Mobilizing domestic financial resources for Africa's development

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Abstract

The paper discusses the possible sources of domestic finance for Africa's development and the challenges entailed in its mobilization. It argues that the difficulties involved in mobilizing domestic resources are not insurmountable and that significant advances can be made even in the short run as evidenced by the success of several countries in raising domestic revenues. Improving domestic resource mobilization in Africa requires an innovative configuration which calls for a rationalization of existing approaches to resource mobilization in general. This includes reforms to: (i) Africa's financial systems to address financial segmentation in order to improve the efficiency of financial intermediation and enhance domestic savings; (ii) revenue collection and administration to increase public revenues; and (iii) specially targeted programmes to enhance the flow of remittances through formal channels for investment, and to stem the flow of flight capital. The support of the international community is critical to the success of these reforms, which will benefit the whole economy.

The views expressed in this paper are those of the author, and should in noway be attributed to the UNCTAD secretariat or its Secretary-General.

1. Introduction

Alternative sources of closing Africa's development resource gap only started to be seriously considered in the wake of the first UN International Conference on Financing for Development (FFD) held in Monterrey, Mexico (March 2002). This conference pushed the limits of the debate about development finance beyond its traditional boundaries of increased official development assistance (ODA) and its effective use, debt relief, and foreign direct investment (FDI) to the mobilization of domestic financial resources. Thus, mobilizing domestic financial resources for development, an issue which had until then been neglected, was forced into the headlines.

Despite this, however, not much headway has been made and domestic resource mobilization has to date received little attention, even in the literature[1]. In part this is explained by the mistaken assumption that it is not realistic to expect a large and sustained increase in domestic resource mobilization in Africa because of low levels of income, demographic factors and the weakness of financial markets. This method of closing Africa's resource gap has therefore been described by one observer as "hard option", which is only feasible in the long term (Aryeetey, 2004). The upshot of this is that the international development community has more or less continued to be fixated on closing the continent's resource gap primarily from external inflows (aid, FDI, and debt relief), at least until 2015 (see McKinley, 2007).

The objective of this paper is to discuss the possible sources of domestic finance for Africa's development and the challenges entailed in its mobilization. It argues that the difficulties involved in mobilizing domestic resources are not insurmountable and that significant advances can be made even in the short run as evidenced by the success of several countries in raising domestic revenues. Improving domestic resource mobilization in Africa requires an innovative configuration which rationalizes existing approaches to resource mobilization in general:

(i) Africa's financial systems to address financial segmentation in order to improve the efficiency of financial intermediation and enhance domestic savings;
(ii) revenue collection and administration to increase public revenues; and
(iii) specially targeted programmes to enhance the flow of remittances through formal channels for investment, and to stem the flow of flight capital. The support of the international community is critical to the success of these reforms, which will benefit the whole economy.

2. Closing the development resource gap: brief overview of options

Much of the material for this paper is derived the Economic Development in ***Africa: Reclaiming Policy Space - Domestic Resource mobilization and Developmental States published by UNCTAD in July 2007*** *and an ongoing Project on Domestic Resource Mobilization in Africa. The author is the Team leader for the report.*

The growth and gap models of the 1950s and 1960s established the economic case for providing aid to poor developing countries. These models assumed that in an open economy, savings finance investment with the total savings in the economy comprising domestic and foreign savings. A savings gap exists if domestic resources are much less than what is required to fund the investment necessary to attain a target rate of growth. Similarly, a "trade gap" or "foreign exchange gap" is identified if there is insufficient foreign exchange (i.e. insufficient exports) to pay for imported goods, which must complement domestically produced investment goods in order to attain a target growth rate (Rosenstein-Rodan, 1961).

These models posit that aid, by providing an initial boost to domestic capital formation and incomes, can raise domestic savings in both the corporate and household sectors. As a result, it will stimulate an investment-export nexus that will eventually close the gap between domestic resources and the supply of foreign exchange. In the medium to long term, growth and development should become self-sustaining and the needs for aid disappear.

The two-gap model of Chenery and Bruno (1962) contended that the main constraint to economic development was capital accumulation, and therefore the role of aid was to supplement domestic savings. The prevailing notion that there were significant market failures and externalities implied that the government had a role to play in managing the investment and aid process in poor recipient countries. During much of this period, private capital markets had little or no interest at all in these poor developing countries (colonies). The interests of the erstwhile European colonial masters revolved around increasing exports and retaining cultural and commercial ties. And in the case of the United States (US), political strategic and military advantages were the main driving force in providing aid to these countries.

For much of the 1950s and 1960s, there appeared to be some consensus that the resource gap of developing countries should be financed by transfers from the developed countries (bilateral aid). Multilateral aid began to take hold much later from about the early 1970s, but like its bilateral counterpart, it was essentially to governments which were regarded as the main agents of development within a statist development paradigm.

The intellectual case for openness, against statist development strategies, started gaining ground in the 1970s.[2] However, it was a series of economic and political developments in the 1970s and 1980s that eventually swung the development pendulum in favour of openness, and with this, a change in the aid doctrine.[3] The financial crises of the late 1970s and early 1980s, in the wake of global instability, provided a great leverage for those able to finance or refinance developing country debts. The then nascent neo-liberal paradigm provided the basis for market oriented development policies packaged into the intellectual framework that came to be known as the "Washington Consensus".

The "Structural adjustment programmes" (SAPs), derived from the Washington Consensus, see increased FDI as the key to sustained economic growth, in conformity with "market fundamentals". FDI inflows have come to be perceived as an essential source of investment finance for all low-income countries, for a variety of other reasons. First, other sources of development finance – ODA, private capital flows and domestic savings – dwindled to levels way below that required for undertaking projects or programmes needed to bring about economic growth, development and poverty reduction. Second, the composition of capital inflows had shifted away from bank loans and other forms of capital inflows towards FDI and portfolio investment. Finally, it was contended that the resilience of FDI during financial crises and the fact that there exists substantial evidence that such investments are beneficial to its hosts, particularly developing countries, makes it a development finance of choice (Loungani and Razin, 2001).[4] The experience of the newly industrializing economies (NIEs), a small number of fast growing countries in south East Asia, was also important in endorsing the new notion that attracting FDI was the key to bridging the resource gap of low income countries and avoiding a new debt build-up. Typically for Africa, the implementation of responsible macroeconomic policies, within a context of accelerating pace of liberalization, deregulation and privatization was expected to attract FDI (UNCTAD, 2005), and among other things, to close its resource gap.

The unanticipated outcomes of SAPs in Africa, and the mounting debt crisis, led to much soul-searching on the part of the World Bank and the IMF. The two institutions launched the Heavily Indebted Poor Countries (HIPC) Initiative in 1996 (and enhanced in 1999) to address the debt overhang of debt distressed poor developing countries. Ironically, this Initiative created opportunities for external resource "transfers" to these countries, about two-thirds of which are African, as it largely wrote off their external debt obligations. An important conditionality of the Initiative was that debt relief resources transferred to a beneficiary country should not be offset against its normal ODA flows. That is, debt relief should be additional to the amount of ODA that it would ordinarily have received, hence the principle of "additionality". That these "additional" resources were to be devoted to poverty reduction in the HIPCs gave rise to the idea of resource transfers occasioned by debt relief to close, or at least bridge, the resource gap in debt distressed poor countries.[5]

3. How big is Africa's resource gap?

The resurgence of interest in aid to Africa since the turn of the century dates to the UN Millennium Summit in 2000 at which all member states signed up to the MDGs, the first one of which is to halve world poverty by 2015. This is derived, in principle, from the consensus that the continent lacks sufficient domestic resources to attain an annual growth rate of 7 per cent, which most analysts consider to be the minimum rate required to achieve the first MDG. However, there is no such consensus on the amount of official development assistance (ODA) required to bridge the resource gap in order to attain this rate of growth. This uncertainty itself drives, in part, from the difficulties of estimating the costs of meeting the MDGs in general[6] which has led to the wide variety of estimates produced by different institutions (see table 1).

In sum, it is difficult to estimate with any degree of certainty the size of Africa's resource gap that needs to be filled to enable it to attain the MDGs by 2015. The accuracy of this estimate will depend *inter alia* on the specific assumptions made regarding infrastructure needs, the outcome of efforts to increase domestic resource mobilization, and the current state of absorptive capacity. Nevertheless, on the basis of existing estimates, it would appear that, at the minimum, Africa's additional aid requirements are likely to be around $20 billion per annum by 2008–2010, and increasing to about $25 billion per annum by 2015. This figure could almost certainly be reduced, at least by half, if efforts to mobilize domestic resources bear fruit in the medium term.

4. The rationale for domestic resource mobilization

The discussion above illustrates that proposals regarding how to close the resource gap in poor developing countries appear to have shifted consonant with the evolution of development thinking, and the prevailing development ideologies at each period: from aid flows (state-led development) to FDI (neo-liberal development framework), and then to debt relief (prioritization of poverty reduction).

The debate on how to close the financing gap for Africa is, however, far from settled. Both ODA and FDI are unlikely

Table 1. Estimates of additional resource requirements for Africa

Source	Estimates (US$ per annum)	Comments
Zedillo report (Zedillo et al., 2001)	50 billion	Applies to all developing countries
Devarajan et al. (2002)	40-60 billion	Two different approaches were used. The first approach estimates the MDG resource needs by calculating the required economic growth rates of countries, and then the investment required to achieve these. The second approach separately estimates the costs of achieving individual goals. Both estimates exclude certain costs, notably those of the complementary infrastructure required to support the necessary rates of growth and investment.
NEPAD framework document (Funke and Nsouli, 2003)	64 billion	Equivalent to 12 per cent of Africa's GDP
Commission for Africa (CFA, 2005)	$37.5 billion	This is to finance public expenditures until 2010. One third of this is to come from domestic resources and $25 billion from aid.
G8 Gleneagles Declaration	$25 billion a year by 2010	N/A
World Bank and IMF (Gupta, Powell and Yang, 2006)	14–18 billion (2006–2008); 24–28 billion (by 2015)	It is argued this is the amount Africa could use effectively for the improvement of infrastructure and human development.

to flow in sufficient quantities to plug the resource gap, and serious questions remain about their quality, impact and the set of conditionalities that come with them. Indeed, both remain very volatile, with estimates suggesting that ODA, for example, is up to four times more volatile than domestic revenues (For a detailed discussion of FDI and ODA with reference to Africa, see UNCTAD, 2005 and 2006 respectively). And despite all its good intentions, the HIPC debt relief programme has fallen short of its own cardinal principle of additionality, although it has provided a great relief from the debt distress that afflicted the beneficiaries at the time it was launched.[7] Furthermore, several observers have cautioned against the possibility of re-accumulation of external debts, and the destabilizing impact of huge domestic debts, all of which raise the spectre of a new debt overhang in these countries.

In this context, domestic resource mobilization and its efficient investment acquire greater significance. More reliance on domestic resources will reduce the dependence of African countries on external capital inflows and associated conditionalities, and reduce their probability of accumulating unsustainable external debts. Furthermore, this will enable them to regain the policy space that is necessary for the pursuant of truly nationally-owned development strategies that respond to their development priorities. That is, a structural transformation of their economies which leads to sustainable development in the medium to long term.

Unfortunately, mobilizing domestic resources for development has not been systematically addressed in African countries beyond financial sector reforms and the introduction of consumption taxes such as VAT (value added tax). The next section seeks to address this imbalance by discussing possible sources of domestic resources and policies that may be useful for mobilizing them.

5. Mobilizing Domestic Financial Resources

The question that one frequently confronts when discussing the mobilization of domestic resources to fund development in Africa is usually: where would these coming from? And even if they exist, do these countries have the capacity to mobilize them?

These questions are quite pertinent, and are in part a reflection of the low revenues generated by low income countries during the 1980s and early 1990s. The tax revenue to GDP ratio of a representative of low income countries during this period was in the region of 17-19 per cent. This state of affairs has been explained partly by the recession or low growth experienced by these countries during this period as well as the downsizing of governments in these countries because of the perception that they were too big. Most controversially, the international financial institutions are blamed for their "faulty tax advice" to these countries (McKinley, 2007).

Most often, however, the fact that these countries have domestic resources which could be mobilized is overlooked; or the size of these resources is underestimated by most analysts. And while it is true that there is a capacity problem in most African countries, it is also correct to say that even whatever capacity is available is being seriously underutilized. The available evidence suggests that with some innovation, principally in diversifying their approach to revenue mobilization, countries can mobilize more domestic resource than they do at present. Countries as diverse as Ethiopia, Ghana, Mali, Rwanda and Uganda, for example, increased their revenue GDP ratios by four percentage points or more during 1994 to 2004 by increasing their reliance on multiple sources of revenue (McKinley, 2007).

The immediate sources of domestic financial resources in Africa that could be mobilized are domestic savings, and public revenues. Workers' remittances and curbing or reversing capital flight would also yield significant resources that could be considered domestic.

(a) Domestic savings

Domestic savings can be categorized into public and government savings. The latter has, however, been estimated to be very low in Africa over the last decade, averaging about 2 per cent of GDP (Brownbridge, 2007). Hence domestic savings in Africa consist almost entirely of private savings.[8]

In sub-Saharan Africa (SSA) savings rates are low: they are the lowest of any region. In 2005, gross domestic savings represented just about 18.0 per cent of GDP in the region; four percentage points lower than in Latin America and the Caribbean, and less than half the average in East Asia and the Pacific countries (World Bank, 2007a) (Figure 1). The trend in savings in the developing world has been one of increasing disparity between various regions, especially after 1980. Africa's saving rates have fallen, Latin America's have stagnated and East Asia's rates soared (see figure 1). These trends mirror the general economic performance of these regions over the past four decades or so (Hussein and Thirlwall, 1999).

In addition to savings rates, stability of savings over time is crucial for smooth and predictable investment, and Africa again fares worse than other developing regions in this area. A major reason for this is the volatility of the sources of income, which is higher in Africa than in other developing regions, due mainly to exogenous shocks. The standard deviation for gross national savings as a share of GDP from 1965 to 1992 was 8.7 per cent for Africa, 6.6 per cent for the East Asian "Tigers" and 6.0 per cent for Latin America and the Caribbean (Schmidt-Hebbel et al., 1994).

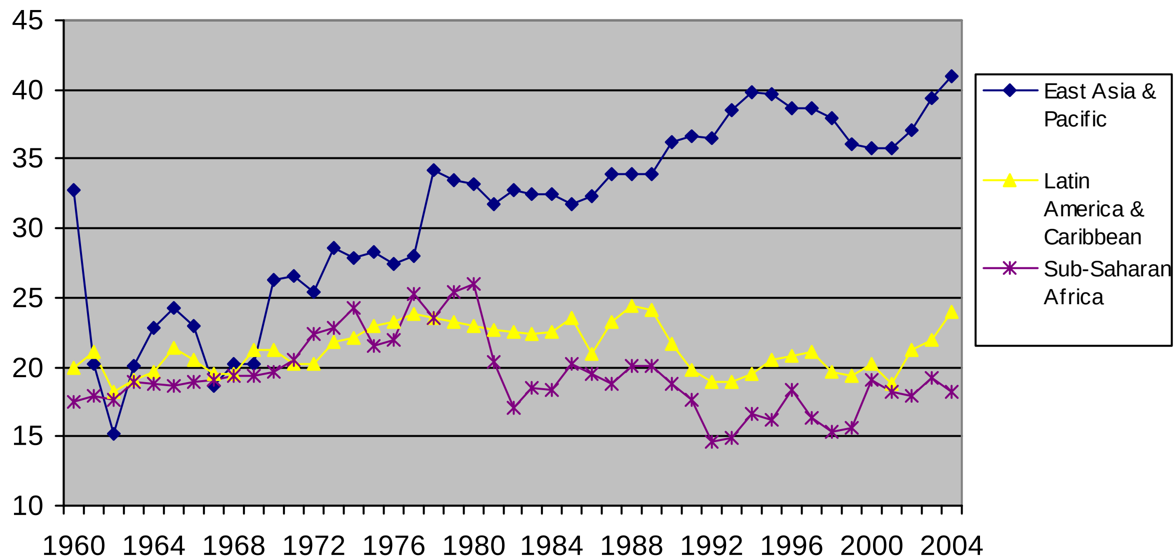
The capacity to save is mainly determined by income level, rate of income growth and the dependency ratio, i.e. the ratio of population under 16 or above 60 years old to that of the working-age population (Loayza et al., 2000). A positive relationship exists between savings rate and per capita income (Hussein and Thirlwall, 1999). Savings rates have also been found to increase in response to rises in the rate of growth of per capita income. Finally, savings rates appear to respond negatively to increases in the dependency ratio. On the other hand, the willingness to save is believed to depend on the ease of access to savings instruments, the attractiveness of such instruments and the prevailing economic conditions (Wright, 1999; Hussein and Thirlwall, 1999).

It is important to note that there are three characteristics of Africa's domestic savings that are often ignored in the current discourse on African development. First, the average savings rate for Africa masks important disparities across the continent. In 2005, Algeria and the Republic of the Congo both achieved gross domestic savings rates of more than 50 per cent of their GDP, while Eritrea and Sao Tome and Principe both had rates far below minus 20 per cent, indicating dissaving on a massive scale (World Bank, 2006) (see also Table 2).

Second, the savings rate for SSA has broadly evolved over the years. From 1960 to 1974, it increased steadily from 17.5 per cent to 24.3 per cent of GDP (World Bank, 2007). It then experienced much higher volatility before reaching its highest rate of nearly 26 per cent in 1980. Then came Africa's "savings collapse" (Eldabawi and Mwega, 2000), as the rate fell to under 15 per cent in 1992. Since then, there has been a tentative recovery, yet the rate has remained low, and was only 17.6 per cent in 2005 (see Figure 5). It is important to note also that until Africa's savings collapse, SSA, for example, was able to finance its investment from its own savings (Figure 2).

Third, official savings data do not capture the full extent savings already being made by households in Africa: fi-

Figure 1. Gross domestic savings by developing regions, 1960–2004
(percentage of GDP)



nancial savings in the formal financial sector represent only a small fraction of total savings. Domestic savings in much of Africa are being held in the non-financial form (e.g. physical assets such as jewellery, livestock, etc) and in the informal system of susu or savings and rotating credit agencies (ROSCAs). The evidence is limited, no doubt, but it is estimated that about 80 per cent of all households' assets in the rural areas are in non-financial assets. These are not available for further intermediation, and only a small part can be used for productive investment. Besides in both urban and rural areas, there are financial savings outside the banking/ financial system, which are not captured by official statistics. These savings are also not available for intermediation.

Considering Africa's savings performance during the 1970s and 1980s it is not impossible for Africa to attain higher savings rates to fund much of its domestic investments in the future. The important ingredient of this is economic growth, which has been increasing steadily in the past five years, with Africa attaining high growth rates not witnessed in the past three decades. It is therefore not surprising that since 2000 Africa has emerged as the most dynamic region in terms of investment way ahead of Asia, although the latter received a much higher share of FDI. The continent has doubled its fixed investment because of a robust growth domestic investment (UNCTAD, 2007b).

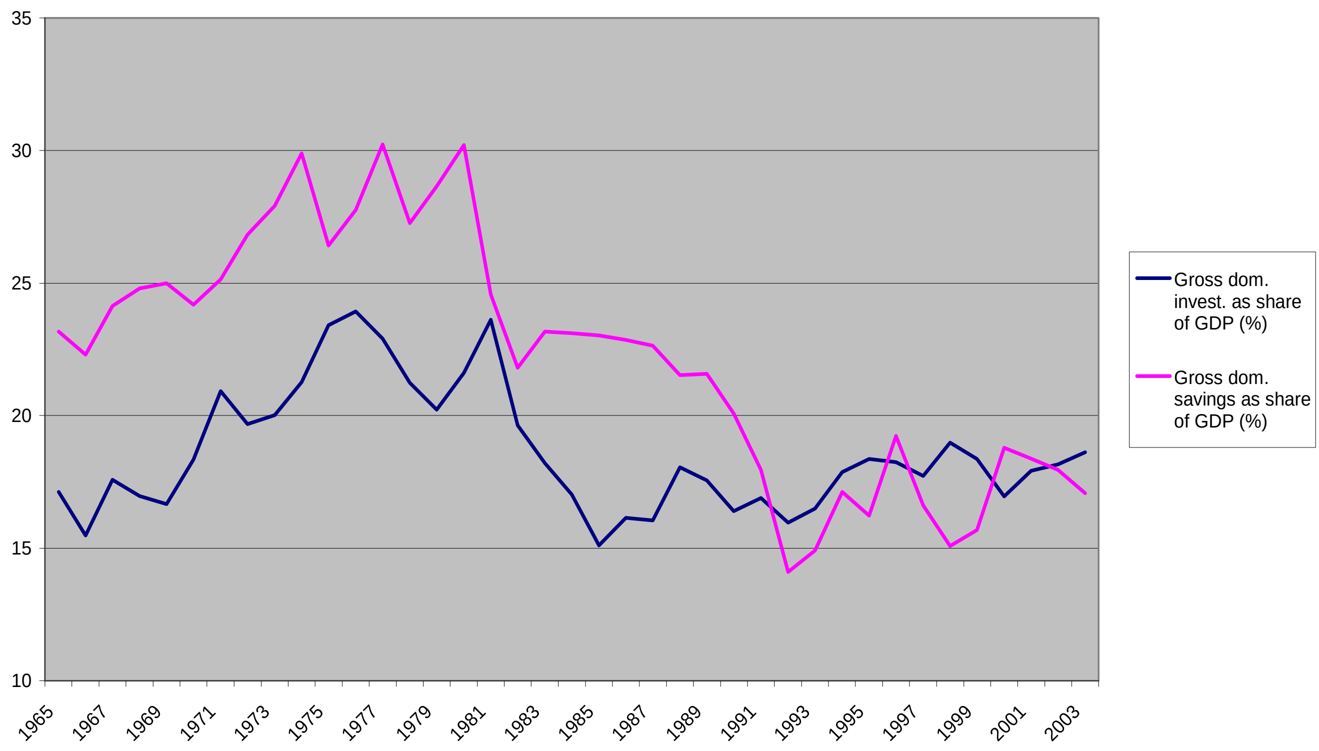
If current growth rates are sustained into the future, Africa could well surpass its highest savings rate of 26 per cent registered in 1980. And with the necessary

Table 2: Distribution of savings rates in Africa, 2000–2005 (number of countries)

Negative	0–10% of GDP	10–20% of GDP	20–30% of GDP	Over 30% of GDP
11	14	13	7	5

Source: UNCTAD, 2007a

Figure 2. **Gross Domestic Investment and Gross Domestic Savings in Sub Saharan Africa 1965-2003**
(source: World Bank Africa Database 2005)



reforms, the savings mobilization efforts would benefit from the financialization of non-financial assets (i.e. converting them into financial assets and lodging them into the formal financial system) (see discussions below).

(b) Public revenues

As in the case of private savings, low per capita incomes in Africa limit the volume of public revenues that could be mobilized via taxation. This is exacerbated by the structural features of most economies - a dualistic economy with a large informal sector, including subsistence agriculture which exist side by side with a small (and in several cases) shrinking formal sector. Furthermore, the weak and corrupt tax systems of most countries means that most of total potential tax goes uncollected and in some case diverted into private pockets.

Nonetheless, there is a considerable diversity of experience in tax revenue collection among African countries. The ratio of tax revenues to GDP, for instance, ranged from less than 10 per cent (Chad, Niger, and Sudan) to as high as 38 per cent (Algeria and Angola) in 2002. And the tax ratio is much higher in North Africa (25 per-cent) than in SSA (20 per cent). Excluding South Africa, the tax ratio for SSA is only 16 per cent (UNCTAD, 2007a).

Furthermore, in recent years some countries have been able to improve their tax-GDP ratios considerably, on average by about four percentage points or more. Ghana, for example, improved its tax-GDP ratio from about 12 to 24 per cent between 1990 and 2004 (McKinley, 2007). In Zambia, recent reforms to tax policy and administration have increased the share of income tax from about 35 per cent to almost 50 per cent, even as the proportion of VAT more or less stagnated and that of trade taxes declined from more than 50 per cent to well below 30 per cent over the same period. Domestic revenues are projected to account for about 71 per cent of the 2008 budget.[9] During the 2005-2006 fiscal year, Kenya relied on its own domestic resources to finance all but 4 per cent of its budget, which was financed by grants (compared to more than 50 per cent in several African countries). These experiences suggest that, several countries could double their current level of tax revenues. This will however require concerted efforts directed at reforming and strengthening the tax system and tax administration, as discussed later.

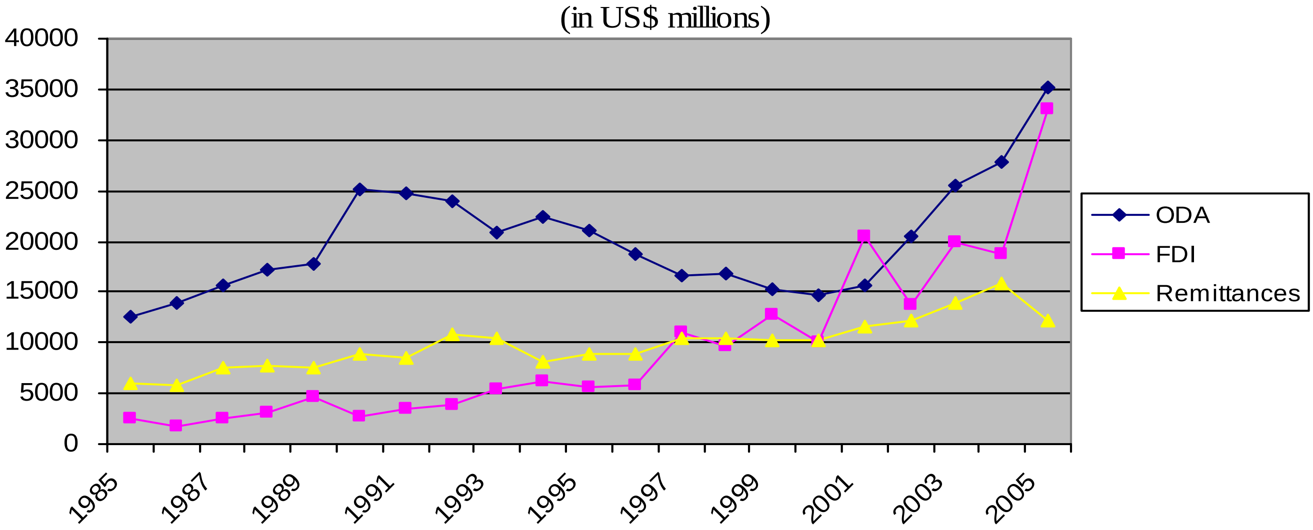
(c) Workers' remittances

The International Monetary Fund (IMF) Balance of Payments Statistics has been criticised as not accurately reporting data on remittance flows (Solimano, 2003). This data tend to include transfers that are not strictly speaking remittances as it includes all private transfers to the non-corporate sector. This notwithstanding, there is a general belief that official remittance figures underestimate the actual flows. This is because a large proportion of remittances which flow through informal channels tends to be unreported, Intra-regional remittances are particularly prone to under-reporting, if at all reported.

Official figures do, however, provide an idea of the importance of remittance flows and of their evolution over time; and these suggest that in recent years, remittances from migrant workers to the developing world have increased considerably. At about $184 billion in 2005, remittances ranked second in terms of capital inflows after FDI (about $281 billion); and are estimated to have grown at a rate of about 8 per cent per annum between 1980 and 2002 (Solimano, 2003). Generally, however, estimates for remittances to developing countries range from $240 to $300 billion per annum.

The UNECA estimates that Africa as a whole receives around 15 per cent of global remittance flows, with around two thirds of these going to North Africa (UNECA, 2006). Remittances to the continent have increased considerably since the mid-1990s, overtaking FDI as the second most important capital inflow till about 2000, when they were overtaken by the phenomenal increases in FDI flows to the continent (Figure 3). They are thus increasingly being seen as important resources for development.[10] According to recent IFAD estimates, actual remittance transfers to sub-Saharan African countries are worth around twice the recorded amount of US$ 9.25 billion in 2006. For Africa as a whole, these amounted to about $40 billion in 2006, mostly to North African countries. Country-by-country data suggests that remittances represent about 5 per cent and 27 per cent of GDP and export receipts respectively, although the importance of remittances varies hugely from country to country. They make up more than 5 per cent of the GDP of Egypt, Gambia, Lesotho and Morocco; about one-fifth of that of Burundi, Liberia and Lesotho; and more than a third of the GDP of Cape Verde and Eritrea (Table 3), both of which have historically experienced high rates of emigration.

Figure 3. Capital flows to Africa, 1985–2005
(in US$ millions)



Sources: UNCTAD 2007a

Table 3: Remittances to Africa, 2006 (per cent of GDP)

Share of GDP (per cent)	Countries (amount in US$ million)
0-5	Algeria (5,399); Angola (969); Cameroun (267); Central African Republic (73); Chad (137); Cote d'Ivoire (282); Equatorial Guinea (77); Ethiopia (591); Gabon (60); Egypt (3,637); Libya (134); Malawi (102); Mauritania (103); Nigeria (5,397); South Africa (1,489); Sudan (759); Swaziland (89); Tunisia (1,559); Tanzania (313); Zambia(201).
6-10	Congo (423); Congo, DR (636); Morocco (6,116); Madagascar (316); Mauritius (356); Mozambique (565) Rwanda (149); Uganda (642): Zimbabwe (361); Benin (263), Burkina Faso (507); Ghana (851); Guinea (286); Niger (205); Senegal (667); Togo (142).
11-15	Mali (739); Sierra Leone (168).
16-20	Gambia (87).
20+	Burundi (184); Comoros (85); Lesotho (355); Liberia (163).
30+	Eritrea (411); Cape Verde (391).

Source: Extracted from IFAD at http://www.ifad.org/events/remittances/maps/africa.htm (assessed 29 January 2008)

It must, however, be noted that remittances are at present largely being transferred through unofficial channels and are therefore not recorded. Furthermore, the costs of transfers have remained very high because of regulatory restrictions and prevalence of monopolies (banks and few money transfer operators) which have exclusivity deals with banks.[11] These and the lack of appropriate financial services for remittances in recipient countries will have to be addressed before the full potential development impact of these funds could be unlocked.

(d) Capital flight

Capital flight is not a clearly defined concept; and there are probably as many definitions and measurements as there are writers on the subject! Basically, it involves the investment of domestic or national savings in foreign assets, and as such entails a loss of resources which could otherwise be invested domestically. Broadly defined, it would cover all investments in external assets by the private sector, whether legal or illegal. A narrower definition would be all investments in external assets by the private sector which are not reported to the authorities and, therefore, not recorded in balance of payments statistics. The latter definition would include the proceeds of corruption and money gained from illicit activities.

The essential conceptual difference between various measures for capital flight, however, lies in the coverage of outflows of capital. That is, whether the distinction is made between capital flight caused by increased risk entailed in holding domestic assets (i.e., political and economic uncertainty), and “normal” capital outflows that would happen regardless of such uncertainties. One set of measures looks at the total amount of resources leaving the country, while the other looks more specifically at episodic surges of capital “fleeing” unfavourable conditions, including low returns. Understandably, these different sets of measures produce different, and sometimes conflicting, estimations of the magnitude of capital flight in African countries. Unfortunately, there are not many empirical studies of capital flight in African countries and differences in the definitions of capital flight, calculation methods, sample countries and years covered make comparisons between these studies almost impossible.

Highly conservative estimates of capital flight from Africa suggest that it averaged nearly $3 billion per year between 1976 and 1997, an annual loss of 2.6 per cent of GDP (Lensink et al., 2000). Other estimates report capital flight levels of above $13 billion per year between 1991 and 2004, a staggering 7.6 per cent of annual GDP (Salisu, 2005). It has been estimated that the cumulative stock of flight capital for sub-Saharan Africa from 1970 to 1996 was approximately $285 billion. Considering that the combined external debt of the region was $178 billion as of 1996, this arguably makes SSA a “net creditor” vis-à-vis the rest of the world (Boyce and Ndikumana, 2001). A recent update of this study puts the accumulated stock of flight capital in SSA at $476 billion in 2004, representing more than two times the region's external debt stock. In some countries, capital flight is estimated to be as much as four times their external debt stock (Boyce and Ndikumana, 2007).

The extent of the problem varies from country to country. In Burundi accumulated capital flight was worth 216 per cent of the country's GDP in 2004. In Sierra Leone and Mauritania, the comparable figures were 214 per cent and 62 per cent respectively. However, in Benin and Niger capital flight is negative, implying that these countries experienced higher capital inflows than outflows (Boyce and Ndikumana, 2007).

Capital flight is currently diverting a large amount of resources from countries that are in urgent need of financing for development. The social cost of flight capital in terms of lost output is high. Africa's GDP per capita would have been 16 percent higher if its private wealth had been retained at home (Ibid.). In effect, irrespective of the absolute magnitude of capital flight, it is clear that African countries have lost a considerable amount of resources to capital flight and reversing this will greatly reduce their resource gap.

Capital flight is the result of a decision to hold assets abroad rather than within the domestic economy. As such, it is responsive to factors such as macroeconomic and political instability, as well as financial market depth, all of which influence the risk-adjusted returns of domestic assets. These issues have to be taken into account in designing programmes to reverse or stem capital flight.

To sum up, if the robust economic growth rates experienced in recent years continue, Africa should be in a position once more to fund more and more of its investment needs from its own resources, as rates of savings pick up. Tax revenues should also increase in such an environment although this would require specific policy reforms. Macroeconomic stability and current improvements in governance should make it much easier to stem capital flight and possibly reverse it, and encourage the transfer of remittances into productive investments.

If as estimated by IFAD, the flow of remittances to African countries was indeed about 5 per cent of GDP on average for each country in 2006, then conservatively, resources mobilized from remittances and from the other sources discussed here (tax revenues, reversing capital flight, enhanced savings mobilization, including the financialization of non-financial assets) could fill at least half of Africa's resource gap in the short to medium run. There are, however, some challenges to be overcome before African countries are able to raise this much of their own resources to close their resource gap, but these are not insurmountable. The next section discusses some of these challenges and proposes some policies top respond to them.

6. Addressing the challenges

The main challenges to domestic resource mobilization in Africa are generally related to attaining and sustaining robust economic growth rates. This in turn requires improvements in macroeconomic management to attain low and stable rates of inflation as well as stable and flexible exchange rates. Maintaining political stability through improvements in good governance is also critical to Africa's good economic performance.

Some of the challenges, however, relate to taking specific actions at the micro or sectoral level. These include improvements to the financial sector, reforms to the tax system and tax administration, and programmes targeted at enhancing the flow of remittances and directing these into productive sectors, stemming and finally reversing flight capital.

(a) Increasing domestic savings

Reforms to enhance domestic savings will have to be directed at deepening and improving the efficiency of the financial system though better prudential regulation and supervision to ensure efficient management of financial institutions. These reforms must encourage the financialization of non-financial assets held in the informal sector and tackle the issue of prevailing segmented financial systems. This will be policies to encourage greater competition, more diversified and new financial products that cater to the interests of different categories of clients - poor, rich, urban and rural. These financial products must respond to the saving needs of most households, in particular the precautionary motive for saving. As such, they must permit easy access and small transactions at frequent intervals in order to smooth consumption patterns.

These objectives cannot be attained without bridging the gap between informal, (semi-) and formal financial institutions. To tackle this, would require a differentiated regulatory system that accommodates different actors in the financial sector, in particular those in the informal sectors. This regulatory mechanism if properly designed and implemented should encourage the emergence of different categories of financial institutions (semi-formal and formal) that serve the potential customers in these sectors.

For these reforms to work, they will have to be accompanied by policies that improve access to the formal financial system, enhance trust in financial institutions, as well as encourage households to deposit financial savings in (semi-) formal financial institutions. These could be through increased use of technology and more innovation to extend coverage of the formal financial institutions, and the establishment of deposit insurance schemes to protect small savers in case banks fall into financial distress. Indeed, the advent of mobile telephone banking is already revolutionizing savings in some African countries - e.g., Kenya, South Africa and Zambia.[12]

(b) Improving public revenues

The main problem of raising public revenue in African countries is that the tax base tends to be particularly narrow, with a small number of people and businesses accounting for a significant proportion of tax revenue. This situation has often become more acute in recent years due to the fall in international trade taxes resulting from trade liberalization. One main factor contributing to this narrow tax base is the huge size of the informal sector in most African countries. This is estimated to account for about 58 per cent of GNP in Nigeria and Tanzania (UNCTAD, 2005). And according to Xaba et al. (2002), in 2001, the informal sector accounted for 78 per cent of non-agricultural employment in Africa.

The first step to increasing revenues will therefore have to be to widen the tax base in order to reduce the sometimes excessive burden currently imposed on a small number of large contributors.[13] This will include policies to entice more businesses into the formal sector by reducing the costs of entry while at the same increasing the benefits for these informal sector operators coming out of the shadows. This is because the decision of firms to remain in the informal sector is one of costs versus benefits. The costs normally faced by these businesses are those of obtaining a license, hiring staff, or obtaining legal title deeds to land and other real estate, which act as powerful disincentives for firms to join the formal sector. On the other hand, the provision of useful services (such as, training, improved access. to credit, participation in business forums, assistance with export procedures, etc) and facilitating registration or obtaining title deeds can help to induce firms to enter the formal sector voluntarily. This will also unlock the actual value of real estates, which can then contribute to increasing financial depth and sophistication. The creation of a 'one-stop shop' for businesses where they can register legally, obtain or renew licences, register property and fulfil their other administrative obligations is one of the ways in which states can seek to reduce the administrative burden on them. This was successfully implemented in Benin in 1995 and has contributed to improving the business environment there.

Most African public revenue structures are over reliant on tax revenues, so there will be the need to explore non-tax revenue mechanisms, such as car park fees, advertising fees, royalties, licenses, etc in order to expand the tax base

Reforms will, however, need to go beyond simply expanding the tax base to improving its efficiency, including simplifying tax regimes and codes, in particular taking into account equity issues, and introducing presumption taxes, and realistic income tax thresholds (below which a firm is not taxed) to encourage compliance. Tax and duty concessions granted to various entities will have to be rescinded or rationalised as African countries lose a sizeable portion of their potential tax revenue though them (e.g., 55 per cent of total fiscal revenue in 2005 was lost in Burundi to these exonerations). These concessions are difficult to implement and contain many loopholes which are easily exploited. Besides, once granted they are difficult to renegotiate even if conditions dictate otherwise. They should be replaced with accelerated depreciation and capital allowances for both domestic and foreign investors, which has the additional advantage of levelling the playing field for all investors. A reorganization of the tax system along functional lines rather than along tax handles, as at present, will enhance efficiency, reduce corruption and evasion.

Improving tax collection will obviously require greater capacity within the tax collecting institutions, which points to the need for a reform of the public financial management system with a view to strengthening it in the medium to long term. Human as well as financial and physical resources will need to be invested in improving the quality and volume of tax collected. Corruption in tax collection agencies must be seriously addressed by designing a system that rewards efficient and honest staff and imposes stiff penalties on the dishonest. Automation of tax administration could also reduce the possibilities for graft, in particular if complemented with regular audits of firms and corporations and measures that encourage voluntary compliance. Voluntary compliance with tax obligations would be enhanced if the tax system is simple, perceived to be fair, and tax resources are put to good use.

(c) Specially-targeted programmes.

Remittances, as discussed earlier, represent major capital inflows to many African countries. There is nonetheless good reason to believe that it is possible to augment the impact of remittances on development beyond its current level, and usage which is mainly consumption. Reducing the transaction costs on the transfer of remittances that fund investments can increase their developmental impact. Indeed, such transfers occur as a result of a portfolio choice to invest in the receiving country rather than elsewhere. They are therefore much more sensitive to transaction costs and investment conditions in the receiving country.

The financial sector should seek to improve the relevance and quality of their services with regards to remittance transfers in order to attract a larger proportion of these transfers into formal transmission channels. This would require the development of appropriate institutions and products for the transfer of remittances with minimum transaction costs from their originating country to the beneficiary. Products could also be developed to capture a larger amount of remittances for investment. Foreign currency accounts operated by local banks at competitive costs are one example of such products implemented by several African countries in recent years. This ensures that savings are ring-fenced from the economic instabilities in the home countries as they are safe from devaluation of the national currency, thereby reducing the risk of loss of value.

Other successful policies involve offering investment opportunities tailored to the Diaspora. One bank in Burundi, for example, offers the possibility for Burundians residing abroad to use their remittances to fund real estate developments. This provides a valuable service as it is very difficult to purchase a property or have one built whilst residing abroad. The savings of the Burundian Diaspora who took part in this project reached $1.5 million in 2007, the launch year.

African countries could also sign partnership agreements which oblige developed countries from which the remittances originate to help lower transaction costs on remittance transfers that use formal channels. For example, these countries could offer tax breaks on the sums remitted,[14] thereby lowering the final cost. These tax breaks could be considered as development assistance for the receiving countries, constituting a novel and indirect way of delivering aid to the private sector. An added advantage of this will be enhanced transparency of remittances which will facilitate the identification of remittances for illegitimate purposes, such funding acts of terrorism.[15]

Capital flight basically refers to private assets held abroad. Some proportion of these assets leave their country of origin simply as the result of a portfolio choice to invest in foreign markets which may be safer and/or offer better returns. However, a sizeable portion of these assets may comprise the proceeds of criminal activities that are fleeing the country to avoid being used as evidence to prosecute owners and thereafter confiscated. This dual nature suggests that some proportion of capital flight might be prevented if more investment opportunities are created at home. Preventing 'portfolio choice' type capital flight is only one aspect, however. Countries that suffer from capital flight should seek to attract some of the large stock of capital flight back home and should also take measures to reduce the size of criminally-induced capital flight. Assets held abroad in order to evade the law will only return to the originating country if the owners of these assets feel that they are safe from prosecution and that their assets are also free from expropriation. While this may constitute type of 'reward' for criminal activities, it may nonetheless be expedient to offer a "no-questions-asked amnesty" as a time-bound measure to attract capital back into the country.[16] In Italy for example, a one-year amnesty on private holders of foreign assets yielded $ 30 billion from Swiss banks.

Another approach to the repatriation of illegally acquired assets held abroad may be to use legal channels to impound these assets and forcibly repatriate them. These assets are generally held in foreign banks, which make it difficult for African countries to have them repatriated or even obtain information them. Increased cooperation and dialogue with banks combined with appeals for assistance from governments of countries in which the assets are held could help to identify and repatriate some of these assets. A 'naming and shaming' approach has also proved successful in some high-profile cases to obtain the repatriation of illegally-gained assets.

7. Concluding remarks

Domestic resources certainly have some advantages over external inflows such as ODA and FDI. They are more stable. They have no conditionalities attached and therefore give governments more leeway to design and implement development policies that they believe address their most urgent priorities. As they do not also generate external debt obligations they are probably more suitable for countries just emerging from a severe debt crisis. In the short term, they are essential for complementing external capital inflows. Over the medium to long term, the successful mobilization of domestic resources should enable governments to reduce gradually their over dependence on external resource inflows. Considering these advantages, and in particular the fact that the conditionalities associated with external inflows greatly curtail the policy space of governments, domestic resources should become the main source of development finance, rather than a complement to external resources, for Africa.

The issue is just not about mobilizing more resources domestically, however. There is the need to channel these into productive investments to ensure a sustainable basis for development as well as for greater and greater volumes of domestic resources. This requires a well-functioning financial system, which is capable of performing its role of financial intermediation efficiently. Unfortunately, most African financial systems are weak and shallow, although reforms in recent years have started bearing fruits in a few countries. In the medium to long term, however, capital and bond markets will have to be developed to support investments in the real sector. In addition, there is the need to strengthen the administrative and technical capacity of the private sector, while reducing the administrative barriers to the activities in the sector. The infrastructural bottlenecks faced by the sector will also have to be addressed (see UNCTAD 2007 for more details).

Policies relating to the reform and reorganization of the tax system and tax administration should enable scarce expertise to be deployed more effectively. These should also improve the efficiency of collecting tax revenues by encouraging the willingness to pay thereby reducing the opportunities for evasion, fraud, and graft, and lead to improvements in overall tax take. As informal sector activities account for a large proportion of the GDP of most African countries, improving the efficiency of production in this sector, as well as expanding taxable activities being undertaken will benefit the whole economy. Reversing capital flight and increasing remittances will expand the volume of development finance available to these countries without creating future debt obligations. While there may be dangers of a Dutch Disease arising from large inflows of foreign exchange and from a lack of absorption capacity, this could be averted with proper management, in particular if inflows are used to address supply constraints in the economy.

The problems of implementation notwithstanding, the potential benefits of successful policy reform are enormous. Indeed, improved mobilization and use of domestic resources will reduce the over dependence of African countries on external sources of capital with their associated conditionalities. It will also strengthen the capacity of the state to identify and pursue a truly nationally-owned development strategy which facilitates the internal integration of the economy.

Recent improvements in governance, exemplified by the African Peer-Review Mechanism of NEPAD/AU, and the greater stability of African economies compared to previous decades offer some hope for the future of African development. Growth rates are improving and commodity prices are high. At present, African countries thus have a good opportunity to place themselves firmly on the track to faster and more inclusive growth.

These same factors, nevertheless, point to the fragility of the growth process and how it can easily be undermined. Africa could not build on similar high growth episodes in the past for a variety of reasons. First, these were not accompanied by diversification away from primary commodity production and export entailed in a process of structural transformation. Second, with its boom and bust cycles (the bust period historically longer lasting than the former), high dependence on commodities has proved the Achilles heel of most African economies.

While some developing economies, in particular China and India, have emerged as new sources of growth for the global economy, the impact of the US economy as the main engine for the global economy cannot yet be so easily dismissed. Thus, in all probability, the capacity of African economies to continue to enjoy these high growth rates and sustain them into the foreseeable future depends on their success in diversifying their economies into higher value-added exports, including manufactures and dynamic export products. This demands good economic and political governance in the following areas: public expenditure management, specifically in the management of windfall income from high commodity prices, credibility of public appointments, and in maintaining overall macroeconomic stability, including avoiding a debt overhang and exchange rate instability. In the final analysis, even with a highly successful mobilization of domestic resources, several African countries may continue to rely on external resources even in the long term. Indeed, external assistance may even have to increase in the immediate period if some of the proposed reforms are to succeed.

Disclaimer

The views expressed in this paper are those of the author, and should in anyway be attributed to the UNCTAD secretariat or its Secretary-General.

Endotes

1. There are notable exceptions to this, however: Aryeetey, 2004, UNCTAD, 2007, and Mckinley, 2007
2. See, for example, the writings of Bela Bellasa, Jagdish Bhagwati, Anne Krueger, Ian Little, during this period.
3. These are the: OPEC oil shocks of 1973-1974, and 1979-1980; the Latin American debt crisis of the early 1980s; the emergence of conservative administrations in US (Reagan), UK (Thatcher) and Germany (Kohl) during the 1980s; and finally, the fall of the Berlin Wall and subsequent collapse of the Soviet Union in 1990.
4. When UN member states signed up to the MDGs in 2000, some analysts also started advocating FDI as capable of filling Africa's annual resource gap of 12 percent of its GDP, or US $64 billion to enable it achieve the estimated 7-8 percent annual growth rate needed to meet them – particularly, the goal of reducing by half the proportion of Africans living in absolute poverty by the year 2015 (NEPAD, 2001: 44).
5. It has to be added, in all fairness however, that no one ever really argued that the HIPC Initiative would be able to fill all the financing gap of the beneficiary countries.

6. Two broad methodologies have been used in estimating the resource needs for attaining the MDGs. One is based on global costing exercises with global elasticities and an average cost guide, the other is based on country-level estimates from which global level requirements are extrapolated. Neither effectively incorporates the multi-sectoral dimension, which is addressed by two well-known studies: the Report by the High-Level Panel on Financing for Development (known as the Zedillo Report (Zedillo et al., 2001)) and a World Bank study by Devarajan et al. (2002).

7. For detailed discussion of the HIPC Initiative, including its shortfalls, see UNCTAD, 2004 .

8. This can be disaggregated into household and corporate savings, but data on corporate savings component of private savings in Africa is non-existent for many countries.

9. Government of Zambia, Budget Statement delivered to parliament on 28 January, 2008.

10. Remittances have some notable advantages too. They are a more stable resource inflow than either ODA or FDI, they have no associated conditionalities, and they reach their beneficiaries directly thereby playing an important poverty reduction role notably by allowing recipient households to pay for school fees or health services, and boosting aggregate demand.

11. See IFAD, http://www.ifad.org/events/remittances/maps/africa.htm

12. The Equity Bank in Kenya, for example, has increased its delivery of financial services in rural areas without incurring the large costs involved in setting up a branch network. It has invested in vans that serve as mobile branches, visiting areas on a frequent cycle. Each van is equipped with the hardware and communication capacity to provide a large array of financial services. The bank has also combined this extension of coverage with new savings products more adapted to the needs of poor and rural households in order to attract their custom. As a result, the bank grew from serving 100,000 depositors in 2001 to serving 375,000 in 2004. By mid-2003 two thirds of its loan portfolio was accounted for by clients served through mobile banking. In South Africa, some banks have improved their cash delivery service to remote areas by installing ATMs or even small bank branches that are powered through solar electricity and rely on satellite communications. In many other African countries, e.g. Democratic Republic of Congo and Zambia, mobile phones enable the "unbanked" to access financial services. Typically, this involves allowing customers who have a deposit account with a bank to make payments and transfers, as well as check their remaining balance via mobile phone.

13. Programmes that seek to augment tax revenues without widening the tax base (i.e., simply by levying higher taxes on existing taxpayers) are likely to have a negative effect as a higher tax yield is attained at the cost of private savings.

14. This could be all sums, or those remitted for specific investment purposes.

15. In addition to an Inter-Agency Task Force on Remittances, the World Bank, IMF, DFID (UK) are conducting studies to enhance their understanding of remittances in order to be able to design effective policies to improve their benefits, including developmental impact (see IFAD, 2006).

16. The success of such a policy is largely dependent on careful phasing. Indeed, capital will only be attracted back to the country if sufficient profitable investment opportunities are created. If the domestic economy is attractive enough, holders of capital abroad may consent to the implicit trade-off of capital repatriation. Indeed, while the owner of capital benefits from being able to repatriate his assets, he also acknowledges his past faults and implicitly accepts a higher level of scrutiny in the future.

17. Indeed, the "return of stolen assets" is a fundamental principle of the UN Convention Against Corruption.

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