensuring there is capacity to understand that need and using resources effectively to deliver real change and progress.

Key elements of a strong enabling environment are:

- Strong political commitment and institutional coherence – important to both improving DRM and securing international support
- Strengthened transparency and accountability structures – to improve relations and information available to all development partners
- Strategic policy formulation and coherence – which articulate the role of domestic public resources in financing development, a strategy for DRM and the role for development partners
- Dialogue mechanisms – to clearly communicate plans with partners and ensure effective participation of other actors such as civil society and the private sector.

Case study: Somalia
How high-level political commitment is driving DRM and encouraging international support

Since the Federal Government of Somalia was formed in 2015, it has led numerous fiscal reforms, guided by the 2016 Vision and supported by the IMF. These include forming staff-monitored programmes in 2016/17 and in 2017/18, with 87 technical assistance programmes since 2013. Following elections in early 2017, the new government has made its commitment to DRM clear, with the Prime Minister and Minister of Finance both vocal advocates of fiscal reform and DRM to fund development. Recent tax reforms are hoped to steadily improve government tax-to-GDP from 1.6% in 2016 to 2.0% in 2020. With international support, the government is also working with state governments to harmonise tax policy.

Sources: Reuters, 2017. Somalia's budget meets IMF terms, official says, Halbeeg, 2018.[5] Somalia to Implement Harmonized Tax Policy for the First Time Over 27 years[6] and IMF staff report[7].

Better assessment of progress on what has worked (and what has not) is also an important element to building capacity and a strong enabling environment. This should ideally look beyond more traditional measures such as tax-to-GDP ratios or public financial management performance. For example, where changes are only visible much further downstream from intervention, using tools such as integrated national financing frameworks which could help to understand progress in 'real time' within the much wider framework of development financing and sustainable development.

Putting countries in the driving seat – ownership and coherence

How support is provided and how providers behave are also critically important to effective ODA for DRM; development partners must continue improving the effectiveness of the support they provide. Here development effectiveness principles – country ownership and policy coherence in particular – have much to offer in providing a useful roadmap[8] on how to redress the disconnect between international commitment, action on the ground and progress.

Country ownership

Successfully strengthening DRM requires not just support for those systems but a more holistic approach to support building state capacity and using countries' own systems. Duplication or fragmentation weaken state legitimacy (and thus willingness to pay tax)[9] whereas effective use of modalities such as budget support strengthen public financial management systems including revenue collection. This is particularly important for fragile and least developed countries, where systems are less well-developed, and so are less used and need more support.[10]

Policy coherence

This is an area where ATI signatories committed to make improvements but to date the focus has been on strategic policy and institutional coherence, among ministries for example. Emphasis could also usefully be placed on developing a stronger evidence base on the impact of DRM support, how wider policies and projects are influencing DRM, and a clearer alignment of support to the SDGs to better demonstrate how increased support is translating into results. For example, rather than assuming that increased DRM will necessarily increase social spending in line with pro-poor development goals, further research and evaluation could improve understanding and evidence impact.

notes

1 Addis Ababa Action Agenda of the Third International Conference on Financing for Development, available at: www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

2 The ATI is voluntary initiative launched in 2015 at the Third International Conference on Financing for Development in Addis Ababa where countries committed to enhance the mobilisation and effective use of domestic resources and to improve the fairness, transparency, efficiency and effectiveness of their tax systems. For more information see https://www.addistaxinitiative.net

3 Inter-agency Task Force on Financing for Development, 2018. Financing for Development: Progress and Prospects, p. 41. Available at https://developmentfinance.un.org/iatf2018

4 For example, the corporate plans of the Liberian, Ugandan and Kenyan revenue authorities all show substantial gaps to fill in their multi-year budgets from US$42m to US$156 equating to up to 25%

5 Available at: https://www.reuters.com/article/somalia-budget-idAFL8N1OF1O9

6 Available at: https://en.halbeeg.com/2018/03/16/somalia-to-implement-harmonized-tax-policy-for-the-first-time-over-27-years

7 Available at: http://www.imf.org/en/Publications/CR/Issues/2018/02/26/Somalia-2017-Article-IV-Consultation-and-First-Review-Under-the-Staff-Monitored-Program-45662

8 UN Development Programme, 2016. Making Development Cooperation More Effective: 2016 Progress Report. Available at: www.undp.org/content/undp/en/home/librarypage/development-impact/making-development-co-operation-more-effective--2016-progress-re.html

9 Global Economic Governance Programme, 2015. Continuity, Aid and Revival: State Building in South Korea, Taiwan, Iraq and Afghanistan. Available at: www.geg.ox.ac.uk/publication/geg-wp-2015109-continuity-aid-and-revival-state-building-south-korea-taiwan-iraq-and

10 UN Development Programme, 2016. Making Development Cooperation More Effective: 2016 Progress Report. Available at: www.undp.org/content/undp/en/home/librarypage/development-impact/making-development-co-operation-more-effective--2016-progress-re.html

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