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Incorporating Political Economy Considerations in DRM Strategies

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Contents

Executive Summary

Few countries aspire to receive increased levels of foreign aid as a long-term development strategy. Many developing countries seek greater levels of economic development and less reliance on foreign donors. They seek science and technology partnerships, trade and investment, political and economic stability, and reduced levels of poverty. Most dream of self-reliance and the ability to provide services for their citizens without foreign aid. On this journey from developing to developed, few things are more important to a country's government than domestic resource mobilization (DRM).[1]

As countries mobilize more resources to fund their governments and services, they can think more strategically about transitioning from a reliance on foreign aid to more mutually beneficial relationships with foreign countries. There are structural challenges to mobilizing domestic resources that long have been the focus of DRM efforts; however, addressing the political economy and structural challenges will be critical in the face of increased need and plateauing levels of foreign aid. It is critical that development approaches create the foundational capabilities and systems necessary to capitalize on political windows of opportunity.

Structurally, tax administrations must overcome many obstacles to improve domestic resource mobilization. Many countries coming out of conflicts or periods of instability have few taxpayers and low taxpayer morale; many also lack the infrastructure or strong institutions to broaden the tax base or build political support. Corruption or lack of transparency throughout governments and collection processes can prevent countries and the donors supporting them from understanding the core issues and areas in need of improvement. Further complicating matters, politicians often take advantage of preferential tax treatment (e.g., exemptions either for themselves or for companies with which they are connected) and can be reluctant to change. Another challenge to DRM is transfer pricing,[2] which is difficult to detect and accounts for millions of dollars in

1. DRM refers to the set of financial resources that governments can use domestically to fund their operations, including taxes, other revenue, and borrowing from local capital markets. Daniel Runde and Conor Savoy, *Domestic Resource Mobilization and Public Financial Management* (Washington, DC: Center for Strategic and International Studies, 2016), https://csis-prod.s3.amazonaws.com/s3fs- public/publication/160916_Runde_DRMPublicFinancialMgt.pdf.
2. Transfer pricing refers to prices that are paid in transactions between two entities controlled by a single owner and can be an important tax compliance issue when the entities exist in different jurisdictions with different income tax rates.

profits that multinational corporations are moving out of developing countries without paying taxes.

Without rethinking DRM—structurally and from a political economy perspective—many countries currently dependent on foreign aid for most of their government funding will struggle to meet the 17 Sustainable Development Goals (SDGs). An estimated $2.4 trillion a year of additional financing is needed to achieve the poverty, hunger, and other SDGs by 2030;[3] at the same time, official development assistance (ODA) and global economic growth have plateaued after increasing for decades. From 2013 to 2017, total ODA went from $135.2 billion to $146.6 billion, even decreasing for a period by $3.8 billion from 2014 to 2015.[4,5,6] Increased foreign aid can lead to further dependence; developing countries will need to rapidly improve DRM capabilities to address the $2.4 trillion per year gap and fund the development needs of their citizens themselves. The World Bank estimates that between 50 and 80 percent of the funding gap for the SDGs could be financed by domestic resources in developing countries.[7]

It is no wonder that DRM is an increasing focus of development programs, whether directly (as the entire focus of a program) or indirectly (whereby DRM elements are incorporated into other types of programming). These initiatives typically focus on technocratic solutions and projects that can yield outcomes that are measurable and tangible: the number of registered taxpayers, total revenue collected, and revenue collection as a percentage of GDP. These are all important pieces of the puzzle and worthwhile endeavors; however, efforts focused only on the structural rather than the political *and* the structural find themselves at the risk of ineffectiveness should the political winds blow in the wrong direction. Conversely, efforts that consider only political economy dynamics may fail to create the foundational capabilities and systems necessary to take advantage of political windows of opportunity. DRM efforts must attack resource mobilization challenges from both directions.

This report examines how to do this and argues for greater integration of political considerations in DRM efforts. Even the best reforms can fail without political support, country ownership, and systems to hold elected officials accountable. DRM efforts can be thwarted by low tax morale and little political incentive to change; no politician anywhere wants to run on a platform of increasing taxes. In many instances, domestic resources can be increased without introducing new taxes on citizens or new legislation, but rather through short-term administrative reforms, such as e-filing and customs adjustments or long-term reforms, such as strengthening institutions and increasing transparency. Nonetheless, strategies that do not effectively link taxes to such government services as infrastructure, healthcare, and education—thus demonstrating *why* more resource

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3. The Business and Sustainable Development Commission, Better Business, Better World, January 2017, http://report.businesscommission.org/uploads/BetterBiz-BetterWorld_170215_012417.pdf.
4. "Development aid stable in 2014 but flows to poorest countries still falling," OECD, August 4, 2015, http://www.oecd.org/dac/stats/development-aid-stable-in-2014-but-flows-to-poorest-countries-still-falling.htm.
5. "Development aid stable in 2017 with more sent to poorest countries," OECD, September 4, 2018, http://www.oecd.org/newsroom/development-aid-stable-in-2017-with-more-sent-to-poorest-countries.htm.
6. "Final Official Development Assistance Figures in 2015," OECD,http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/final-oda-2015.htm.
7. Mara Niculescu, "Impact investment to close the SDG funding gap," July 12, 2017, UNDP, http://www.undp.org/content/undp/en/home/blog/2017/7/13/What-kind-of-blender-do-we-need-to-finance-the-SDGs-.html.

mobilization is necessary—run the risk of failure. Some of these considerations require new or strengthened capabilities and systems. Some require political will. Most require both.

Not all DRM efforts require political will at the presidential and parliamentary levels, however, and donor agencies should adjust their programming according to individual country contexts. Building a foundation for DRM reforms is critical so that when political windows of opportunity arise, development agencies can respond quickly and implement more long-term and impactful reforms such as changes to the tax code. Incorporating a political economy lens to DRM strategy development would help development agencies determine the best points of entry and the opportunities for reform.

There is growing recognition at USAID and among other donor agencies that DRM is a critical long-term path to sustainable development finance. USAID Administrator Mark Green has recognized the potential of DRM reforms and has made them a central theme of USAID's new *Journey to Self-Reliance* framework.[8] These agencies know that DRM provides governments with the funds needed to alleviate poverty, deliver public services, and meet the SDGs. They know that DRM is a critical step on the path out of aid dependence. The government of Georgia, for example, was able to increase its domestic revenue by close to $4 billion between 2005 and 2011 with USAID's support.[9] Rwanda has been able to increase tax revenue by about 6 percentage points of GDP over the past 17 years.[10]

This report discusses the political conditions necessary for transformational DRM in Chapter 1, efforts to improve collection and increase transparency in government spending in Chapter 2 and offers country case studies on Uganda and Liberia in Chapters 3 and 4. The report concludes with the following recommendations in Chapter 5:

I. Create an Agency-Wide USAID DRM Strategy
   - Use benchmarking metrics and one-year feasibility studies to assess opportunities and political will for DRM reforms
   - Set realistic timelines and expectations
   - Integrate transparency, accountability and anti-corruption initiatives while tying revenue mobilization with expenditures

II. Identify and Seize Political Opportunities at Home and Abroad
   - Engage the U.S. Congress on DRM programming
   - Target exemptions

III. Incorporate DRM into Policy Dialogues
   - Mobilize democracy and governance partners
   - Expand DRM beyond USAID

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8. "The Journey to Self-Reliance," USAID, October 23, 2018, https://www.usaid.gov/selfreliance/.
9. "Domestic Resource Mobilization: Business-Friendly Reforms Boost Revenue for Georgia's Transition," USAID, January 12, 2017, https://www.usaid.gov/documents/1865/drm-business-friendly-reforms-boost-revenue-georgia%E2%80%99s-transition.
10. USAID, Domestic Resource Mobilization: Case Study of Rwanda, 1990–2016 (Washington, DC: USAID, 2018), https://www.usaid.gov/sites/default/files/documents/1865/Rwanda_DRM_case_study_briefing_note_FINAL.pdf.

Overview and Project Background

This report analyzes the political economy opportunities and constraints of domestic resource mobilization on the road to self-reliance. CSIS, in partnership with DAI, conducted research in Kampala, Uganda and Monrovia, Liberia to assess the current political and economic conditions affecting DRM reform efforts. Uganda and Liberia were selected because both are low-income countries struggling to expand their respective tax bases, increase tax-payer morale, have equitable tax administrations, and implement reforms to mobilize more domestic resources. Many of the constraints in both countries relate to transparency, corruption, underdeveloped systems and low capacity of tax authorities. However, many of the constraints are more political in nature, including a lack of support in parliament, outsized influence of the elite, entrenched bureaucratic interests, resistance from the private sector, unpopular changes to legislation and general distrust of government by civil society.

Uganda, in particular, has been the focus of DRM programs over the years—many of which were deemed successful.[11] These efforts initially achieved results and Uganda saw a slow and steady increase in the 1990s and early 2000s in its tax-to-GDP ratio. The Uganda Revenue Authority (URA) also gained an enviable reputation for being professional and relatively free of corruption. Over the past decade this has fundamentally shifted as the URA has struggled to maintain momentum in the face of political challenges. Liberia, on the other hand, is a country that has suffered many crises but is going through an historic period of peaceful political transition, which presents a window of opportunity for reform. If they hope to improve, both countries will require a better understanding of the political economy aspects of domestic resource mobilization while mobilizing the political will necessary to execute necessary reforms.

This report offers a fresh perspective for U.S. policymakers and other development agencies on how they can better partner with developing country governments on the shared goal of increased DRM, focusing on addressing the political economy opportunities and constraints to increasing the impact of development efforts. Although it is widely understood that increasing tax revenue and improving capacity is important, it is worth exploring why some efforts are more successful than others. Further incorporating

11. African Development Bank Group, *Domestic Resource Mobilization for Poverty Reduction in East Africa: Uganda Case Study* (ADB, 2010), https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Uganda%20case%20study%20final.pdf.

political economy aspects into DRM efforts will make them more successful in reducing the need for foreign aid in developing countries as well as increasing accountability and transparency. The U.S. and other development actors need to understand when DRM efforts are needed to promote economic development and stability and how they can be implemented to get the best results, based on a country's political economy environment.

Introduction | The Current State of Play

Domestic Resource Mobilization (DRM) refers to the set of financial resources that governments can use domestically to fund their operations, including taxes, other revenue, and borrowing from local capital markets. DRM activities include expanding tax bases, reducing tax evasion, and finding new sources of income via natural resource wealth, domestic debt financing, and e-filing. Expanding tax bases may lead to more revenue, but it may also reduce price distortions in the economy by taxing the tax base more uniformly and by allowing governments to reduce their tax rates. Eliminating price distortions may increase efficiency and lead to higher levels of GDP. Countries face many challenges in tax policy and administration, including low tax compliance, high levels of informality, uneven revenue streams, and corruption. DRM reforms can increase nationally available resources, strengthen country ownership of development priorities, and promote good governance.[12] For most governments, the single largest source of revenue is through the collection of taxes which are broken into direct (income and property) and indirect taxes (excise, sales, or value-added taxes).[13]

Donors and their partners also should consider the need for efficiency and fairness. An effective system of revenue mobilization requires ways to address political economy challenges that exist in every country context. Doing so effectively can have the side benefit of helping strengthen the social contract between citizens, the private sector, and government. Governments often understand their constituencies and reform constraints better than foreign development actors, but they still need assistance to implement DRM reforms where they lack experience and resources to overcome their constraints. Donors should include their views and expertise in the reform process, as it is not only cost-effective to do so but also increases the probability of scalable and sustainable progress. However, governments need to build confidence by demonstrating they can efficiently spend resources and effectively deliver services to improve tax morale. Doing so is often a political economy issue, one that requires significant and thoughtful research to advise future policy, ways to address the underlying issues of transparency and corruption, and incentives for political leaders to act in the best interest of constituencies.

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12. Daniel Runde and Conor Savoy, *The Promise and Limits of Domestic Resource Mobilization* (Washington, DC: Center for Strategic and International Studies, 2016), https://csis-prod.s3.amazonaws.com/s3fs-public/publication/160916_Runde_PromiseLimitsDRM.pdf.
13. Daniel Runde and Conor Savoy, *Domestic Resource Mobilization Tax System Reform* (Washington, DC: CSIS, 2016), https://csis-prod.s3.amazonaws.com/s3fs-public/publication/160825_Runde_DRMMemo1.pdf.

DEFINING PUBLIC FINANCIAL MANAGEMENT

Public financial management (PFM), as defined by the Governance and Social Development Resource Centre, refers to the set of laws, rules, systems, and processes used by sovereign nations (and sub-national governments), to mobilize revenue, allocate public funds, undertake public spending, account for funds, and audit results.[14] Although this report sometimes refers to the expenditure side, it focuses more on mobilization and hence uses DRM more often than PFM.

DRM has been a major component of many international development conferences over the past ten years. The First International Financing for Development (FfD) conference held in Monterrey, Mexico in 2002 sought to address the issues related to financing for development and highlighted the need for developing countries to mobilize resources internally.[15] Similarly, the Second High-Level Meeting of the Global Partnership for Effective Development Cooperation drew attention to the importance of establishing an enabling environment and sound macroeconomic policies to enhance DRM.[16] Additionally, partner countries further committed to mobilize domestic resources and strengthen financial management capabilities at the 2005 Paris Declaration on Aid Effectiveness and increase country ownership of DRM projects at the 2008 Accra Agenda for Action.[17]

These efforts were reinforced at the second FfD conference in Doha in 2008 and accelerated as part of the third—and most recent—FfD conference held in Addis Ababa in 2015. The third conference produced the so-called Addis Ababa Action Agenda, a strategic framework that acknowledged that development finance is changing, and it will require trillions—not billions—of dollars in financing to meet global development challenges.[18]

The Addis Ababa Action Agenda created several initiatives to coordinate DRM and lay the groundwork for others to follow. The most important of these is the Addis Tax Initiative (ATI). ATI is a joint effort between donors and recipient countries that aims to double the amount of ODA directed towards DRM programming, from approximately 1 percent of global ODA to 2 percent.[19] Countries participating in the ATI agree to double technical cooperation with development partners by 2020, step up DRM for inclusive development and achieving the SDGs, and improve policy coherence for development.[20] The International Tax Compact (ITC) hosts the ATI and facilitates its commitments.[21]

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14. Andrew Lawson, "Public financial management," *Governance and Social Development Resource Centre* (GSDRC), March 2015, https://gsdrc.org/professional-dev/public-financial-management/.
15. UN Department of Economic and Social Affairs, *Monterrey Consensus of the International Conference on Financing for Development* (New York: United Nations, 2003), http://www.un.org/esa/ffd/wp-content/uploads/2014/09/MonterreyConsensus.pdf.
16. Global Partnership for Effective Development Cooperation, *Nairobi Outcome Document* (Nairobi: Global Partnership for Effective Development Cooperation, 2016), http://effectivecooperation.org/wp-content/uploads/2016/12/OutcomeDocumentEnglish.pdf.
17. Organization for Economic Co-operation and Development, *The Paris Declaration on Aid Effectiveness and the Accra Agenda for Action* (Paris: OECD, 2008), http://www.oecd.org/dac/effectiveness/34428351.pdf.
18. *From Billions to Trillions: Transforming Development Finance, Post-2015 Financing for Development: Multilateral Development Finance*, (AfDB, ADB, EBRD, EIB, IDB, IMF, and World Bank, 2015), http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002(E)FinancingforDevelopment.pdf.
19. USAID Presentation, CSIS Working Group, November 13, 2015.
20. Addis Tax Initiative, *Fact Sheet: What is the Addis Tax Initiative?* (Addis Tax Initiative, 2016), https://www.addistaxinitiative.net/documents/Addis-Tax-Initiative_Factsheet_EN.pdf.
21. International Tax Compact, *International Tax Compact: At a glance*, (International Tax Compact, 2018), https://

The ITC is a platform that brings together policymakers, academics, civil society, and the private sector working on tax and development and facilitates cooperation between tax organization networks.[22]

Under the ATI, partners will need to increase gross disbursements to $444 million and commitments to $474 million by 2020 to double ODA spending in DRM.[23] As of 2016, ODA totaled $358 million in disbursements and $375 million in commitments. France was the biggest contributor to the ATI in 2016, disbursing $154.95 million to two new DRM projects.[24] One was a loan to Indonesia for $110.58 million whereas the other was a loan to Armenia for $44.23 million.[25] The United States was the second largest contributor to the ATI in 2016, disbursing $45.97 million.[26] However, a recent report by Oxfam found that donors are not on track to meet their commitments to double support for DRM; support only increased by 5 percent from 2015 to 2016.[27] The report found that donors channeled $7.5 million in DRM funding through multilateral institutions, expanding their role in this area.[28]

The World Bank provides advisory services and lending for DRM in 59 countries and has pledged to help increase the tax-to-GDP ratio in a third of International Development Association (IDA) countries.[29] The International Monetary Fund (IMF) launched the IMF Revenue Mobilization Thematic Fund (RM-TF) in 2016, a $60 million project that helps meet demand for DRM by supporting transformation reform, technical assistance, diagnostic tools, and research.[30] The IMF, United Nations (UN), Organization for Economic Co-operation and Development (OECD), and World Bank coordinate their capacity-building efforts via the Platform for Collaboration on Tax.[31] All these organizations also work with the European Commission (EC), the Inter-American Development Bank (IDB), the African Tax Administration Forum, and the Inter-American Center of Tax Administrations (CIAT) on the International Tax Dialogue, an initiative that facilitates discussion between officials and regional and international organizations on tax matters and promotes good practices.[32]

The OECD also is involved through the Tax and Development Programme, which provides guidance to development cooperation agencies via research, bilateral assistance programs, and multi-stakeholder task forces.[33] The OECD and UNDP coordinate Tax Inspectors Without

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www.taxcompact.net/documents/18-02-09_ITC_Factsheet-EN.pdf.
22. Ibid.
23. Addis Tax Initiative, *ATI Monitoring Brief 2016* (International Tax Compact, 2018), https://www.addistaxinitiative.net/documents/Addis-Tax-Initiative_Monitoring-Brief-2016_I_EN.pdf.
24. Ibid.
25. Ibid.
26. Ibid.
27. Oxfam International, *Doubling Down on DRM* (Oxfam International, 2018), https://www.oxfamamerica.org/static/media/files/DOUBLING_DOWN_ON_DRM_-_2018.pdf.
28. Ibid.
29. World Bank, *Financing for Development at the World Bank Group* (World Bank Group, 2018), http://pubdocs.worldbank.org/en/822151531513670691/FinancingforDevelopmentattheWBGBrochureJuly2018Edition-Updated-July-22-2018-reduce-file-size-final.pdf.
30. International Monetary Fund, *Revenue Mobilization Trust Fund (RM-TF)*, (Washington, DC: International Monetary Fund, August 2016), https://www.imf.org/external/np/ins/english/pdf/RMTF_Program_Document.pdf .
31. "Platform for Collaboration on Tax," World Bank Group, 2016, http://www.worldbank.org/en/programs/platform-for-tax-collaboration.
32. "Conferences," International Tax Dialogue, http://www.itdweb.org/.
33. Organisation for Economic Co-operation and Development, *OECD Work on Taxation* (Paris: OECD, 2018),

Borders, a program that brings together experts and local tax auditors in developing countries that is credited with generating $414 million in tax revenues for host administrations.[34] This program claims to have generated more than $100 for every $1 invested.[35]

Foreign governments and bilateral aid agencies in developed countries are also contributing to DRM efforts in developing countries. For example, the UK Government's Department for International Development (DFID), in collaboration with the Bill and Melinda Gates Foundation, funds the International Centre For Tax and Development (ICTD), a research network focused on taxation issues primarily in sub-Saharan Africa.[36] The Tax Administration Diagnostic Assessment Tool (TADAT) assesses the components of a country's system of tax administration based on key performance outcome areas.[37] TADAT is funded by the European Commission, Germany, IMF, Japan, Netherlands, Norway, Switzerland, United Kingdom, and World Bank.[38] TADAT is managed by a secretariat and a steering committee.[39]

The OECD and UNDP coordinate Tax Inspectors Without Borders, a program that brings together experts and local tax auditors in developing countries that is credited with generating $414 million in tax revenues for host administrations. This program claims to have generated more than $100 for every $1 invested.

The U.S. government supports DRM efforts abroad. The U.S. Treasury's Office of Technical Assistance (OTA) provides financial sector assistance in five core areas: revenue administration and policy, budget and financial accountability, government debt issuance and management, banking and financial services, and economic crimes.[40] OTA currently operates in Cambodia, Afghanistan, Indonesia, India, and Mongolia.[41] The State Department and USAID Budget Request for 2019 calls for $75 million to support a new DRM initiative so countries can mobilize their resources more effectively and sustainably lead their own development.[42] USAID currently spends $20 million a year on DRM in more than 15 countries and recently released a new approach to capacity-building and international development titled the *Journey to Self-Reliance*.[43] The broad aim of this new

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https://www.oecd.org/tax/centre-for-tax-policy-and-administration-brochure.pdf.

34. Tax Inspectors Without Borders, *Annual Report 2017/18* (OECD/UNDP, 2018), http://www.tiwb.org/resources/publications/tax-inspectors-without-borders-annual-report-2017-2018-web.pdf.
35. Jamie Drummond and Alex Their, "Opinion: 3 years since the launch of Addis Tax Initiative, what's been achieved?" Devex, August 20, 2018, https://www.devex.com/news/opinion-3-years-since-the-launch-of-addis-tax-initiative-what-s-been-achieved-93302.
36. "About Us," International Center for Tax and Development, http://www.ictd.ac/about-us/.
37. "Overview," Tax administration Diagnostic Assessment Tool, http://www.tadat.org/overview/overview.html.
38. "TADAT Partners," TADAT, http://www.tadat.org/overview/tadat_partner.html.
39. Ibid.
40. "Office of Technical Assistance (OTA), United States Department of the Treasury," Devex, https://www.devex.com/organizations/office-of-technical-assistance-ota-united-states-department-of-the-treasury-37671.
41. Ibid.
42. U.S. Department of State Office of the Spokesperson, "State Department and U.S. Agency for International Development FY 2019 Budget Request," U.S. Department of State, February 12, 2018, https://www.state.gov/r/pa/prs/ps/2018/02/278228.htm.
43. "Domestic Resource Mobilization," USAID, https://www.usaid.gov/what-we-do/economic-growth-and-trade/

approach is to orient USAID programming to initiatives that let countries address their own development challenges, to design roadmaps based on metrics that strengthen country ownership, and to use improvements in metrics to signal when USAID should consider a strategic transition away from foreign aid to a different kind of bilateral relationship.[44] One of the metrics is government capacity, and DRM figures fall directly under the "efficiency of tax administration" category.[45] In addition to OTA and USAID, the Millennium Challenge Corporation (MCC) is part of the Addis Tax Initiative and provides technical assistance for procurement and tax reform efforts.[46]

As part of its own internal reform process, Administrator Mark Green has made DRM one of USAID's key priorities. In his testimony before Congress on April 25, 2018, Administrator Green highlighted the $75 million requested for strategically-managed DRM assistance.[47] He noted the success of DRM efforts in the nation of Georgia where $12 million in DRM assistance from USAID led to an additional $4 billion in tax revenue from 2005 to 2011.[48] USAID's DRM efforts in Georgia helped expand taxpayer registration by 137 percent in just one year.[49] Georgia is just one example of where DRM programs have increased tax collection dramatically and cut down on corruption in the process. Another example is El Salvador, where USAID efforts helped increase annual revenue by $350 million and increase annual social spending by $160 million.[50]

DRM will continue to be a major focus of USAID's *Journey to Self-Reliance* framework. Successful case studies show that DRM reforms can increase the tax-to-GDP ratios, support trade liberalization, increase funding for development, and build local capacity, sustainability, and monitoring and evaluation.[51] Indeed, the African Union has highlighted the need to strengthen DRM to build capital markets, reduce aid dependency, and enhance domestic savings in its Agenda 2063.[52] Nevertheless, corruption, a narrow tax base, and weak institutional capacity all are significant barriers to tax system reform.[53] DRM reform also must be accompanied by strong public expenditure management (PEM) to ensure that financial resources are efficiently and transparently spent.[54] All reforms also need to consider the political economy conditions necessary for DRM reforms to take hold.

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domestic-resource-mobilization.

44. Drew D'Alelio, "USAID Just Released Its "Journey to Self-Reliance" Indicators. What Comes Next?" Center for Global Development, June 19, 2018, https://www.cgdev.org/blog/usaid-just-released-its-journey-self-reliance-indicators-what-comes-next.
45. "The Journey to Self-Reliance: Country Roadmaps," USAID, https://selfreliance.usaid.gov/.
46. "Domestic Resource Mobilization," Millennium Challenge Corporation, https://www.mcc.gov/initiatives/initiative/domestic-resource-mobilization.
47. "U.S. Agency for International Development Administrator Mark Green Testimony on the Fiscal Year 2019 Budget Request," USAID, April 25, 2018, https://www.usaid.gov/news-information/congressional-testimony/apr-25-2018-us-agency-international-development-administrator-mark.
48. Ibid.
49. "Domestic Resource Mobilization: Business-Friendly Reforms Boost Revenue for Georgia's Transition," USAID, January 12, 2017, https://www.usaid.gov/documents/1865/drm-business-friendly-reforms-boost-revenue-georgia%E2%80%99s-transition.
50. "Domestic Resource Mobilization: El Salvador Tax Reform Boosts Revenues for Development," USAID, August 5, 2015, https://www.usaid.gov/documents/1865/domestic-resource-mobilization-el-salvador.
51. "U.S. Agency for International Development Administrator Mark Green Testimony on the Fiscal Year 2019 Budget Request," USAID, April 25, 2018, https://www.usaid.gov/news-information/congressional-testimony/apr-25-2018-us-agency-international-development-administrator-mark.
52. African Union Commission, *Agenda 2063: The Africa We Want* (Addis Ababa: African Union Commission, April 2015), http://www.un.org/en/africa/osaa/pdf/au/agenda2063.pdf.
53. Daniel Runde and Conor Savoy, *Domestic Resource Mobilization Tax System Reform*.
54. PEM is the expenditures side of fiscal reforms. DRM and PEM make up PFM. Runde and Savoy, "Public Finan-

HOW TO MEASURE THE SUCCESS OR FAILURE OF DRM PROGRAMS

The most common way to measure the success or failure of DRM programs is to look at a country's tax-to-GDP ratio over a period of time. This ratio demonstrates whether revenue collection has increased and also considers growth or contractions in a country's economy. The OECD produces a report each year that calculates tax-to-GDP ratios for its 34 member countries as well as many in Africa.[55] For these reasons, this report discusses DRM in terms of this ratio.

However, it is worth noting that the tax-to-GDP ratio does not always tell the full story. Determining the GDP of a low-or middle-income country can be challenging, and GDPs are constantly being recalculated. Countries may be collecting more taxes but because of increases in GDP, the tax-to-GDP ratio could decrease. Excessively high tax rates would also raise the ratio but would have a negative economic impact on citizens and businesses. The tax-to-GDP ratio also does not show which areas of a tax system need the most improvements.

A more effective way of measuring the capacity of a country's tax collection system is to complete a more holistic benchmarking report.[56] Such reports look beyond just the tax-to-GDP ratio and evaluate other areas of tax systems, for example, the excise-to-GDP ratio, goods and services tax (GST)/value-added tax (VAT)-to-GDP ratio, property tax-to-GDP ratio, and the cost of tax administration per $100 collected. USAID and other donors should use these metrics and others, such as, the time it takes for citizens and businesses to file taxes and the expansion of taxpayer registration to target areas for reform within tax administrations.[57]

cial Management."

55. OECD, *Revenue Statistics 2018* (Paris: OECD Publishing, 2018), https://www.oecd-ilibrary.org/taxation/revenue-statistics-2018_rev_stats-2018-en.

56. USAID/DAI, Benchmarking the Tax System in Liberia (USAID, 2017), 4, https://www.dai.com/uploads/BENCHMARKING%20THE%20TAX%20SYSTEM%20IN%20LIBERIA.pdf.; "Aid at a glance charts," OECD-DAC, December 22, 2017, https://public.tableau.com/views/OECDDACAidataglancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

57. "Charting a path toward self-reliance: Case Studies of Domestic Resource Mobilization (DRM) Reform," USAID, November 21, 2018, https://www.usaid.gov/documents/1865/charting-path-toward-self-reliance-case-studies-domestic-resource-mobilization-drm.

1 | Incorporating Politics into DRM Strategies

Improving developing countries DRM systems is an important step on the road to self-reliance and reduced dependency on foreign aid. A country that can raise its own revenue and use those funds to efficiently pay for public goods—education, health, and infrastructure—will strengthen the societal bonds that exist between the government and its citizens.[58] Over the past 20 to 30 years, there has been an increased focus on DRM collection globally but there has been significant variation from country-to-country. In 2016, the world average tax-to-GDP ratio was 15 percent: its highest point in seven years.[59] However, tax systems remain relatively weak across most developing countries, and overall tax-to-GDP ratios are significantly lower than in advanced economies. The ideal tax-to-GDP ratio will vary among countries depending on the performance and structure (specifically public versus private sectors) of their economy, but the difference in tax-to-GDP ratios for developed versus developing economies remains significant. The average in OECD countries was 34.3 percent, whereas an average developing economy collects just 15 percent of GDP in taxes.[60,61] One lesson that has become increasingly clear in recent years is that developing countries—in particular developing country politicians and senior government officials—need to create the right political economy environment for DRM reforms to become transformational. Progress can surely be made without this, but transformational progress requires political will.

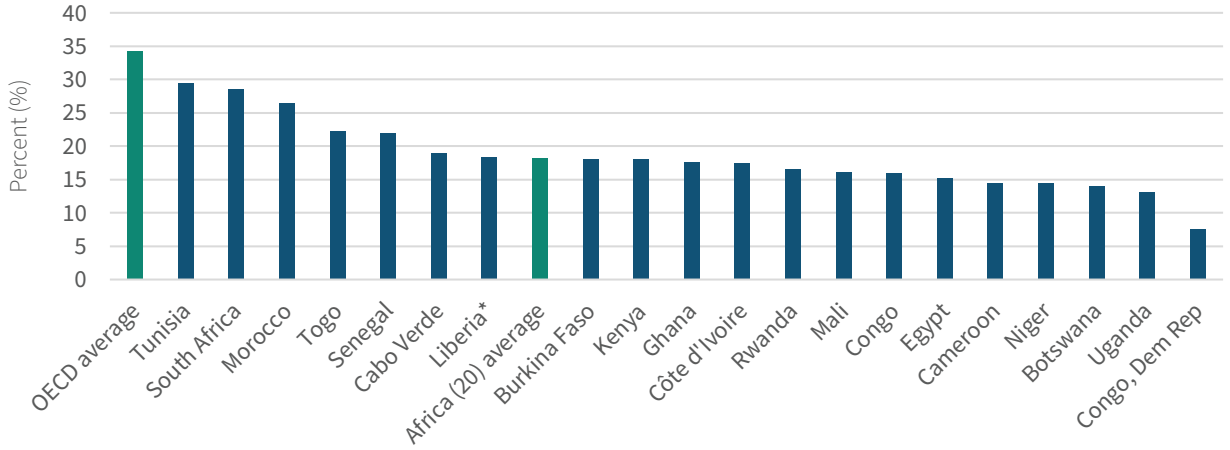
Even without a strong focus on political economy considerations, the increased international attention paid to DRM is having tangible effects in Africa. Since the 1990s, the average tax-to-GDP ratio has been increasing on the continent.[62] In sub-Saharan Africa, taxes collected rose by more than four times, from $100 billion to $461 billion from 2000 to 2014, while ODA rose from $80 billion to just $137 billion over the same

58. Runde and Savoy, *Domestic Resource Mobilization Tax System Reform*.
59. World Bank Group, "Tax Revenue (% of GDP)," Raw data, https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS.
60. OECD, *Revenue Statistics 2017: Tax Revenue trends in the OECD* (OECD, 2017), 2, https://www.oecd.org/tax/tax-policy/revenue-statistics-highlights-brochure.pdf.
61. Bernardin Akitoby, "Raising Revenue," IMF, March 2018, https://www.imf.org/external/pubs/ft/fandd/2018/03/pdf/akitoby.pdf.
62. Amadou N.R. Sy and Mariama Sow, *Domestic Resource Mobilization and External Financing: When Does Governance Matter? Evidence from sub-Saharan Africa* (Washington, DC: Brookings Institution, 2016), https://www.brookings.edu/wp-content/uploads/2016/12/global_122116_governance.pdf.

period.[63] A handful of countries are driving this increase while a number of countries continue to be left behind. The commodities boom of the 2000s, commonly referred to as the "commodities super cycle," was a major contributor to increased tax revenue in Africa. However, even in Rwanda, which does not have a primarily commodities-based economy, improved legislation, administration, compliance, and increasing revenue productivity led to an increase in tax-to-GDP ratio from 10.2 percent in 2000 to 16.6 percent in 2016.[64] Improved DRM in Rwanda helped mobilize resources for health spending, and per capita spending on health more than doubled from 2008 to 2013, from $32 to $70.[65] Similarly, government spending on education rose from to 5 percent of GDP in 2013 from 4.4 percent in 2007.[66]

One might naturally assume that resource mobilization efforts would be more successful in more stable and democratic countries, but this is not always the case. For example, Togo ranked 142 out of 167 countries in the Economist Intelligence Unit's 2017 Democracy index, yet its tax-to-GDP ratio was 22.2 percent in 2016 according to the OECD.[67,68] Out of the sub-Saharan African countries included, only South Africa had a ratio higher than Togo.[69] Democracy is not a prerequisite to increase domestic resources, though it can be an important factor in sustainable DRM reform, especially the aspects of democracy that promote transparency, electoral accountability, and political participation.

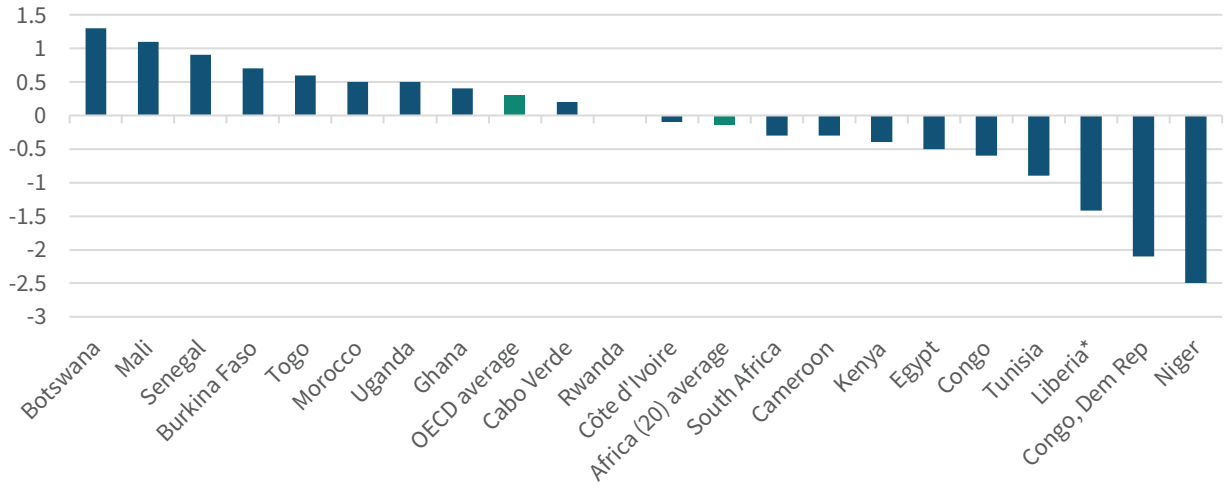
Figure 1: Tax-to-GDP Ratio, 2016



Source: OECD, ATAF, and AUC, *Revenue Statistics in Africa 2018* (Paris: OECD Publishing, 2018), https://www.oecd-ilibrary.org/taxation/revenue-statistics-in-africa-2018_9789264305885-en-fr; Liberia Revenue Authority, Annual Report Fiscal Year 2016-2017 (LRA, 2018), http://www.lra.gov.lr/Admin/Official_Files/reports/67b61e40138c9f2b57d63678743b2a61.pdf.

63. Runde and Savoy, *Domestic Resource Mobilization Tax System Reform*.
64. OECD, "Revenue Statistics in Africa 2018 – Rwanda," 2018, http://www.oecd.org/tax/tax-policy/revenue-statistics-africa-rwanda.pdf.
65. OECD and ITC Secretariat, *Examples of Successful DRM Reforms and the Role of International Co-operation* (Bonn: ITC and OECD, July 2015), https://www.oecd.org/tax/tax-global/examples-of-successful-DRM-reforms-and-the-role-of-international-co-operation.pdf.
66. Ibid.
67. The Economist Intelligence Unit, *Democracy Index 2017*, 33, http://www.eiu.com/Handlers/WhitepaperHandler.ashx?fi=Democracy_Index_2017.pdf&mode=wp&campaignid=DemocracyIndex2017
68. OECD, ATAF, and AUC, *Revenue Statistics in Africa 2018* (Paris: OECD Publishing, 2018), 29, https://www.oecd-ilibrary.org/taxation/revenue-statistics-in-africa-2018_9789264305885-en-fr.
69. Ibid.

Figure 2: Change in Tax-to-GDP Ratios, 2015 to 2016



Source: OECD, ATAF, and AUC, *Revenue Statistics in Africa 2018* (Paris: OECD Publishing, 2018), https://www.oecd-ilibrary.org/taxation/revenue-statistics-in-africa-2018_9789264305885-en-fr; Liberia Revenue Authority, *Annual Report Fiscal Year 2016-2017* (LRA, 2018), http://www.lra.gov.lr/Admin/Official_Files/reports/67b61e40138c9f2b57d63678743b2a61.pdf.

That said, countries engaged in active conflict, such as South Sudan, Somalia, and the Democratic Republic of Congo (DRC) and with weak governments tend to have poor statistics and, even if figures do exist, they show extremely low revenue. According to the OECD, the DRC had a tax-to-GDP ratio of just 7.6 percent in 2016, the lowest of all 85 countries observed.[70] A 2011 report by the Overseas Development Institute (ODI) found that there was statistical correlation between state fragility and the performance of countries on PFM systems.[71] GDP calculations can fluctuate in conflict-affected countries, but it remains clear and unsurprising that without stable governing institutions and central governments, countries are unable to significantly increase DRM.

Democracy is not a prerequisite to increase domestic resources, though it can be an important factor in sustainable DRM reform, especially the aspects of democracy that promote transparency, electoral accountability, and political participation.

Although democracy may not always be a determinant of high tax-to-GDP ratios (at least in the short-term), revenue collection systems certainly are. USAID continues to update its "Collecting Taxes Database" which looks at the performance of more than 200 national tax systems.[72] One of the indicators measures the efficiency of revenue authorities in

70. Ibid., 29.
71. Paolo de Renzio, Matt Andrews, and Zac Mills, *Does donor support to public financial management reforms in developing countries work?* (London: Overseas Development Institute (ODI), 2011), https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/7098.pdf.
72. USAID, "Collecting Taxes Database" Raw Data, November 2018, https://www.usaid.gov/what-we-do/economic-growth-and-trade/domestic-resource-mobilization/collecting-taxes-database.

using their financial resources to collect tax revenue, by comparing the total annual tax administration expenditures (budget) with the tax revenue collected.[73] USAID was able to collect data from 97 countries; South Sudan has the lowest cost of collection at 0.01 percent.[74] The efficiency of a DRM system clearly varies depending on the country.

Incorporating political economy aspects of DRM will help development agencies determine the appropriate level of reforms and appropriate entry points. In environments where there is no political will for transformational change, a political economy lens allows one to consider what DRM reforms are possible; efforts could start with administrative reforms, building institutions, and strengthening the enforcement of existing policies. Even in the absence of political will, DRM reforms still should occur to build the foundation for the implementation of large-scale reforms if a political window of opportunity arises. Entry points for DRM reforms include:

Legislature: Changes to tax laws are highly political and often require support from the head of state and the parliament or legislature. Although political support is critical, these reforms are not needed very frequently and can take time. For example, bank secrecy laws and extensive tax concessions (or incentives as they are known locally) have hurt collections in Philippines. Political support from legislatures is critical for introductions or major changes to specific taxes, such as VAT or excise tax.

Ministry of Finance: At the minister of finance level (depending on the level of autonomy of the revenue authority), ministerial decrees can have a significant impact without requiring legislative changes. When legislative changes are required, new initiatives are often implemented via the ministry of finance, and the ministry will be required to present and support the legislation in front of the legislature.

Revenue Authority: Revenue authority directors can typically address regulation implementation and procedures with some degree of autonomy. At this level, regulations must comply with legislation but provide more detail and specifics regarding implementation of legislation. Changes in regulations may or may not require approval from the MOF; the more autonomy enjoyed by a revenue authority, the fewer outside approvals are necessary. Regulation changes seldom affect tax rates and deductions but may change how a tax authority performs or supports functions. For example, audit regulations and procedures will explain what auditors are authorized to do and could be used to introduce risk-based audit selection. Within the revenue authority, the middle level of management is a key constituency to deal with. These officials may be resistant to change but implementation of reforms will seldom succeed without their involvement.

Periods of political transition offer opportunities for transformational reform. Improved transparency within tax systems—especially when this transparency ties revenues to expenditures on services to taxpayers—can help new governments gain the trust of their citizens and can encourage support for national social agendas. Once politicians agree to improve tax administrations, reforms such as e-filing can be quickly introduced (especially

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73. USAID, *Collecting Taxes 2017/2018: Program Document A guide to understanding and using the USAID Collecting Taxes Database* (USAID, 2018), 13, https://www.usaid.gov/sites/default/files/documents/1865/CTD_Program_Document_-_2017-18_-_FINAL.pdf.
74. Ibid., 13.

Sample DRM Reform Timeline

FIRST PHASE

1–3 YEARS

- Often low-income and/or post-conflict states
- DRM programs should focus on short-term improvements that can be implemented without political will, such as administrative reforms, e-filing, and customs adjustments

EXAMPLE
Libya

SECOND PHASE

4–9 YEARS

- Builds off reforms implemented in the first phase
- Often relatively stable and usually low- or middle-income countries
- DRM programs should focus on more long-term adjustments, for example, changing the tax code, introducing new taxes like VAT and excise taxes, addressing transfer pricing or building autonomy for revenue authorities which require political will from the government writ large and from the revenue authority

EXAMPLE
Georgia

THIRD PHASE

10+ YEARS

- Builds heavily off the reforms implemented in the first and second phases
- Often countries who are more stable and transitioning to middle-income status
- DRM programs are focused on hitting hard targets, for example, increasing tax-to-GDP ratio to above a certain percent or funding more than 75 percent of government services through tax collection

EXAMPLE
Philippines

if the foundations for such reforms were laid before the window of opportunity presented itself) and can have a dramatic impact on revenue mobilization. Such political change also affords the opportunity to signal the importance of DRM to taxpayers, thus broadening the tax base, increasing taxpayer morale, increasing efficiency and ultimately compliance. Demonstrating that political leaders are onboard with reforms and comply with tax requirements like everyone else is critical: if the leaders of a country do not pay their own taxes, then why would the people?[75]

Ghana is an example of where increasing country ownership has had a significant positive impact on DRM reforms over the years and where new political leadership will be critical to achieving further reforms. President Nana Akufo-Addo took office in 2017 through a democratic transfer of power from one party to another.[76] Since 2000, the tax-to-GDP ratio in Ghana has increased by 6.6 percentage points to 17.6 percent in 2016; but Ghana still has significant steps to take if it is to increase this ratio to the desired 20 percent[77] or even the average for Africa in 2016, 18.2 percent.[78] Since being elected, President Akufo-Addo has focused much of his rhetoric on reducing Ghana's reliance on natural resources and moving beyond foreign aid.[79] In order to reduce donor dependency, he realizes that Ghana must collect more taxes, spend revenue more effectively, and stimulate economic growth. Though the rhetoric is appropriate, the shortfall between what was budgeted and what was collected in tax revenue was 10 percent in 2017. Nevertheless, the government still believes that it can increase tax revenue by 25 percent through administrative reforms alone, even though no new taxes have been introduced.[80]

"It is not right for a country like Ghana, 60 years after independence, to still have its health and education budgets being financed on the basis of the generosity and charity of the European taxpayer. By now we should be able to finance our basic needs ourselves."

– President Akufo-Addo of Ghana in December 2017 at a press conference with President Emmanuel Macron of France

75. In June 2016, a *New York Times* article condemned widespread corruption within South Africa's tax system between 2012 and 2014 and exposed President Jacob Zuma's refusal to pay taxes during his time in office. Selam Gebrekidan and Norimitsu Onishi, "Corruption Gutted South Africa's Tax Agency. Now the Nation is Paying the Price," *New York Times*, June 10, 2018, https://www.nytimes.com/2018/06/10/world/africa/south-africa-corruption-taxes.html.
76. David Pilling, "Akufo-Addo wins Ghana presidential election," *Financial Times*, December 10, 2016, https://www.ft.com/content/785703ea-be6e-11e6-8b45-b8b81dd5d080.
77. OECD, "Revenue Statistics in Africa 2018 – Ghana," 2018, http://www.oecd.org/tax/tax-policy/revenue-statistics-africa-ghana.pdf.
78. Ibid.
79. Kylie Kiunguyu, "Ghana – Pres Nana Akufo Addo Makes Firm Statement on African Autonomy from European Aid," All Africa, December 7, 2017, https://allafrica.com/stories/201712040768.html.
80. PricewaterhouseCoopers (PwC), *2018 Budget Highlights: "Putting Ghana Back to Work"* (PwC, 2017), 3, https://www.pwc.com/gh/en/assets/pdf/2018-budget-highlights.v2.pdf.

2 | Improve Collection and Spend More Efficiently

Many DRM reform programs have focused predominately on increasing tax revenue and have not dedicated enough attention to helping countries spend their tax money more effectively, even though the mobilization and expenditure sides are inextricably linked, and both require similar levels of political will. More transparency in the tax collection and procurement processes in developing countries is needed; tax officials may be asking for bribes, but at the same time they may not be making enough income to support their families. Senior government officials might be demanding exemptions for themselves or their businesses, as seen in South Africa.[81] When looking at the similarities among high-performing tax administrations, a few different aspects stand out.

Improving Collection

COMMON DENOMINATORS AMONG QUALITY DRM SYSTEMS

1. **Simplified filing systems for individuals and businesses**: Most people in low-income countries do not know the official processes for filing taxes for individuals or businesses. Even if they do, the systems are usually overly complex and require in-person trips to government offices. The more people one must meet with in order to file taxes, the more opportunities for corruption. Ideally, most of the filing and payment processes would be moved online and would not require changes in legislation. Reduced corruption would increase tax morale amongst citizens as well. Having to take time out of the work week is challenging for people with full-time jobs, and even worse, government offices are open only at certain times and usually have long wait times. DRM programs have attempted to address these challenges by implementing "one-stop shops" where one can register and complete all tax forms at the same time.[82] DRM programs also are working with country governments to digitize filing systems. According to USAID, 143 countries have electronic filing systems, and 133 countries have e-payment systems.[83] E-filing systems reduce errors

81. Gebrekidan and Onishi, "Corruption Gutted South Africa's Tax Agency. Now the Nation is Paying the Price,"
82. "Domestic Resource Mobilization," World Bank Group, October 4, 2018, http://www.worldbank.org/en/topic/governance/brief/domestic-resource-mobilization.
83. USAID, "Collecting Taxes Database" Raw Data, November 2018, 15, https://www.usaid.gov/what-we-do/economic-growth-and-trade/domestic-resource-mobilization/collecting-taxes-database.

by tax administration officials, centralize the filing system, and reduce corruption by eliminating opportunities for officials to request bribes. Simplified filing systems for households and businesses will expand countries' tax bases.

2. **High tax morale and expanded tax net**: Countries should credibly link taxes to the benefits that they provide (i.e., education, health care, and other government services) and, in doing so, promote the legitimacy of the government and increase tax payer morale. Citizens who see where their money is going through transparent budgets and actual expenditures will be encouraged to meet their tax obligations.[84] Higher tax morale, especially when coupled with strong DRM systems, could allow countries to successfully collect VAT, property, and corporate income taxes in addition to personal income taxes. These taxes help countries target wealthier households that are more able to pay while avoiding politically sensitive tax rate increases. Reducing tax evasion and increasing punishments of those who do not pay taxes can also help tax morale in addition to generating more revenue.

3. **Small informal sectors**: Countries with large informal sectors are not collecting as much tax revenue as they should. In India for example, almost 90 percent of the workforce is informally employed, meaning that a large portion of its population does not pay taxes and lacks social safety nets.[85,86] Countries with successful tax collection systems reduce informality by simplifying registration and filing services. Linking taxes to benefits and increasing enforcement measures can also help reduce informality.

4. **Independent revenue authorities**: In some instances, revenue authorities have gained more autonomy in the government budgeting process and more general autonomy by becoming semi- or fully-independent from the ministry of finance and other government institutions. Seventy-seven countries worldwide have fully- or semi-autonomous revenue authorities.[87] A revenue authority is considered semi-autonomous if it operates independently from the government in legal form, financial resources, HR, and/or administrative practices.[88] Independence can offer protection from political changes in, or political interference by, presidents, prime ministers, and ministries of finance.

5. **Credible, independent, and rules-based appeals system**: Developing countries with successful tax administrations tend to have an independent and efficient appeals system that gives taxpayers a platform to voice their concerns. The existence of a credible and quick appeals process improves taxpayer's confidence in the tax system and reduces opportunities for corruption or extortion by tax officers. Appeals processes typically go through the ministry of finance but creating independent

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84. Kyle Murphy, "Paying for Performance," Abdul Latif Jameel Poverty Action Lab, 2016, https://www.povertyactionlab.org/sites/default/files/publications/paying-for-performance.pdf.
85. Safety net programs include cash and in-kind transfers targeted to poor and vulnerable households, with the goal of protecting families from the impact of economic shocks, natural disasters, and other crises. "Safety Nets," World Bank Group, April 5, 2018, https://www.worldbank.org/en/topic/safetynets.
86. Romina Bandura and Casey Sword, *The Future of Global Stability: The World of Work in Developing Countries, Case Study India* (Washington, DC: CSIS, 2018), 7, https://csis-prod.s3.amazonaws.com/s3fs-public/publication/181018_India.pdf?BhGEVVYGe.rjaSHc.GZKb0mcJioUgJD6.
87. USAID, *Collecting Taxes 2017/2018*, 12.
88. Ibid.

courts could be valuable. The speedy resolution of tax disputes benefits both taxpayers and tax administrations.

Spending more efficiently

TYING MOBILIZED RESOURCES TO QUALITY EXPENDITURES

In most developing countries, the VAT or GST represents the largest amount of revenue collected. Personal income taxes only account for around 1–3 percent of GDP in developing countries whereas the percentage in more developed countries is around 9–11 percent of GDP.[89] In contrast, corporate income taxes accounted for around 17 percent of tax revenue in developing countries and only 10 percent in OECD countries.[90] Property taxes represent 6.7 percent of total revenues in OECD countries, compared to 2.4 percent in larger developing and transitional countries.[91] These are just three of the most common sources of domestic revenue; there are countless other examples where sales taxes or "sin taxes" on goods like tobacco and alcohol have increased collection and targeted specific individuals instead of entire populations. Beyond these examples, many developing countries rely on foreign aid to meet the basic service needs of their citizens for healthcare, education, and infrastructure.[92]

Once mobilized, how revenues are spent—and, importantly, the effect of the public perception of the spending on future mobilization—often is not included in DRM strategies.

Photo 1 is from DAI; Liberia—Revenue Generation for Governance and Growth (RG3), DAI, https://www.dai.com/our-work/projects/liberia-revenue-generation-governance-and-growth-rg3

Some countries are taking steps to better link government benefits and projects to tax collection. For example, the Liberia Revenue Authority (LRA) has put up signs all over

89. Runde and Savoy, *Domestic Resource Mobilization Tax System Reform*.
90. Ibid.
91. Dirk Willem te Velde, "Typical tax findings and challenges in developing," in *Taxation and Developing Countries: Training Notes* (London: Overseas Development Institute, September 2013), 8, https://www.odi.org/sites/odi.org.uk/files/odi-assets/events-documents/5045.pdf.
92. "Domestic Resource Mobilization," USAID.

Monrovia, the capital, to link taxes to different development projects. Similar steps to educate the public on how taxpayer money can be used to fund projects should be included in DRM programs in other low- and middle-income countries. Tax morale will increase if governments can demonstrate to their citizens that they are effectively and efficiently spending taxpayer money. Linking taxes to construction projects such as roads and transportation would also increase tax morale.

Expenditure analysis and how countries can maximize impact should be a part of DRM programming. Countries typically spend tax revenue on government salaries, education, healthcare, agriculture subsidies, and social safety nets. However, adding transparency to government spending is important. For example, Ghana's Ministry of Finance released "Citizens' Budgets" for 2017 and 2018 that project government spending by type for those years.[93] Figure 1 shows the proposed spending by the government of Ghana in 2018; the actual expenditures for 2018 have not been released yet. Compensation of employees, interest payments, and capital expenditure make up the largest portions.[94] Becoming more transparent in government spending is just one way that countries can demonstrate to taxpayers how the government is spending their money. Adding transparency and moving procurement processes online, for example, by posting all tender winners publicly, is another way that governments can gain the trust of their citizens.

Figure 4: Ghana's Expenditure Items and Their Allocations for 2018 (in USD millions)

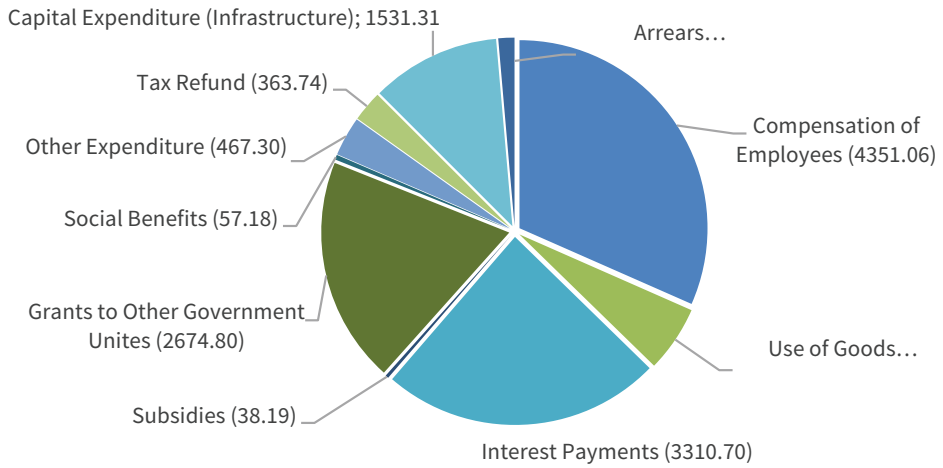

Figure 4 is an original creation of CSIS based on a similar pie chart by Ghana's Ministry of Finance.

Source: Republic of Ghana, Citizens' Budget -2018- An Abridged and Simplified Version of the 2018 Budget Statement and Economic Policy (Accra, Ghana: Ministry of Finance, 2017), 4, https://www.mofep.gov.gh/sites/default/files/budget-statements/2018-Citizen-Budget.pdf.

93. Republic of Ghana, *Citizens' Budget -2018- An Abridged and Simplified Version of the 2018 Budget Statement and Economic Policy* (Accra, Ghana: Ministry of Finance, 2017), 4, https://www.mofep.gov.gh/sites/default/files/budget-statements/2018-Citizen-Budget.pdf.
94. Capital Expenditure refers to the money spent on infrastructure projects such as roads, schools, hospitals, bridges, transport, water systems, plant and machinery etc. Republic of Ghana, *Citizens' Budget -2018*, 4.

Governments in developing countries should be more transparent about how the budgets for government spending are determined and how estimates for tax revenue are made. Citizens should look to government ministries and the legislature to explain capital expenditures and infrastructure agreements and even to publish their own salaries. Governments should also properly document and record the steps taken to determine budgets so that they can be reviewed later. With more transparency in the budgeting process, citizens and international actors can hold governments more accountable and make sure that revenue targets are realistic.

ETON AND EBOMAF LOAN AGREEMENTS IN LIBERIA

Liberia faced international backlash when the media exposed two loan agreements with businesses from Singapore and Burkina Faso signed by the president in June 2018 that totaled more than $1 billion.[95] The lack of available specifics concerned the international development community and Liberians; without the details of the agreements, there was little way to calculate risk.[96] At the IMF-World Bank annual meetings in October 2018, Liberia received a commitment of $500 million for road development from the World Bank and other development partners as well as an additional $500 million commitment from the private sector.[97] When there is greater transparency in government spending and procurement processes, countries reduce the risk of defaulting on loans, and international actors are more likely to offer alternative financing with more favorable interest rates.

Many tax revenue authorities face pressure from other parts of the government to meet the projected budget each year, even though they have little (if any) influence over how this budget is determined. Some countries base their forecasts for tax revenue from previous years, expected GDP growth projections (which can be wildly unrealistic), and the introduction of new taxes and/or higher tax rates (which are unpopular the world over). One consistent problem is disagreement among governmental ministries and political parties. Based on politics and the influence of individual ministers, different parts of the government can receive vastly different allocations. Another weakness is the unpredictability of emerging economies (i.e., inflation, commodity shocks, financial crises). In many cases, the economic assumptions underlying projected government spending could change due to unexpected fluctuations in different sectors and changes in commodity prices, for example, crude oil.

Another challenge among developing countries is the lack of long-term planning when preparing the budget, especially in countries such as Liberia or Uganda that have dealt

95. Lennart Dodoo, "Liberia: Finance Minister Hints Cancellation of ETON, EBOMAF Loan Agreements," *Front Page Africa*, October 31, 2018, https://frontpageafricaonline.com/front-slider/liberia-finance-minister-hints-cancellation-of-eton-ebomaf-loan-agreements/.
96. In-person interviews with stakeholders in Monrovia, Liberia, August 2018.
97. Republic of Liberia's Ministry of Finance and Development, "Liberia's Delegation to the 2018 IMF – World Bank Annual Meetings Score Big Gains," Press Release, October 19, 2018, https://www.mfdp.gov.lr/index.php/media-center/press-releases/636-liberia-s-delegation-to-the-2018-imf-world-bank-annual-meetings-score-big-gains.

with long periods of extreme violence and instability. Health crises or natural disasters further exacerbate these challenges. As a result, many ministries are only considering one-year estimates when determining budgets instead of multiyear planning.[98] Lack of long-term planning also is a problem among citizens, as many end up requiring government services because they fail to plan for retirement or lack additional social safety nets to fall back on. Unfortunately, this often means that governments collect less tax revenue than is required by the budget, damaging the credibility of the revenue authorities and making governments look inefficient.

98. Barry Potter and Jack Diamond, "Guidelines for Public Expenditure Management," International Monetary Fund, 1999, https://www.imf.org/external/pubs/ft/expend/index.htm.

3 | Uganda Case Study

"The Cautionary Tale"

Uganda gained its independence in 1962 and faced nearly two decades of internal conflict that broke down many of the pre-independence social and political bonds. In 1986, President Museveni came to power following an armed insurgency and has served five presidential terms in office. Museveni ushered in a period of relative political stability and some economic growth under what is essentially one-party rule. One-party rule has led to significant human rights abuses (especially with minority groups), suppression of free speech and civil society, and significant nepotism focused on the ruling political elite. Museveni maintains support by reminding Uganda of the instability that existed prior to his rule and increasing reliance on cash during elections to generate support for his political party.

That said, Uganda's population is young, with more than half of the population estimated to be under the age of 30. These young people have few (if any) memories of pre-Museveni Uganda, making it more difficult to maintain rule. Museveni recently changed the law raising the presidential age limit to allow him to remain in office. There is a political opposition in Uganda, but it remains disorganized and at a disadvantage in fighting Museveni's party, which can draw on the full power of the government—especially financial.[99,100]

Uganda remains heavily dependent on foreign assistance, receiving approximately $1.6 billion annually for the past five years. This assistance is vital for Uganda's health and education systems to continue to function: individuals interviewed for this case study in Uganda indicated that without this support, both systems would likely collapse. Even with this support, the health system has largely ceased to function and simply provides reactive care as well as it can. The education system essentially operates as a large daycare system, which has had the consequence of allowing more women to enter the work force. Museveni has also established Uganda and by extension himself as an important guarantor of regional stability, which makes Western donors (especially the United States)

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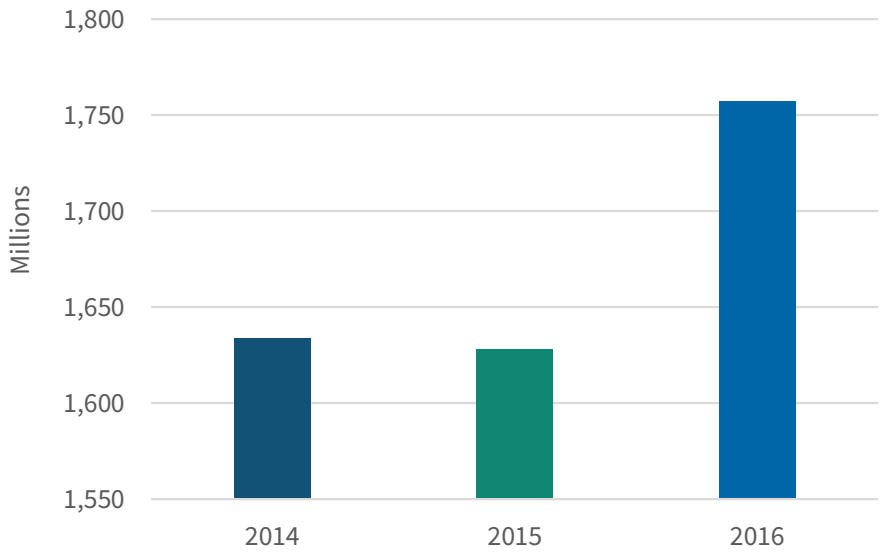
99. African Center for Strategic Studies staff, "Scrapping Presidential Age Limits Sets Uganda on a Course of Instability," August 27, 2018, Africa Center for Strategic Studies, https://africacenter.org/spotlight/scrapping-presidential-age-limits-sets-uganda-on-course-of-instability/.
100. Al-Jazeera staff, "Uganda enacts law ending presidential age limits,"Al-Jazeera, January 2, 2018, https://www.aljazeera.com/news/2018/01/uganda-enacts-law-presidential-age-limits-180102182656189.html.

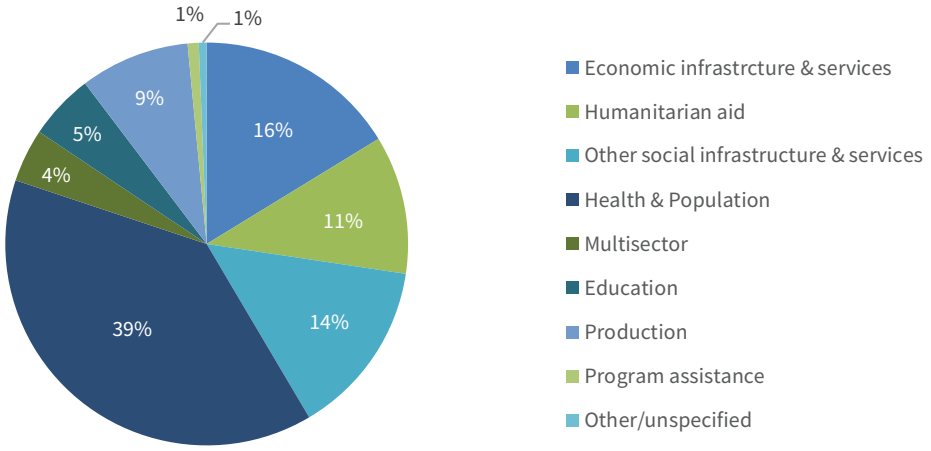
loath to push too hard on reforms. The Ugandan army provides the largest contingent for the African Union's peacekeeping mission in Somalia (AMISOM) and is a critical counter-terrorism partner in the larger region.

Figure 5: Uganda's Net ODA (USD millions), 2014–2016



Source: OECD DAC Aid at a glance by recipient, Uganda, OECD, https://public.tableau.com/views/OECDDACAidata-glancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

Figure 6: Bilateral ODA to Uganda by Sector, 2015–2016



Source: OECD DAC Aid at a glance by recipient, Uganda, OECD, https://public.tableau.com/views/OECDDACAidata-glancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

President Museveni has boasted of his success of increasing revenue and focusing the development budget on improving roads and electricity for the country in the last three decades. However, the Ugandan government continues to spend more than it collects, which has led it to resort to debt financing. Donors have continued to play a large role in supporting infrastructure investment, and Uganda's dependence on donors for its health and education system is disconcerting.

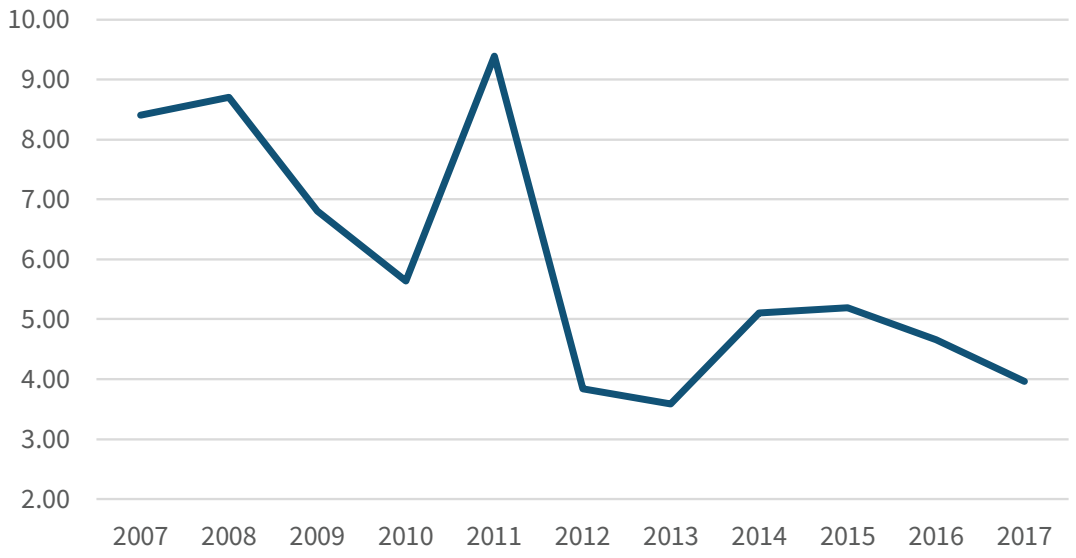
Museveni also has sought to use taxes to target segments or issues that he disapproves of, such as the recently introduced "social media tax" that targets users of 58 social media services, including WhatsApp, Facebook, Twitter, Uber, Instagram, and others.[101] The tax charged users 200 shillings ($0.05) per day to access their accounts; Museveni justified the taxes as a way to end "gossip" and "fake news" and characterizing social media as "luxury." Alongside the social media tax, the government also introduced a 1 percent levy on all mobile money transactions. The taxes proved unpopular and triggered demonstrations in Kampala in July 2018.[102] Ultimately, the social media tax was referred back to parliament for review, but it remains in place. The mobile money tax was revised downward to 0.5 percent levy on transactions with Museveni later claiming that he had never called for a 1 percent tax and parliament "misinterpreting" what he wanted.[103,104]

Uganda's economy remains relatively underdeveloped, with most economic activity concentrated in the Kampala capital region, accounting for nearly 60 percent of Uganda's yearly economic output. Uganda holds great economic potential, especially in agriculture, tourism, and potentially light manufacturing. The eastern city of Jinja, for example, was at one time a center of manufacturing. The government, however, does not prioritize investments in these sectors and instead has focused resources on infrastructure development, creating a national road network. The road network has generated benefits, but there has been limited investment in other forms of infrastructure, in particular, electricity generation and improved cross-border linkages that would help facilitate the flow of goods and services with Uganda's neighbors. Recently, Uganda has taken steps to produce and refine its own oil by 2020, which has been a bigger driver of potential economic growth.[105] Some estimates suggest that oil has the potential to generate more than $2 billion in annual revenue for more than 20 years.[106] However, the construction costs of infrastructure for this are estimated to be $10 billion.[107]

Some estimates suggest that oil has the potential to generate more than $2 billion in annual revenue for more than 20 years.

101. Molly Schwartz, "If You Charge People to Tweet, They'll Revolt in the Street," *New York Magazine*, October 2, 2018, http://nymag.com/developing/2018/10/uganda-social-media-tax-youth-protest.html.
102. "Uganda social media tax to be reviewed," BBC News, July 11, 2018, https://www.bbc.com/news/world-africa-44798627.
103. Daniel Mumbere, "Uganda removes taxes on 'depositing and sending' mobile money," *Africa News*, July 17, 2018, http://www.africanews.com/2018/07/17/uganda-removes-taxes-on-depositing-and-sending-mobile-money/
104. CSIS interviews in Kampala, Uganda, July 2018.
105. David Herbling and Fred Ojambo, "Uganda Sees $70 Million Initial Spending on Oil Storage," *IOL*, July 13, 2018, https://www.iol.co.za/business-report/international/uganda-sees-70-million-initial-spending-on-oil-storage-15997182.
106. Ben Shepherd, *Oil in Uganda: International Lessons for Success* (London: Chatham House, 2013), 2 https://www.chathamhouse.org/sites/default/files/public/Research/Africa/0113pr_ugandaoil.pdf.
107. Ibid.

Figure 7: Uganda's GDP Growth (%) over the Past 10 Years



Source: World Bank Development Indicators, "GDP growth (annual %)," (current US$), 2007–2017 Data, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2017&locations=UG&start=2007.

Growth can help increase revenues, but Uganda has seen uneven growth for the past few years. This year the country is on pace to grow at approximately 7 percent, but last year only managed 2–3 percent. An elite comprising a small group of successful businessmen who are close to the regime controls much of the productive economy and does not pay taxes. There is little interest on the part of Museveni's government to invest in productive sectors of the economy, which includes agriculture, tourism, and potentially light manufacturing.

Agriculture accounts for 71 percent of GDP. Museveni, however, abolished cooperative societies in the late 1980s/early 1990s as a threat to his power. Since then, there has been little effort to organize small farmers in any meaningful way, with the government preferring farmers to remain unorganized and operating at a subsistence level. Further, there is no investment by the government in inputs (seeds, fertilizer), no extension training service, no investment in irrigation (Uganda remains dependent on highly variable rains), and relatively little investment in storage or processing facilities.

There are several factors that hinder Uganda's economic development, including poor infrastructure (high transport costs, underdeveloped transportation systems, lack of electricity) and low agricultural productivity.[108] These factors increase business costs and thereby hinder foreign investment and economic growth.[109,110] A weak enabling environment for businesses and limited access to capital for entrepreneurs and small

108. World Bank Group, *Uganda Economic Update*, 11th edition (Washington, DC: The World Bank Group, 2018), https://openknowledge.worldbank.org/bitstream/handle/10986/29916/126184-WP-PUBLIC-FinalReportUgandaEconomicUpdate.pdf?sequence=1&isAllowed=y.
109. Bank of Uganda, The Uganda Bureau of Statistics and the Uganda Investment Authority, *Private Sector Investment Survey 2016 Report* (Bank of Uganda, 2017), https://www.bou.or.ug/bou/bou-downloads/publications/PrivateSectorCapital/PSIS/2016/All/Private-Sector-Investment-Survey-2016-REPORT.pdf.
110. IMF, *Regional Economic Outlook: Domestic Resource Mobilization and Private Investment, Sub-Saharan Africa* (Washington, DC: IMF, 2018), https://www.imf.org/en/Publications/REO/SSA/Issues/2018/04/30/sreo0518.

businesses contribute to the challenges that the private sector faces.[111] In the agriculture sector in particular, underdeveloped trade networks and complex trade processes limit export competitiveness. The country also has high levels of business informality and high rates of informal-sector labor force participation.[112]

Uganda's DRM Landscape

Until recently, Uganda had a relatively well functioning revenue system, with the Uganda Revenue Authority (URA) seen as an example of a professional and relatively non-corrupt government institution. The Government of Uganda created the URA in 1991 to professionalize and improve its overall tax collection efforts. This helped raise Uganda's tax-to-GDP ratio to approximately 12.5 percent by the early 2000s, but this ratio subsequently stagnated as Uganda entered a more challenging period. Uganda now has a ratio of approximately 14.7 percent and most experts agree that if Uganda tackled existing exemptions and closed some loopholes, it could rise to 20 percent.[113]

Uganda's framework for tax and budget expenditure remains weak. The overriding tax act is frequently amended at the start of the year with little stakeholder consultation and frequently at the whims of the president. Exemptions and incentives are issued by the minister of finance to those close to the regime and select foreign investors, though the prevalence of the latter practice is unclear. The URA is a semi-autonomous organization that has a dotted-line report to the ministry of finance, but there is little coordination between the two bodies, with the ministry handing out exemptions with little regard to how they impact URA's revenue targets.

Donors continue to provide support for DRM and public financial management reform projects in Uganda with the UK's Department for International Development (DFID), European Union, IMF, and World Bank all have projects currently underway. DFID's projects are programmed as part of its overall governance reform efforts. USAID does not presently have a large DRM or PFM project in Uganda, only a small project under the Leadership in Public Financial Management project executed by Nathan and Associates. LPFM in Uganda provides technical assistance on tax policy and tax administration systems, as well as support for improved program budgeting at the Uganda Ministry of Health.

According to the IMF's 2018 *Regional Economic Outlook for Sub-Saharan Africa*, several measures were adopted in Uganda in recent years to eliminate distortions of value-added taxation, expanding the network of withholding agents, changing VAT thresholds to improve targeting of high-value businesses, and voiding/suspending certain tax exemptions.[114] An IMF program in 2014–2016 set forth fiscal objectives, which include scaling up investment, broadening the tax base, and improving public financial management (PFM).[115]

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111. World Bank Group, *Doing Business 2019: Uganda*, 16th edition (World Bank Group, 2019), http://www.doingbusiness.org/content/dam/doingBusiness/country/u/uganda/UGA.pdf.
112. Mouris Opolot, "Informality Growing Faster than Formality," EPRC, September 20, 2017, , http://eprcug.org/press-media/news-opinions/584-informality-growing-faster-than-formality.
113. CSIS interviews in Kampala, Uganda, July 2018.
114. IMF, *Regional Economic Outlook: Domestic Resource Mobilization and Private Investment, Sub-Saharan Africa*.
115. Ibid.

Recently, the donor coordinating group on DRM in Uganda pushed the government to create a medium-term revenue strategy (MTRS). The IMF, in particular, wanted such a document before continuing its technical assistance projects for the Ministry of Finance and URA. The Ministry of Finance's tax policy department is preparing the strategy, although it has little technical capacity to do so. The IMF, however, is providing support to the ministry to produce an MTRS that will help to identify and address the underlying political and economic challenges facing the government. The MTRS will likely yield short-term gains and donors likely will deploy technical assistance to address the gaps in tax administration the MTRS will highlight.

Challenges

Despite existing efforts, there are inherent political and economic challenges in Uganda that prevent domestic resource mobilization programs and efforts from succeeding. To date, donors have focused their energies on technical assistance programs to help build the capacity of the URA and Ministry of Finance. Although these projects can help address many of these challenges, without sustained efforts aimed at specifically addressing the political economy it is unlikely donor support will achieve lasting results.

Each year there are provisions added and eliminated in tax policy. Rewriting policy every year makes it difficult to stay up to date on the changes. Even the tax administration personnel who are supposed to be most informed are unaware of the changes, and there is a lack of consistent knowledge across the administration. This contributes to a broader issue of a lack of taxpayer knowledge; without proper resources and access to knowledgeable personnel, citizens are less likely to educate themselves about the tax system and contribute to it.[116]

There also is a common perception among the general population that the government gives exemptions to foreign investors, which disincentivizes people to pay taxes. It is true that foreign investors have an advantage when it comes to gaining exemptions and returns on their investments whereas locals receive no exemptions and operate at a loss if they invest in the country. Investor incentives should be in strategic sectors, and they need to be reviewed and within tax law.

The URA cited its focus on expanding the tax base by targeting the informal sector and reviewing exemptions (discretionary) for companies that haven't paid taxes in the first place. Several publications over the last five to seven years cited that evaluating exemptions should be a top priority. One report by the Southern and Eastern African Trade Information and Negotiations Institute (Seatini-Uganda) in 2012 found that tax exemptions had a contradictory impact on Uganda's economy; instead of stimulating employment, exemptions led to losses in tax revenue.[117] For example, tax exemptions led to a direct loss of 3.99 percentage points for tax to GDP ratio in Uganda in FY2009-2010.[118]

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116. On the issue of tax education, traders often lose out on exemptions because of a lack of information. A registered business pays VAT and other general taxes, whereas unregistered businesses pay many more taxes. They essentially are penalized for their lack of knowledge.
117. Southern and Eastern African Trade Information and Negotiations Institute (Seatini-Uganda), *Tax Exemptions: Implications on socio-economic development* (Seatini-Uganda, 2012), 7, http://www.seatiniuganda.org/publications/downloads/89-tax-exemptions-implications-on-the-socio-economic-development-3rd-dec-2012/file.html.
118. Ibid.

BROADENING THE TAX BASE

There are clear political boundaries to broadening the tax base. The needs are immense: 20 percent of taxpayers generate 80 percent of revenue. The URA gave us a figure of 1.3 million taxpayers in the country (41 million total population, with youth accounting for half). Most people interviewed as part of this report thought that the 1.3 million figure was a stretch, and that many of these reported taxpayers are likely not complying fully. The best guess from those in the know in Uganda was 300,000 to 500,000 compliant taxpayers per year. Most taxpayers live or work in the Kampala area. The URA is given a target figure to be met, but instead of looking at *how* the authority gets this revenue, it considers only the number itself.[119] The URA recently implemented an electronic registry process to increase accessibility and expand the tax base, but given the URA's limited technical capacity, the authority will need support for it to be effective. Moreover, rather than bring more taxpayers into the system, the URA has resorted to levying additional taxes on current taxpayers. For example, MTN, the South African mobile phone company, pays six taxes: corporate, VAT, excise, property, commission tax, and social security.

Uganda's revenue base is made up of a mix of taxes: payroll, corporate, VAT, import duties, and excise tax on various goods and services. There is widespread non-compliance with these taxes, especially VAT and other import duties. There are categories of people or taxes that are off limits: farmers, livestock, other parts of the agricultural sector. Museveni refers to these people as "my people," as he sees them as his base of support and thus is loath to bring them into compliance with existing taxes. Uganda recently sought to generate additional revenue through the imposition of the social media tax mentioned earlier in this report, which has been widely unpopular, especially with youth, who considered it an infringement of their freedom of speech.[120] The social media tax drives up the cost of using the internet and limits the ability of low-income or unemployed Ugandans to use social media.[121] The World Bank found that only 22 percent of Uganda used the internet in 2016.[122]

The informal sector is large and diverse in Uganda. Although we often think of small traders or other individuals selling products by the roadside, the informal sector in Uganda also includes large businesses that conduct transactions totaling billions of Ugandan shillings. Given that when a business does formalize it is exposed to a significant tax burden, there is little incentive to do so.

This has also created problems with tax fatigue and low tax morale, with many Ugandan taxpayers questioning what they receive for paying their taxes. This is especially true in the health and education systems, which continue to face significant problems. With such poor infrastructure, many businesses are not able to operate during rainy seasons without basic public services such as roads and electricity. The same situation is apparent in the education system; those families that are able to pay taxes often place their children in private school (which they pay for) because of the poor quality of education in the public

119. CSIS Interview in Kampala, Uganda, July 2018.
120. Stephanie Busari, "Uganda government sued over social media tax," CNN, July 2, 2018, https://www.cnn.com/2018/06/01/africa/uganda-social-media-tax/index.html
121. Ibid.
122. The World Bank Group, "Individuals using the Internet," Raw Data, 2016, https://data.worldbank.org/indicator/IT.NET.USER.ZS?locations=UG&view=map.

system. One of the major concerns for taxpayers is accountability—they want to know where their money is going, and they want to see the results reflected in public services. The government will need to focus on rebuilding the social contract with its citizens to increase tax morale and compliance.

BUDGET EXPENDITURES

Ugandan government spending has steadily increased over the past few years largely driven by infrastructure costs, debt servicing, defense and security, and off-balance sheet outlays. There is little money directed to social services (as noted, according to most Ugandans, the health and education system are near collapse and sustained only by donors) or investment in the productive economies. The government largely is sustained on a cash basis, with it routinely making cash payouts to supporters, especially during parliamentary elections. The government presents the budget to parliament in May and it is approved by June, before the beginning of the fiscal year on July 1. The URA is given a target figure that they must raise to meet planned expenditures in the yearly budget. There is little discipline around budget expenditures, with the government frequently presenting supplementary budgets that justify overspending.

CORRUPTION

There is considerable political interference and dysfunction in the tax system. Candidates buy votes in their constituencies, contributing to the broader breakdown in institutional capacity that exacerbates the issues described in this report. The challenge of corruption is embedded in the tax administration as well, which directly affects personnel and staff turnover, and the low capacity of the URA hinders its ability to train new hires.

The URA[123] is accused of being particularly aggressive in collecting taxes given the aforementioned quotas that they are required to fulfill given the philosophy of the government to overspend what they collect, so they abuse the tax base.[124] In addition, several companies have accused the URA staff of being involved in trades that negate the integrity of the institution. Several of these companies have found challenges when bringing these accusations forward to the courts as well. Nonetheless, the URA argues that external contractors check and evaluate URA staff engagement.

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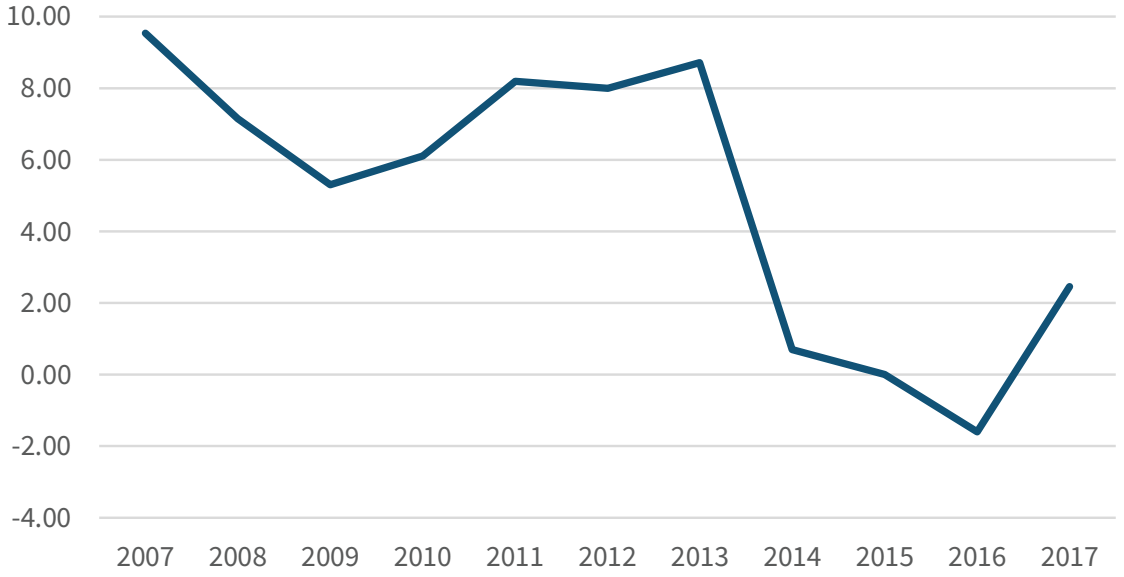
123. David Kizito, "#Beat Corruption," Transparency International, January 17, 2018, https://tiuganda.org/icg-corrupted-government-agencies/.
124. GAN Integrity, "Uganda Corruption Report," Business Anti-Corruption Portal, https://www.business-anti-corruption.com/country-profiles/uganda/.

4 | Liberia Case Study

"A Window of Opportunity"

Liberia is currently in a period of transition from the administration of President Ellen Johnson Sirleaf to the newly elected president, George Weah. The democratic transfer of power was a major victory given the country's history of civil war and crises, but many challenges remain to reduce Liberia's donor dependency. President Weah focused on empowering the common man and promised jobs for young people and economic prosperity, a winning campaign formula that will be challenging to execute.

Figure 8: Liberia's GDP Growth (%) over the Last 10 Years

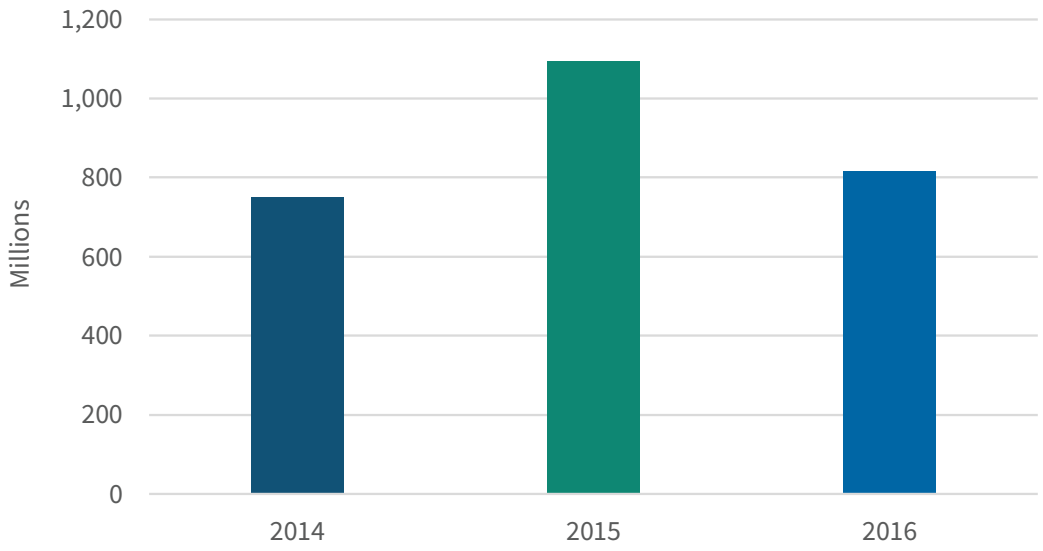


Source: World Bank Development Indicators, "GDP growth (annual %)," (current US$), 2007–2017 Data, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2017&locations=UG&start=2007.

Liberia has suffered many traumas. After a decades-long period of almost constant civil war, it also endured the Ebola crisis in 2014. As a result, the country under President Sirleaf focused primarily on stability and peace. The economy shrunk from 2015–2016

but bounced back in 2017 by growing 2.45 percent.[125] There seems to be a level of "donor fatigue" amongst the international community seen in the withdrawal of the United Nations Mission in Liberia (UNMIL) peacekeeping team. The net ODA to Liberia decreased by $279.4 million from 2015 to 2016.[126] Although it may be understandable that there was little focus on domestic resource mobilization, Liberia will have to address some core challenges if it is to become more self-sufficient and less reliant on foreign aid.

Figure 9: Liberia's Net ODA (USD Millions), 2014–2016



Source: OECD DAC Aid at a glance by recipient, Liberia, OECD, https://public.tableau.com/views/OECDDACAidataglance-byrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

Weah's "pro-poor" agenda. To operationalize his campaign vision, President Weah launched the "Pro-Poor Agenda for Prosperity and Development (PAPD)" in October 2018 which includes massive investments in roads, improvements to the education sector, and incentives for private sector growth.[127] The PAPD aims to reduce absolute poverty by 23 percent across five out of six regions over the next five years.[128] The estimated cost of this five-year program is USD 6 billion with 47 percent being financed by the Liberian government and 53 percent in official development assistance (ODA).[129]

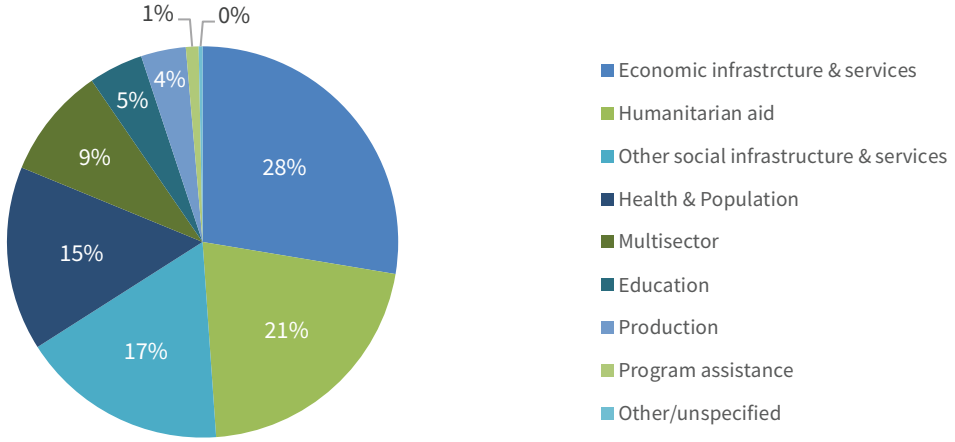
125. World Bank Development Indicators, "GDP growth (annual %)," (current US$), 2007–2017 Data, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2017&locations=UG&start=2007.
126. "Aid at a glance charts," OECD-DAC, December 22, 2017, https://public.tableau.com/views/OECDDA-CAidataglancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:-showVizHome=no.
127. "Liberia: CDC-led Government Launches Long Awaited Pro-Poor Agenda for Prosperity and Development," Front Page Africa, October 29, 2018, https://frontpageafricaonline.com/business/economy/liberia-cdc-led-government-launches-long-awaited-pro-poor-agenda-for-prosperity-and-development/ .
128. Ministry of Finance and Development Planning, Republic of Liberia, "Pro-Poor Development Agenda to be Launched in Ganta City,", Press Release, October 24, 2018, https://www.mfdp.gov.lr/index.php/media-center/press-releases/638-pro-poor-development-agenda-to-be-launch-in-ganta-city.
129. Estimates from in-person interviews conducted in Monrovia, Liberia, August 6–10, 2018.

Photo 2: By Christopher Metzger in Monrovia, Liberia, August 2018. The photo depicts a billboard of President George Weah and Pillar 2: Economy and Jobs.

For fiscal year 2016–2017, the LRA collected around $523.8 million in total revenue, with the majority of that money going to pay government employees.[130] When compared with the amount of revenue originally forecast, there was a deficit of $76.3 million or 13 percent.[131] In February 2018, President Weah announced that he would take a 25 percent pay cut in his own salary in order to try reduce politicians' salaries.[132] It is widely reported that Liberian members of Congress make around $12,000 a month ($144,000 annually)[133] with some estimates even as high as $200,000 a year when bonuses and benefits are counted.[134] In comparison, most U.S. senators and representatives made $174,000 in 2018.[135] If the Liberian government can demonstrate that it is spending tax revenue on more than just government salaries, then the trust between the government and civil society will improve.

130. Liberia Revenue Authority, *Annual Report Fiscal Year 2016-2017* (LRA, 2018), v, http://www.lra.gov.lr/Admin/Official_Files/reports/67b61e40138c9f2b57d63678743b2a61.pdf.
131. Ibid.
132. Yomi Kazeem, "George Weah is trying to kick-start a pay-cut revolution for Liberia's highly-paid political class," *Quartz Africa*, February 1, 2018, https://qz.com/africa/1195630/liberias-president-george-weah-has-taken-a-pay-cut/.
133. Estimates from in-person interviews conducted in Monrovia, Liberia from August 6–10, 2018.
134. Institute for Research and Democratic Development, "Allocations for Liberian Legislature," Liberian Legislative Watch, National Budget 2015–2016, https://www.liberianlawmakerswatch.org/salaries-and-allowances-lawmakers-national-budget.
135. The compensation for most U.S. senators, representatives, delegates, and the resident commissioner from Puerto Rico is $174,000. The only exceptions are the speaker of the House (salary $223,500), the president pro tempore of the Senate, and the majority and minority leaders in the House and Senate (salary of $193,400). Ida A. Brudnick, *Congressional Salaries and Allowances In Brief*, Congressional Research Service, April 11, 2018, https://www.senate.gov/CRSpubs/9c14ec69-c4e4-4bd8-8953-f73daa1640e4.pdf.

Figure 10: Bilateral ODA to Liberia by Sector, 2015–2016



Source: OECD DAC Aid at a glance by recipient, Liberia, OECD, https://public.tableau.com/views/OECDDACAidataglance-byrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no.

The LRA must both broaden the tax base and strengthen collection methods. In order to finance 47 percent of a USD 6 billion PAPD, the government of Liberia and the LRA are going to have to significantly increase tax collection and domestic resource mobilization. USAID's Revenue Generation for Revenue and Growth (RG3) project, implemented by DAI, produced Liberia's first benchmarking report in 2017 to show the government where the opportunities for tax reform are.[136] The report found many ways that the country could improve its tax collection system including strengthening the excise tax, moving from a goods and services tax (GST) to a value-added tax (VAT), and introducing e-services. Changes to legislation to strengthen the excise tax has had the needed political support. RG3 has also created an e-filing system through which Liberians can pay their taxes by mobile phone, email, and online through commercial banks. These are important efforts that will ultimately enhance Liberia's ability to mobilize domestic resources; however, these gains will likely be incremental without corresponding political changes that address more fundamental and systematic deficiencies.

It is widely reported that Liberian members of Congress make around $12,000 a month ($144,000 annually) with some estimates even as high as $200,000 a year when bonuses and benefits are counted.

Challenges

Tax revenue as a percent of GDP in Liberia is about 12 percent, as compared with 17 percent in other ECOWAS countries.[137] Many challenges to DRM remain in Liberia. Tax morale is a major problem, in part because the country has done very little with the tax revenue other than fund the government. It is difficult to convince someone to pay taxes when the

136. USAID/DAI, *Benchmarking the Tax System in Liberia*, 4.
137. Estimates from in-person interviews conducted in Monrovia, Liberia, August 6–10, 2018.

government does not provide clean water, electricity, or quality education. The few services that are provided rarely are tied to taxes paid. Access is also a challenge because Liberia lacks basic infrastructure to connect its people around the country. For seven months a year during the rainy season, almost half of the country is cut off from Monrovia. Although closing the five-percentage point tax-to-GDP ratio gap is clearly dependent on many factors, the gap is roughly equal to the revenue loss associated with providing preferential tax treatment to concessioners. Liberia must address the major challenges to collection—many of which have roots in politics—and seize the opportunities available.

TAX MORALE

Liberia needs to better connect the services it does provide and the taxes it collects. Surveys by the LRA show that citizens would be willing to pay taxes if they knew that they would be used for education, health, or other basic services.[138] Healthcare in Liberia remains a challenge, and many people still do not get the vaccines that they need to prevent the spread of disease.

Taxpayers are more likely to pay their taxes if the cost of compliance is low and the cost of non-compliance is high (within reason). Public financial management experts therefore focus on reducing the cost of compliance and increasing the cost of non-compliance. Implicit is the idea that taxpayers should be penalized for not paying their taxes.

To the extent that the Liberian dollar depreciates (as it currently is), the reward for waiting to pay taxes is even greater, since the real value of the tax payment has decreased. To the extent that the taxpayer expects waivers of penalties and arrears or the depreciation of the currency, there may be a strong incentive to defer payment of tax, which would have significant consequences for raising revenue and providing public services.

CONCESSIONS

Liberia provides certain businesses and taxpayers with concessions or reduced income tax rates. Tax expenditures are the loss in tax revenue associated with tax provisions that benefit certain activities or groups of taxpayers. They are generally associated with the income tax and represent deviations from a pure measure of income. They may take the form of special exclusions, exemptions, deductions, credits, preferred tax rates or tax deferrals. In a budget sense, tax expenditures are equivalent to direct spending programs except that they are implemented through the tax code. As a result, they should be treated equivalently in the budget process. Indeed, the U.S. Office of Management and Budget (OMB) and the Joint Committee on Taxation (JCT) publish lists of tax expenditures and their associated revenue losses so that policy makers can consider both tax and direct spending programs in the formulation of the budget.

This practice is widely prevalent and a significant drain on government revenue. Concessions lead not only to reduced revenue; they also may distort the relative prices of goods in the economy, leading to economic inefficiencies and welfare costs. They may also make it necessary to increase tax rates, further distorting relative prices. Reform has been difficult over the years in part because of the lack of government transparency in the concession process and the significant personal and political incentives to offer companies

138. In-person interviews conducted in Monrovia, Liberia from August 6-10, 2018.

concessions. The publication of tax expenditure estimates would increase transparency and may provide a political impetus for limiting concessions, thereby broadening the tax base and making it possible to lower distortionary tax rates.

Since the civil war and continued instability in Liberia, there have been few multinational companies that have continued operations in the country. To encourage private sector development, President Sirleaf offered concessions or tax breaks to companies in order to develop the country's economy. Many of these agreements allow the companies to pay very little tax for up to 25 years. Though it is not particularly feasible to expect renegotiation of existing concession agreements, the new Weah administration has the opportunity to carefully consider and ultimately limit the number of new concessions granted. In the past, there have been monopolies on goods such as rice in Liberia that allowed foreign companies to have tremendous profits and overcharge citizens for goods.[139] The Weah administration has the opportunity to disrupt commodity "cartels" and encourage domestic substitutes where appropriate. One way of doing this would be to consider concessions as tax expenditures and publish the revenue loss in the budget.

DUAL CURRENCY

Liberia is one of the few countries in the world with two official currencies: the U.S. dollar and the Liberian dollar. In recent years, the Liberian dollar has depreciated rapidly vis a vis the U.S. dollar, creating macroeconomic challenges not faced by other developing countries. As a result, cash is scarce, and it is expensive to cash paychecks. Government employees can be paid in either currency depending on conversion rates. Liberia's dual currency also allows for taxpayers to delay payment until there is a fluctuation in the Liberian dollar and thus pay less than the amount they originally owed in taxes. Liberia should move towards one official currency in order to address these challenges related to DRM.

TRANSFER PRICING

Transfer pricing refers to prices that are paid in transactions between two entities controlled by a single owner. They can become an important tax compliance issue when the entities exist in different jurisdictions with different income tax rates. Businesses have an incentive to set prices in these transactions in a way that shifts income from higher- to lower-tax jurisdictions and expenses from lower- to higher-tax jurisdictions. Such "income shifting" has the effect of reducing the average tax rate on total profits and increasing total after-tax profits across all jurisdictions. For tax purposes, businesses are generally required to set transfer prices at levels that would result from negotiations between two unrelated parties, but the standards can be difficult to apply, particularly with respect to intangible assets. Businesses have a particular incentive to engage in aggressive behavior when the tax administration has limited resources and sophistication.

Liberia is endowed with certain natural resources—timber, rubber, and iron ore. Multinational companies are extracting and exporting these natural resources. To the extent that the corporate tax rate in Liberia exceeds that of the jurisdiction in which

139. "Liberia: Drop Import Permit Declarations (IPDs) and Open Rice Market to All," *Front Page Africa*, February 2, 2018, https://allafrica.com/stories/201802050773.html.

the related party exists, it may be that Liberian entities are using the transfer pricing mechanism to understate Liberian tax liabilities. Since there are a small number of multinational businesses extracting natural resources (who pay almost no corporate income taxes), it might make sense for Liberia to address these significant transfer pricing issues as a way of increasing revenue.

LRA AUTONOMY

The Liberian Revenue Authority (LRA) was moved out of the Ministry of Finance in 2014 and is characterized as "semi-autonomous," though it appears to be under de facto budgetary control of the Ministry of Finance and Development. The Ministry of Finance still determines its budget each year and the LRA does not receive a percentage of the revenue collected as in many other countries with independent tax authorities. Ideally, the LRA would receive between 3–5 percent of revenue collected in order to strengthen operations. Liberia would require political leadership to realize this goal; despite less control by the Ministry of Finance, greater LRA autonomy could benefit the country.

CORRUPTION

Corruption at all levels remains a challenge for Liberia. The Weah administration recently came under scrutiny from the international community when it was reported that $100 million in newly printed bank notes intended for Liberia's central bank went missing.[140] The ministry of finance and President Weah have since said that they did not lose the money, which was the equivalent of 5 percent of the country's gross domestic product.[141] Regardless of whether the money was ever really missing, the incident has raised questions about Liberia's financial competency and corruption within the government.

Many of the processes to streamline the tax system, such as e-filing, will reduce person-to-person contact and therefore eliminate opportunities for corruption. President Weah has the opportunity to use his populist narrative to tackle corruption at borders and reduce the benefits for government officials. If fighting corruption becomes a major pillar of the Weah administration, Liberia will not only benefit from increased tax revenue, but also from increased foreign direct investment and reduced barriers to trade.

Opportunities

A WINDOW OF OPPORTUNITY WITH THE WEAH ADMINISTRATION

President Weah achieved popular support by rejecting the elites and proposing changes to the traditional system of government. Part of this narrative could be reevaluating the way concessions are determined and adding more transparency to process. If the LRA published the amount of the money forgone because of concessions, there would be more political will to eliminate these agreements and dramatically increase tax collection. President Weah could gain support from his constituents by targeting the four main companies that control 80 percent of imports.[142]

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140. David Pilling, "Liberia probes disappearance of $100m in central bank money," *Financial Times*, September 19, 2018, https://www.ft.com/content/eb6ff49e-bc1f-11e8-94b2-17176fbf93f5.
141. Neil Munshi, "Liberia central bank says $104m in new cash is not lost after all," *Financial Times*, October 2, 2018, https://www.ft.com/content/9a2c2fae-c682-11e8-ba8f-ee390057b8c9
142. In-person interviews conducted in Monrovia, Liberia, August 6–10, 2018.

Liberia should look to expand its tax base and reduce tax evasion. Liberia had 15,905 registered taxpayers in FY2016/2017, including 7,669 enterprises and 8,236 natural persons.[143] Since Liberia's total population was 4.731 million in 2017, this means that on average one in 575 people paid taxes.[144] Besides increasing the number of taxpayers, the LRA should look to remove exemptions or concessions for individuals or companies. Another way to increase the tax base would be to strengthen excise taxes that target specific products, such as tobacco. Enforcing transfer pricing rules and moving to a VAT would also generate more revenue for Liberia.

EXCISE TAX

Liberia's excise tax-to-GDP ratio was only 0.7 percent in 2016, which is much lower than the international average of 3 percent and lower than other Sub-Saharan African countries: Kenya (2.9 percent), Uganda (2.9 percent), and Tanzania (3 percent).[145] The RG3 project worked with Liberia's legislative branch to pass the "Act to Amend the Revenue Code of Liberia, A.D. 2000, as amended by the Consolidated Tax Amendment Act of 2011 to Reform Excise Tax Law (2018)" to strengthen the country's excise tax, especially on tobacco, alcohol, and fuel.[146] The law was signed into law by President Weah on December 19, 2018.[147]

MOVING FROM A GST TO A VAT

Liberia also remains the only country in the Economic Cooperation of West African States (ECOWAS) with a GST instead of a VAT. Although the LRA may not have the capacity to make this move immediately, Liberia should consider transitioning to a VAT. A VAT would be self-enforcing, and Liberia would collect more money from crosschecking invoices and customs. At the moment, this is a very polarizing topic and DRM programs should look to build political support for this movement within the different parts of the government (i.e., Ministry of Finance and Development Planning, Liberian Congress, and the LRA). Moving to a VAT is in the long-term interest of Liberia and could dramatically increase the amount of revenue collected.

PROPERTY AND REAL ESTATE TAX

Most people in Liberia do not pay real estate or property taxes. Property tax in Liberia is only 0.21 percent of GDP which is low even for Sub-Saharan African countries, which have an average of 0.50 percent of GDP.[148] Much of the land in the middle of Monrovia is owned by elites who may not even live in the country. So far, the LRA has not had the capacity to map properties around the country, let alone the capital. According to some, less than 10 percent of property in Monrovia is taxed. The only people who pay taxes are those who are using land as collateral for loans from commercial banks.[149] Even those who do pay are almost certainly not paying the correct amount as the LRA does not have the capacity to double-check valuations.

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143. Liberia Revenue Authority, *Annual Report Fiscal Year 2016–2017*.
144. World Bank Group, "Population, total," https://data.worldbank.org/indicator/SP.POP.TOTL?locations=LR
145. USAID/DAI, *Benchmarking the Tax System in Liberia*, 4.
146. "Liberia: Pres. Weah Signs Bali Island Act, and Two Others into Law," *Front Page Africa*, December 17, 2018, https://frontpageafricaonline.com/front-slider/liberia-pres-weah-signs-bali-island-act-and-two-others-into-law/.
147. Ibid.
148. USAID/DAI, *Benchmarking the Tax System in Liberia*, 4.
149. In-person interviews conducted in Monrovia, Liberia, August 6–10, 2018.

One solution to this problem could be zonal taxing, in which the LRA determines the tax per square meter in different areas. This would require boots on the ground to estimate and would be a short-term solution. Another option could be to set a threshold value above which the property tax would be imposed. This would target higher-income individuals and would be relatively easy to implement since most of the high-value property is in Monrovia. Imposing a more effective real estate tax is one way the Liberian government can increase tax revenue and fund the PAPD.

5 | Recommendations for Policymakers

The United States has a major role to play in DRM efforts worldwide and indeed is one of the leading donor voices in DRM. USAID Administrator Mark Green has signaled his intention to make DRM a cornerstone of the *Journey to Self-Reliance* framework. Reducing dependence on foreign aid by increasing DRM will help spur economic growth by increasing stability, reducing corruption, and opening up markets for U.S. companies.

Administrator Green and USAID are right to place DRM at the center of their financing for self-reliance efforts, but they must do so with some caution. It would be relatively easy to design and launch new projects that will implement technical solutions that will improve the capacity of revenue authorities to carry out their missions. But this is only part of the equation: USAID and other donor agencies, for example, U.K.'s DFID and Agence Française de Developpement, must also engage in a sustained dialogue with countries as equal partners on how to tackle the political economy barriers and design tax policies that increase DRM. This will require that donors (and their implementing partners) become more comfortable working on *political* issues rather than simply pursuing narrow technical paths. The U.S. administration is right to request $75 million to fund a new DRM initiative and Congress should approve it; however, for this to be successful, USAID and its stakeholders must take a hard look at how and where these new programs will be implemented. Below are specific recommendations to help guide this new initiative and support other donor efforts around DRM:

1. **Create an Agency-Wide USAID DRM Strategy.** USAID is transforming its DRM efforts under the *Journey to Self-Reliance* framework. A key pillar of this framework is the "Financing for Self-Reliance (FSR)" track, which seeks to strengthen partner countries' ability to finance their own development agendas.[150] USAID, however, should go further and develop an agency-wide strategy that would specifically guide its new DRM initiative. Such a strategy also should integrate efforts with other U.S. government agencies engaged in DRM reform, such as MCC, the Treasury Department, and State Department, as well as aligning with similar World Bank and IMF efforts.

150. USAID, *Transforming our Programs* (Washington, DC: USAID, 2018), https://www.usaid.gov/sites/default/files/documents/1868/FSR_Fact_Sheet_Revised_11.7.pdf.

- **Use benchmarking metrics and one-year feasibility studies to assess political will for DRM reforms:** USAID should use benchmarking reports and feasibility studies to determine whether long-term DRM projects have the political will to succeed and the opportunities for reform. All USAID missions should build in an assessment of the local financing and provide areas of political and economic opportunity when developing Country Development Cooperation Strategies (CDCS). Such an analysis could be modeled on MCC's constraints to growth analysis that seeks to identify critical barriers to greater economic growth. This could draw on existing diagnostic tools, including the IMF's Tax Assessment Diagnostic Assessment Tool (TADAT) and some of USAID's recent analysis work in support of the *Journey to Self-Reliance* framework development. DRM efforts should be deployed not only in countries that meet the criteria but also in countries that need a foundation for DRM reforms, so that when a window of political opportunity arises (i.e. elections), USAID's programs can have the greatest impact (e.g. political conditions in Liberia under the first years of the Weah administration).
- **Set realistic timelines and expectations:** Over time, DRM projects, done well and with appropriate political economy considerations embedded throughout, can have transformational effects on a country's long-term development; but this requires realistic timelines. Achieving lasting results will require long timelines (measured in decades rather than years) and clear expectations about what can be achieved over a project's timeframe. This also means adopting an incremental approach rather than seeking transformation immediately. DRM efforts should target different areas of government (legislature, ministry of finance, and revenue authority) in order to maximize the possible entry points for change.
- **Integrate transparency, accountability, and anti-corruption initiatives while tying revenue mobilization with expenditures:** DRM projects that focus only on the revenue mobilization side of the equation will be limited in their long-term effects. Rather, USAID and other donors should seek to create integrated projects that advance improvements in managing both the revenue and expenditure sides. Looking at expenditures—how a government spends its revenues—would help to ensure that money is being well spent, especially if coupled with efforts to increase transparency, accountability, and anti-corruption.

2. **Identify and Seize Political Opportunities at Home and Abroad.** U.S. development agencies should highlight DRM reforms that could be quickly implemented and allow USAID to quickly deploy teams to take advantage of political and economic opportunities on the ground. These teams could be modeled on those deployed as part of the Leadership in Public Financial Management (LPFM) II project.[151]
   - **Engage the U.S. Congress on DRM programming:** USAID should work with congressional members and committees to appropriate unearmarked money for DRM. Flexible funds are needed to send technical teams to missions around the world in order to take advantage of political and economic opportunities on

151. "Leadership in Public Financial Management (LPFM) II," Nathan, https://www.nathaninc.com/leadership-public-financial-management-lpfm-ii/.

the ground. As part of its engagement with Congress, USAID should determine whether the $75 million requested for DRM in FY19 is the appropriate amount and which bureaus will receive funding for these activities.

- **Target exemptions:** Countries should publish tax concessions in annual budgets as tax expenditures and make the system by which concessions are determined more transparent. Although these agreements encourage international investment, many companies likely would continue operations even if the agreements were adjusted over time. In many cases, the amount of tax revenue collected would significantly increase if these exemptions were removed or reduced.

3. **Incorporate DRM into Policy Dialogues.** Because of the inherently political nature of DRM reform, the U.S. government should strengthen its policy dialogue at the country-level. This will help to set priorities with local country partners, identify what is achievable, and help achieve needed reforms. Ideally such a dialogue would be the starting point to designing new DRM/PFM projects that would address the gaps that exist; this dialogue could then feed into a country-level strategy and ensure that projects are designed with realistic targets and objectives in mind.
   - **Mobilize democracy and governance partners:** USAID should work with the National Endowment for Democracy (NED), along with its four core institutes, the Center for International Private Enterprise (CIPE), National Democratic Institute (NDI), International Republican Institute (IRI), and the Solidarity Center to brief government officials on DRM efforts during political cycles and periods of transition. This would expand the DRM platform and help garner political support in countries around the world.
   - **Expand DRM beyond USAID:** Political will and local ownership remain one if not the largest challenge to DRM efforts globally. If more U.S. development agencies than USAID promoted DRM programs, host countries might be more willing to engage.

Local leaders who have advocated for donor support for DRM must recommit to eventually financing their own development plans. Well-functioning DRM systems are not only necessary to finance the SDGs over the next 15 years but for the following 15 and 30 years. USAID's agency-wide strategy ultimately is about supporting states so that they can stand on their own, can pay for their own public services, and end the need for foreign aid as we know it. Much can be achieved through technical DRM programs, but if countries and donor agencies do not tackle the political economy aspects, then developing countries will never complete their journeys to self-reliance.

Annex A | List of Entities Consulted for this Report

African Development Bank Liberia

African Development Bank Uganda

American Chamber of Commerce Uganda

Cuttington Graduate School

DAI Uganda

DfID Uganda

Gemini Capital

Global Taxation Services

GLS Group

IMF Liberia

Institute of Certified Public Accountants of Uganda

International Growth Center Uganda

Kacita Cooperative

Kampala Capital City Authority (KCCA)

Liberia Revenue Authority

Millennium Challenge Corporation Liberia

Ministry of Commerce & Industry Liberia

Ministry of Finance and Development Planning Liberia

Ministry of Finance, Planning and Economic Development Uganda

NDI Liberia

NDI Uganda

ODI Liberia

ODI Uganda

Public Finance and Macroeconomics LLC

S Squared Ventures

Snapper Hill Clinic

Southern and Eastern Africa Trade Information and Negotiations Institute

Tony Blair Institute Liberia

U.S. State Department Liberia

U.S. State Department Uganda

Uganda Debt Network

Uganda Revenue Authority

United Nations Development Programme Liberia

USAID Liberia

USAID Uganda

World Bank Liberia

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