The Promise and Limits of Domestic Resource Mobilization

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This is the final in a series of four policy memos that explore various facets of domestic resource mobilization (DRM) and builds on why DRM is critical for the future of development. DRM is commonly defined as the mix of financial resources available to a government to fund its operations, including direct and indirect taxes, other revenue, and borrowing from local capital markets. This series of policy memos is primarily concerned with the tax or domestic revenue side of DRM with the first three examining technical aspects related to tax reform, the role of donors, and how public financial management reform is critical to the DRM discussion. Donors have long provided support for tax reform, but since the adoption of the Millennium Development Goals in the 2000s, donor and recipient governments have increasingly placed local resources at the center of efforts to tackle development challenges. This conversation has gained importance in the last five years as the international development community adopted the more ambitious Sustainable Development Goals (SDGs) in 2015, which aim to end extreme poverty by 2030.

Introduction

Domestic resources in developing countries have grown tremendously in the past 15 years; they are now over double all international resources. Given this reality, the Addis Ababa Financing for Development Conference in July 2015 placed domestic resource at the center of the efforts to finance the new SDGs. Donors are understandably enthusiastic about this new reality, especially with their own constrained resource. But the size of domestic resources is only the beginning of the conversation. As discussed in the three previous memos, there are tremendous challenges to further reforming developing countries’ tax systems and it is not just about improving a country’s ability to raise taxes and other revenue. A significant part of this is also about capacity building and governance reforms, especially around public financial management (PFM). Reforms that aimed only at improving a tax system without improving the way these resources are expended will likely not achieve the

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desired development outcomes. This will require a focus on controlling corruption, improved budgeting, and oversight of this process to ensure transparency and accountability.

First, donors and developing countries will need to place DRM at the center of the development conversation going forward. Second, this conversation must be broadened to include other issues such as public financial management. Third, donors must engage in a deeper dialogue with developing countries on the political and economic challenges that prevent deeper reform from occurring.

The Case for DRM

Simply put, why are domestic resources important? Beyond the size of the resources available (certainly not an inconsequential reason to look at DRM), there are three primary reasons for an increased focus on DRM. First, it allows governments to deliver public goods to their citizens thus strengthening “country ownership” of development priorities. Second, by delivering public goods, the government also builds the social compact that exists between it and its citizens helping to legitimize it. Third, DRM is a facet of the broader good governance agenda that needs to be addressed for societies to progress.

Increased government revenue can pay for public goods such as providing safe drinking water for a remote community or improving health services for young children. Increased access to healthcare, water, increased police presence, and basic education provision are good metrics of success for DRM projects because they are easily quantifiable and their benefits are almost immediately felt by the citizens. There are clear lessons that can be drawn from countries that have successfully implemented tax reforms and, in turn, raised significant government revenue. El Salvador, for example, raised tax revenues a total of 4 percent of their GDP between 2005 and 2013 and used that increased revenue to cut child mortality by 75 percent.² Political leaders seeking to raise government revenue through improved tax collection are often under pressure to demonstrate tangible improvements in public services that benefit taxpayers.

Moreover, there is a question of sustainability. For example, health programs can be created with international donor funding. While these programs surely help people with health challenges, the benefits of programs like this are at risk of termination if a donor suffers “donor fatigue” and can be short-lived and local, especially given the budgetary pressures that exist for traditional sources of official development assistance (ODA). Wider benefits can be felt through local government revenue that spends its increased revenue on general healthcare or increasing the network of clinics that focus on root causes and not disease-specific treatments. DRM gives governments the financial resources to create and pursue their own priorities. Hopefully these local priorities are determined

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through a democratic process. While many DRM reforms may require a financial commitments of official donor resources, these initial investments often see exponential returns.

In Rwanda the tax-to-GDP ratio increased by 6 percent between 2000 and 2014.\(^5\) In 2008, 53 percent of Rwanda’s health budget was funded externally, but by 2015, the increased government revenue meant that only 38 percent was externally funded, even while overall health spending increased.\(^4\) A Save the Children study looked at the effects of a 1 percent increase in DRM and how that did or did not change the investment in children by examining education, health, nutrition, and other metrics. In each case, an increase in DRM led to an increased investment in child welfare.\(^5\)

**Political Will and Community Outreach**

First and foremost, political will matters. The “right” political conditions—stable government, capable staff, and leaders receptive to implementing change—must be in place for DRM and PFM programs to be effective. Increased taxes collected may not always be allocated to preferred social sectors, but it is important that citizens still see benefits as a result of rising tax collection. For example, as governments become more capable of funding social services, Save the Children has chosen to shift into the role of a technical assistance provider, an adviser, and an auditor to increase governments’ performance, which has been successful in several projects.\(^6\)

According to a 2015 report by Bread for the World, governments that depend on taxes for their revenue have a vested interest in their citizens’ economic productivity.\(^7\) This makes low “tax morale” especially critical to address, as it causes compliance problems and prevents governments from harnessing that economic productivity for the public good. If taxpayers notice that their neighbors are not paying taxes or if people believe the government is wasting their tax dollars, they are less likely to honestly report and file taxes. Countries with strong institutions present a higher level of trust between government and the average citizen, which translates into more successful tax reforms and higher compliance rates.

Through engagement with civil society, development actors must become attuned to what taxpayers in developing countries need and want. All stakeholders must be taken into account; without that local element, the government revenue generated by more efficient tax programs will not meet

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citizens’ needs, and tax noncompliance will continue to rise as governments fail to build a social compact around taxation and the delivery of services.

Finding political will within the United States and other donor countries is also a key component of this agenda. Creating support within Congress for DRM initiatives is challenging because the topic can seem obscure and technical, and the current system of congressional directives on the development budget constrain U.S. efforts to invest in DRM even further. Given the United States’ constrained foreign assistance budget and the fact that DRM resources are so much larger and developing countries are seeking to take ownership of their futures through DRM, DRM should be viewed as a crucial and low-cost instrument in the development assistance arsenal, and development actors must appropriately frame the issue to generate the necessary government support.⁸

Conclusions

Given the sheer size of domestic public resources it is easy to think of this discussion as simply about how to finance development. Without a doubt that is true: the SDGs will not be attained if domestic resources are not tapped. With estimates of the cost running into the trillions, domestic resources are one of the keys. But it would be short sighted to think about DRM from a resource angle solely. This memo and the three previous memos attempt to explain the opportunities and limitations of DRM; this cannot simply be about technocratic solutions to narrowly defined problems. As the authors of this memo argued in a 2014 report, Taxes and Development, “reforming tax systems, increasing taxpayer participation, and generating greater revenue for the state is about tackling persistent governance challenges in developing countries.”⁹

Three actionable recommendations to close:

1. On the assumption that congressional directives (e.g., earmarks) are not going to go away, then, where practical, the U.S. government should seek to replicate the Sustainable Financing Initiative that it launched under the U.S. President’s Emergency Fund for AIDS Relief (PEPFAR) in other budgetary line items. This could include the basic education, water and sanitation, and maternal and children’s health. DRM resources will generate the scale and sustainability that advocates for these programs seek and will never get from ODA alone. These programs would help to not only generate additional revenue to fund public goods, but it would also help to build the capacity of the state to deliver public goods on its own.

2. Country ownership is an important component of the development effectiveness agenda, but it should not only be about using a “country’s systems” to program international assistance. Where practical, this can be the case. But how the international development community


understands of country ownership needs to generate its own domestic resources and improve the country’s ability to spend its own resources properly.

3. DRM and PFM should be at the center of a renewed effort around good governance. At the center of this is increased accountability (preferably democratic accountability) toward citizens. Increasing the domestic resources available will allow countries to more ably govern and provide necessary public goods.¹⁰

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¹⁰ This last recommendation is drawn from the authors’ earlier paper: Taxes and Development, 32.