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RESOURCE MOBILIZATION FOR SUSTAINABLE DEVELOPMENT

Best Practices

Geoffrey Chongo, Sydney Mwansa and Chanda Mulenga

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Table of Contents

Forward .... **v**

1. Introduction **1**

2. Background **2**

3. Domestic Resources Mobilization Mechanisms and Trends **3**

A. Public Domestic Resource Mobilization 3

i. Taxation 3

ii. Non Tax Revenue 5

iii. Domestic Borrowing 6

i. Private Savings 6

4. External Resources Mobilization Mechanisms and Trend **7**

i. Overseas Development Assistance 8

ii. Foreign Direct Investment 9

iii. Public–Private Partnership 10

iv. Debt inflow 11

v. Remittances 12

vii. Local government taxation 13

5. Best Practices of Resources Mobilization **14**

i. Institutional Reforms 14

ii. Fiscal Decentralization and Local Tax Mobilization 16

iii. Reducing the size of the shadow economy/ informal sector economy 17

iv. Rationalization of Tax incentives 18

v. Good Development Financing Mix 20

vii. Improved Fiscal Management 20

viii. Arresting capital flight 21

6. Conclusion **21**

Abbreviations

ADB	African Development Bank
AfDBG	African Development Bank Group
AfDF	African Development Fund
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Product
HIPC	Highly Indebted Poor Countries
IDA	International Development Assistance
IMF	International Monetary Fund
JCTR	Jesuit Centre for Theological Reflection
LDCs	Least Developed Countries
MDRI	Multilateral Debt Relief Initiative
MMD	Movement for Multiparty Democracy
ODA	Official Development Assistance
OECD DAC	Organization of Economic Co-operation and Development - Development Assistance Committee
PF	Patriotic Front
PPP	Public Private Partnerships
SNDP	Sixth National Development Plan
UNCTAD	United Nation Conference on Trade and Development
UN LDC	United Nations Conference on the Least developed Countries
UN OHRLLS	United Nations Office of the High Representative for the Least Developed Countries, Landlocked Development Countries and Small Island Developing countries
VAT	Value Added Tax
ZRA	Zambia Revenue Authority

Forward

Forty-seven years after independence, Zambia is still grappling with finding sustainable financing mechanism of its development. The government cannot finance its budget and development programmes entirely from its domestic resources. It often relies on other sources other than taxes such as development aid and external financing. The country however has made gigantic strides in its quest for financial independence; financing about 70% of the budget in 2010 from domestic resources compared to 50% in 2001. Much more however remains to be done to further bridge the fiscal gap and finance development sustainably.

With numerous development challenges Zambia is facing currently, the need for increased resource mobilization cannot be overemphasized. More financial resources are needed to further accelerate economic growth, generate employment and direct resources toward poverty reduction. Government therefore needs to exploit the various mechanisms of resource mobilization to address its developmental challenges, particularly domestic resource mobilization mechanisms such as taxes. Mobilizing domestic resources for development is crucial especially now when other financial sources are declining such as development Aid.

This paper by JCTR is therefore a timely reminder to government to embrace resource mobilization mechanisms that will address the main challenges that the country is facing in an equitable, efficient and sustainable manner. More attention should be given to domestic mechanisms as they are more sustainable. While external financing and development aid are important sources of financing, they should complement and not replace well established mechanisms for generating domestic revenue.

We hope that some ideas contained in this paper will contribute even in a modest way towards the search for appropriate policy instruments that will help the government mobilize sufficient domestic resources to finance our development programme.

Leonard Chiti, Sj
JCTR
22 December 2011

1. Introduction

Every government needs to mobilize financial resources to finance its development programme. The need to mobilize sufficient financial resources is even more urgent for developing countries like Zambia, as they have more development challenges such as reducing poverty. There are various ways to reduce poverty but common approaches are to create jobs, to provide better health care, to provide better education, to build more infrastructure and above all to improve living standards. This requires financial resources to be mobilized for which governments have various ways of doing it. However, not all forms of resource mobilization can finance development in a way that is sustainable, fair and efficient particularly for resource rich countries in the low income and developing world.

The mechanisms for resource mobilization that government directly uses can be classified as domestic or external. Under domestic resource mobilization mechanisms; government employs tools such as *tax revenues*, non *tax revenues* (i.e. public sector fees and fines), *domestic loans* etc. Under external resource mobilization mechanisms, governments rely on *donor aid* and *external loans.* Government employs any one or a combination of these to meet its financial needs.

Governments also rely on indirect tools such as *Foreign Direct Investment (FDI), Public Private Partnerships (PPP),* and *Remittances* which are external revenue sources to supplement the fiscal revenues. It is however worth noting that domestic revenue mobilization is more reliable as it creates policy space for a country and thus a cornerstone to sustainable development. Urging African countries to raise more domestic resources, UNCTAD states in its report that the ability to finance a greater share of development needs from domestic sources gives countries the much-needed flexibility in the formulation and implementation of policies to address development challenges and direct resources into high-priority areas (UNCTAD 2007). A good mix of both external and domestic resource mobilization tools is nevertheless important to improving financial resource mobilization in ways that are supportive to sustainable development.

It is the objective of this paper to highlight the trends of the various resource mobilization mechanisms in Zambia and to compile resource mobilization best practices that ensures sustainable development in an efficient and equitable manner

2. Background

Zambia's development challenges remain daunting and thus the need for increased resource mobilization cannot be overemphasized. Among other things, the inability to sustainably raise sufficient resources domestically has contributed to the lack of development in Zambia. For example, Zambia has not been able to finance its budget entirely from its own resources and has thus relied on a mix of revenue sources among which taxation has been a major source. Other sources like aid and foreign financing have been declining in terms of their contribution to the budget[1]. In light of declining aid Zambia has to strengthen its domestic resource mobilization if it has to avoid debt burden that comes with loan financing which is another option of financing a budget.

JCTR believes that Zambia has the potential to mobilize sufficient resources and improve social justice[2] by employing prudent policies and practices that improve tax revenue collection, administration and makes use of other nontraditional resource mobilization mechanisms such as remittances. It is with this background that JCTR commissioned a study on the equitable and efficient nature of the Zambian tax system and now compiles best practices of resource mobilization to contribute to national policies and strategies that will ensure equitable and efficient mobilization of resources to meet the needs of all Zambians especially the poor.

[1] Donor aid as a share of budget has declined from about 14% in 2010 to about 7% in 2011 according to the 2010 and 2011 budget speeches

[2] Social justice deals with matters of fair distribution of advantages, assets, and benefits among all members of a society. This can be attained through degree of economic equality through progressive taxation, income redistribution, or even property redistribution

3. Domestic Resources Mobilization Mechanisms and Trends

Domestic resources mobilization refers to the generation of savings from domestic resources and their allocation to economically and socially productive investments. Domestic resources mobilization can either be public or private. The private side concerns private domestic savings, which the financial sector channels towards investment. Public resource mobilization on the other hand is about public savings which is the excess of public revenues on the current government expenditure (tax revenue less government expenditure). This is what is available for government to fund public investment such as roads, schools, health facilities etc.

Sustainable development can only be guaranteed with strong Domestic Resources Mobilization, especially through public resource mobilization (mainly taxation). While foreign financing through donor aid and external loans can fill the fiscal deficit in the short run it is unpredictable and thus unreliable in the long run. For this reason well established mechanisms for domestic revenue generation in the long run are indispensable for sustainable development as compared to donor aid and external loans.

A. Public Domestic Resource Mobilization

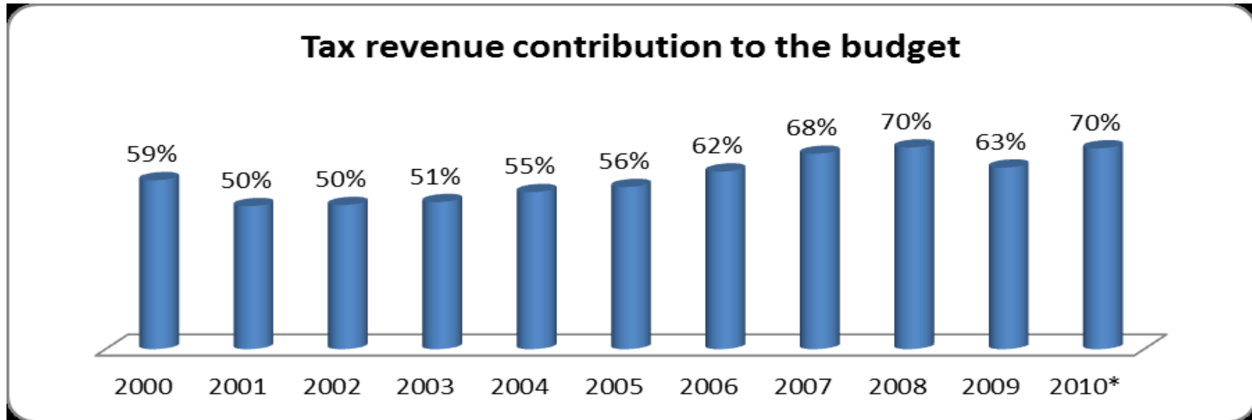
i. Taxation

Primarily, a country‘s tax system must provide sufficient funds for government expenditure programmes. Taxes are the most important source of government revenue in modern economies. It is at the heart of the social contract between a state and its citizens who in return of paying tax are provided with security, infrastructure and social services. In addition to the main objective of providing government with revenue, taxes are also used to redistribute income in the economy to reduce inequality or as a regulatory tool to encourage or discourage certain activities in order to enhance social welfare.

While tax contribution to the budget has shown some improvement from about 50 per cent in 2001 to about 70 per cent in 2010 (figure 1.0), JCTR has noted that taxation is still below its potential in Zambia. For example there has been a decline in the share of tax revenue to Gross

Domestic Product (GDP) while the performance of some tax types, such as domestic VAT and trade taxes, have progressively declined.

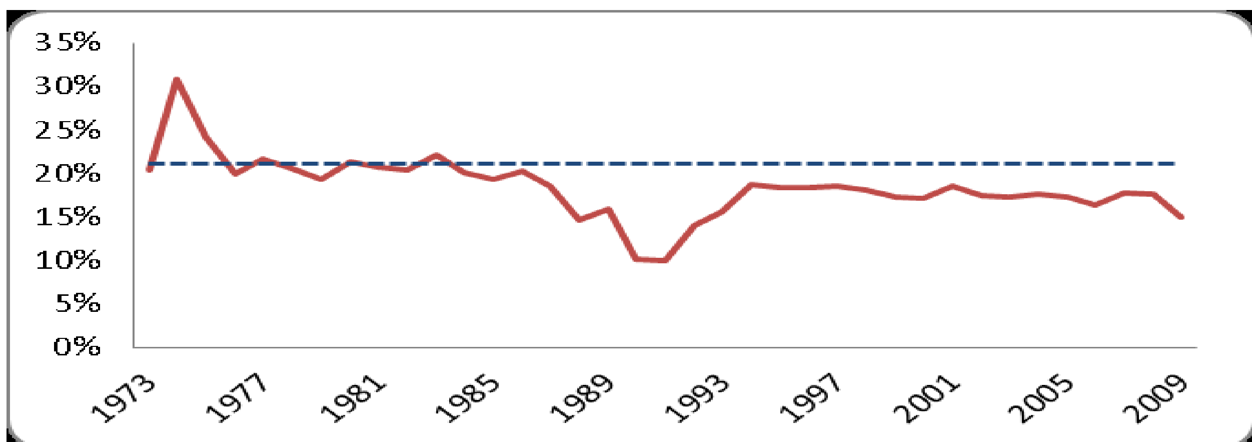
Figure 1.0: Tax Revenue Contributions to the National Budget



Source: JCTR study report, 2011

This has resulted in over reliance on income taxes; particularly personal income tax which has resulted in inequitable issues in the way revenues are being mobilized. Furthermore, the performance of the mining sector taxes and informal sector taxes too has raised questions about whether the sectors are being taxed optimally. Other factors that have contributed to the poor performance of the tax system include numerous tax incentives through which tax revenues have leaked and a large informal sector that has proved difficult to tax.

Figure 1.1: Tax Revenue to GDP ratio



Source: JCTR study report, 2011

While other domestic mechanisms exist to increase domestic resource mobilization such as increasing national savings by firms and households and arresting capital flight; effective tax collection is the most effective way of increasing domestic revenues. It is thus important that governments, particularly those with low tax revenue-GDP ratio of below 20 % threshold which is an internationally recognized minimum tax to GDP ratio step up their commitment to improving revenue mobilization.

ii. Non Tax Revenue

Non tax revenue or receipts are government revenues not generated from taxes and include revenue from state owned enterprises, investment funds, sovereign wealth funds, fines, fees and user fees. Non-tax revenues therefore cover a wide array of government revenue sources. Although non tax revenue currently contributes a paltry 3% to the Zambian government budget, it has the potential to significantly contribute to the revenue base of the country. The problem has been misapplication and abuse of these resources. In its 2011 budget, government increased motor vehicle license fees by 50% under the Road Investment Sector Plan meant for road maintenance. Despite a lot of money being collected for road rehabilitations, the state of most roads in Zambia has remained very poor. Fees and fines, especially traffic offences fines are also other sources of non tax revenues that are highly abused.

There is urgent need for government to put measures in place to curb abuse of meager resources that Zambia desperately needs. The country needs to enhance other sources of revenue to remove pressure on the tax system and promote equity in the way resources are being mobilized. Parastatal companies should also endeavor to remain profitable to meaningfully contribute to non tax revenue base of government and not just drain government coffers in grants.

Non-tax revenue could thus become a more important source of revenue for Zambia even to the level of taxes and this is not impossible to realise. This is suggested by the fact that over a third of government non-tax revenue in Singapore, a country with no mineral or forest resources unlike Zambia amounts to around a third of its revenue (Chia, 1998). Possibly more important,

greater attention to non-tax revenue is needed because of the decreased contribution from other sources such as trade taxes in the wake of regional integration and donor aid.

iii. Domestic Borrowing

Domestic borrowing sometimes referred to as domestic financing is a very important source of financing for government. It forms about 3% of the Zambian government expenditure (2010 budget speech). Whenever government has a fiscal deficit, it turns to the domestic private sector to borrow to fill the fiscal gap. Domestic borrowing is very convenient and cheap to government as it is borrowed in domestic currency and therefore the debt obligation is not affected by currency volatility.

However, government borrowing is always done at the expense of private borrowing. It is therefore always advisable for government to keep its domestic borrowing low thereby making more financial resources to the private sector. By adopting this approach interest rates are kept low thereby allowing the private sector to borrow at a cheaper rate.

The Zambian government however has rarely stuck to its domestic borrowing ceilings mainly due to shortfalls in domestic revenues and grants from cooperating partners. The Sixth National Development plan reports that fiscal deficit during the Fifth National Development Plan period (2006 -2010) averaged 1.9 % of Gross Domestic Product (GDP) compared to average target of 1.7 % of GDP. Government should therefore restrain itself from excessive domestic borrowing to avoid crowding out the private sector even though domestic borrowing might be cheaper than foreign borrowing.

B. Private Domestic Resource Mobilization

i. Private Savings

Theoretical literature asserts a positive relationship between the level of private savings and the level of economic growth of a country. The strong economic growth in East Asia is always used as a classical example of the evidence of a positive relationship between the level of savings and economic growth. Between 1960 and 2000, the average savings rate in the East Asian countries was 25% while that of Latin America was 14%. Over the same period, the East Asian countries

experienced high growth rates while Latin America lagged behind (Aghion et. al., 2009). UNCTAD (2007) also reports that Sub-Saharan Africa has the lowest savings rate in the developing world. Gross domestic savings in the region is said to have averaged about 18 per cent of gross domestic product (GDP) in 2005, compared with 26 per cent in South Asia and nearly 43 per cent in East Asia and Pacific countries. The low savings rate for Southern African partly explains its low levels of development.

This implies that if Zambia has to develop, there must be sustained economic growth which may be sustained by an increased savings rate. However the key problem in Zambia is that only a small portion of the population has access to the saving facilities. Melzer (2007) found that only 14% of Zambians save with banks. Lack of banking facilities is largely responsible for the low level of saving particularly in rural areas but high cost of opening and maintaining bank accounts is also another hindrance. Sometimes even when banks exist, banking services are not accessed due to illiteracy levels and ignorance about the services.

Box 1.0

What if wealthy Africans decided to invest their earnings in Africa instead of overseas? And if the 80 per cent of Africans now without bank accounts got access to formal financial services? And if African governments put their domestic revenues into productive investments? "Rates of savings [would] go up significantly and Africa could perhaps be in a position to meet more than its resource needs," Samuel Gayi, Senior Economist on Africa (UNCTAD).

Source:http://www.un.org/ecosocdev/geninfo/afrec/vol22no3/223-boosting-domestic-savings.html. Accessed on 13.12.2011

4. External Resources Mobilization Mechanisms and Trend

Beside domestic resources mobilization mechanisms, there exist various external mechanisms of funding that must be fully exploited. These other sources however have limitations and addressing these limitations would increase the revenue base, reduce the pressure on the tax system and ultimately make the tax system more equitable. Given the immense challenges of raising sufficient tax revenues which arise in the balancing act between efficiency and equity, there is a case for supporting these alternative revenue mechanisms in developing countries.

Therefore, although taxation is the main form of funding development, it should be complemented by external sources even though some of them are less predictable and unreliable.

i. Overseas Development Assistance

Development aid also called Official Development Assistance (ODA) is aid given by governments and development agencies to support the social, economic, environmental and political development of developing countries. It is distinguished from humanitarian aid by focusing on alleviating poverty in the long term, rather than a short term response. While much of ODA is given as budget support to allow the recipient governments determine its use, the rest of it may go towards supporting specific projects or institutional or technical support.

Aid plays a critical role in fostering economic growth and development in recipient countries especially if certain principles as outlined in the Paris Declaration of Aid Effectiveness and the Accra Agenda for Action are upheld. These Principles are: *ownership* by recipient countries by way of providing effective leadership of their national development plans and strategies; *alignment* of donor support to the nationally identified strategies, institutions and procedures; *harmonization* of donor support for collective effectiveness; *managing* of resources and improving decision-making for results; and *mutual accountability* of both donors and partners for development results (OECD DAC, 2005/8). When these principles are upheld by both donor and recipient countries, Aid effectively augments domestic resources giving recipient countries leverage in implementing their programmes.

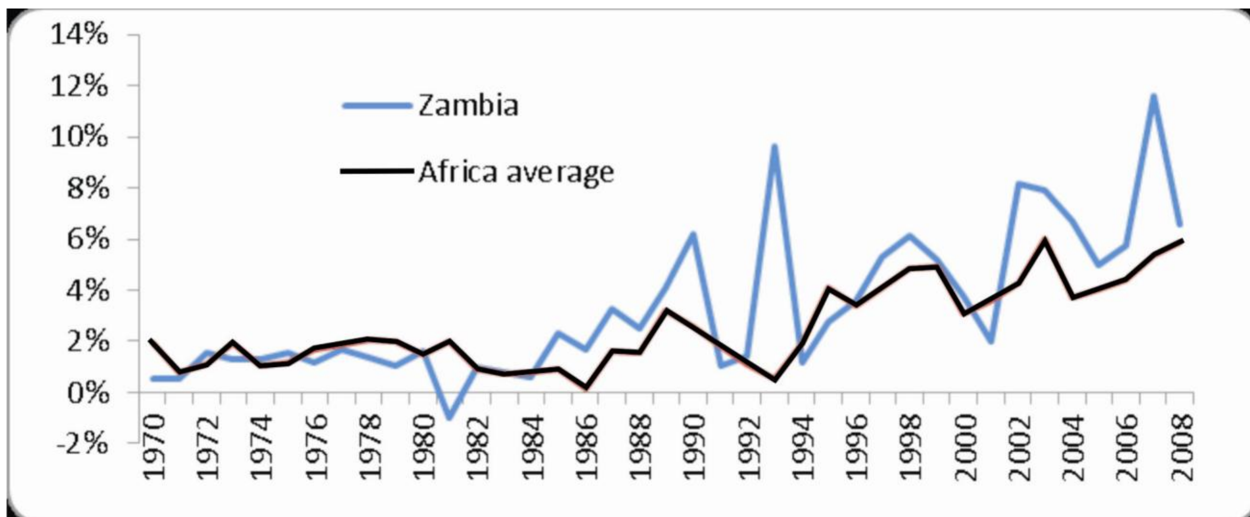
The amount of Aid that Zambia receives has declined considerably in the recent past due to internal and external factors. For example the Aid share of the budget has declined from about 14% of the 2010 budget to about 7% of the 2011 budget. Even where donors have promised to deliver Aid, they have not always kept their promise making fiscal performance of recipient countries difficult. Zambia recorded an average fiscal deficit of 1.9 percent of GDP during its Fifth National Development Plan period against the target of 1.7 percent (SNDP 2011 - 2016) partly due to shortfalls in grants from cooperating partners.

Zambia can maximize on the amount of aid received by adhering to the above mentioned principles and also by addressing the factors that have led some donors to withdrawal aid such as corruption. Aid though helpful should not be regarded as a long term financing mechanism as it is often erratic and unreliable sometimes due to external factors. For example, a number of major donors are currently facing fiscal deficits and thus unable to provide aid as they focus on addressing internal fiscal challenges.

ii. Foreign Direct Investment

Foreign Direct Investment (FDI) is a common source of funding for development for most countries. It has the advantage of offering technological transfer while filling funding gaps. Zambia has been doing comparatively well in attracting FDI (figure 1.2). The trend has been upward especially in the last decade spurring economic growth during the same period.

Figure 1.2: Trend in ratio of FDI to GDP for Zambia and Africa



Source: JCTR Tax Study Report, 2011

FDI as a source of funding is however volatile as it depends on investment parameters that include internal parameters such as political stability and external parameters such as the performance of the global economy which may be beyond Zambia's control. This is evident from a noticeable dip seen in 2008, during the global economic and financial crisis. With such

volatility, FDI may not be relied upon to provide predictable flow of funding especially short term capital which can easily be reversed with catastrophic macroeconomic consequences. To maximize the benefit of FDI, the Zambian government must attract sector specific long term FDI in order to diversify the economy and be able to withstand any future slump in the metal prices on the international market.

iii. Public–Private Partnership

Public–Private Partnership (PPP) describes a government service or private business venture that is funded and operated through a partnership of government and one or more private sector companies. PPP involves a contract between a public-sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and/or operational risk in the project. The private partner can either be foreign or domestic.

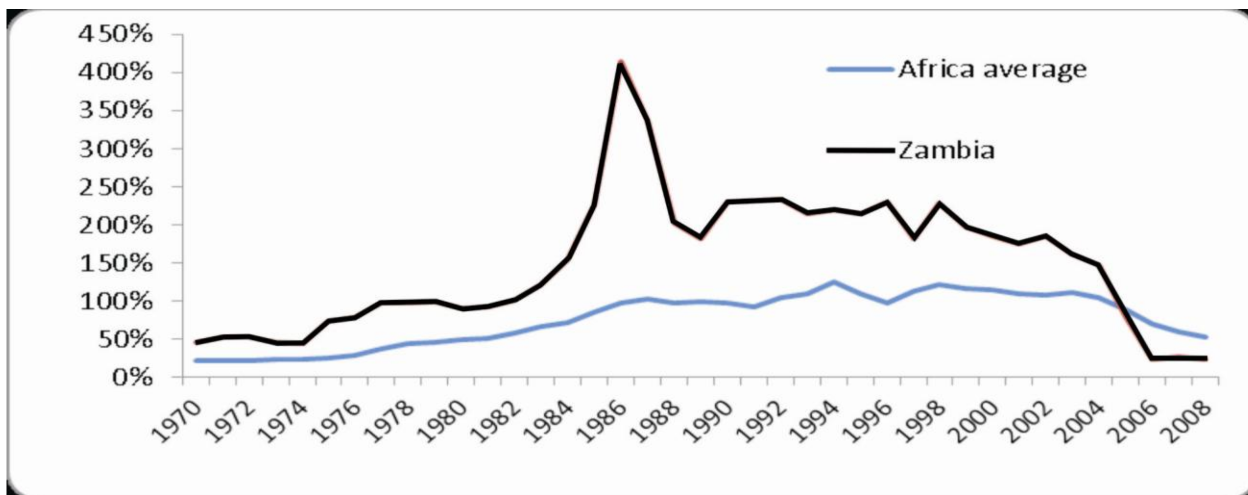
With the level of infrastructure deficit that Zambia has, PPP is a very ideal resource mobilization mechanism for Zambia and government's embracing of this alternative financing mechanism is commendable. Zambia needs good road networks, schools, and hospitals which are huge projects that require huge outlays of financial resources and PPP is a viable means of providing capital for infrastructure development.

Government should however be weary of privatizing profits and socializing costs. Private sector is profit led and might demand to recoup its investment in a short period of time and at high interest rates. This puts pressure on consumers who have to bear the cost of repaying the private provider. Government should therefore not surrender its primary responsibility of providing public goods and services to the private sector. In a poor country like Zambia where the majority of the people do not have a reliable source of income, PPP might be a heavy burden to carry. Government should therefore ensure that PPP financing does not disadvantage poor people.

iv. Debt inflow

Many countries, including developed ones have to borrow money in one form or another in order to meet their investment demands. They issue bonds to borrow from foreign investors with surplus capital to invest. Zambia partly finances its developmental activities through borrowed resources and Figure 1.2 below shows the trend in the ratio of external debt to Gross National Income (GNI) since 1970. For much of its history, Zambia has had external debt levels far higher than the average in Africa.

Figure 1.3 Trend in ratio of external debt to GNI



Source: JCTR tax study report, 2011

The debt levels, however, started to fall after debt cancellation in 2005 and 2006 following the county's attainment of the Highly Indebted Poor Countries (HIPC) completion point and after benefiting from the Multilateral Debt Relief Initiative (MDRI). The MDRI provided for 100 percent relief on eligible debt from three multilateral institutions (IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF) of the African Development Bank to a group of low-income countries that reached the completion point.

Zambia's external debt position currently stands at about US$3.4 billion, of which about US$1.6 is government debt (2012 budget speech). Debt as a source of funding comes with a cost since

the money is pegged to interest rate. If not properly managed, there is a risk of getting into a debt trap if the country's capacity to pay back falls. The resources used for repaying the loan also imply that provision of social services to the public is forgone. This is especially painful if the loan resources where not prudently used. The period before 2005 emphasizes the point that there is a possibility of runaway debt levels. A transparent and participatory legislative environment to ensure accountability in the way debt resources are acquired and utilized is therefore imperative.

v. Remittances

Remittances or financial contributions sent by citizens living abroad can be a potential source of significant revenue for economic development. Countries world over rely on this source to some extent depending on the number of citizens living and working in the Diaspora. For example in 2004, remittances globally became the tenth largest source of foreign income. According to Christopher Lydon (2006) migrant workers in the world remitted more than US$232 billion to their families in 2006, which is twice what the world paid out in international aid in 2005. Remittances can have a positive impact on the recipient economy. It is widely accepted that remittances generate output growth either by increasing consumption or by increasing investment. In addition, it reverses capital out flows in most developing countries that frequently have to service their debt and experience capital flight thereby maintaining adequate foreign reserves.

In some countries, remittances are very substantial and make up an important part of financing economic activity. An estimated 10 million Filipinos is said to have sent home US$16.4 billion in 2008, making the Philippines the world's fourth largest recipient of remittances, trailing only to India (US$45 billion), China (US$34 billion) and Mexico (US$26 billion), according to the World Bank[3].

Even though information on remittances by Zambians living abroad is scanty, it is well acknowledged that Zambia can benefit from remittances with good investment policies targeted at Zambian's in the Diaspora. Information available on remittances estimate that in 2006, Zambians abroad remitted US$201 million in 2006 or 1.8 percent of Zambia's GDP (a little more

[3] http://www.atimes.com/atimes/Southeast_Asia/KH11Ae01.html (Accessed on 10/9/2012)

than what government got from the entire mining sector)[4]. The same report estimates that in the same year, Zimbabweans abroad sent US$361million (7.2% of Zimbabwe's GDP).

Government should therefore endeavor to attract remittances as much as it does in the case of FDI. It should also find a better mechanism of tracking what is already being remitted. Zambian's in the Diaspora can be given tax incentives to invest in capital projects and other long term investment back home. Government can also come up with bonds aimed at borrowing from Zambians living abroad which can provide the needed resources for capital projects.

vii. Local government taxation

Tax revenue mobilization must not only be a preserve of the national tax authority because council taxes, levies and charges can supplement revenue collections and developmental expenditure. Local governments have a role to play in economic development through provision of local social and economic services. However, in the recent past, local governments in Zambia have faced a steady fall in the local revenue sources available to them. Over time, the revenue base of local authorities has eroded due to Government policies such as the withdrawal of grants from some councils, and water services and housing, which were a major source of revenue but were privatized. The councils still have sources of revenue like markets and bus stations, but they have very little power and influence to fully utilize this revenue base as they have been highly politicized.

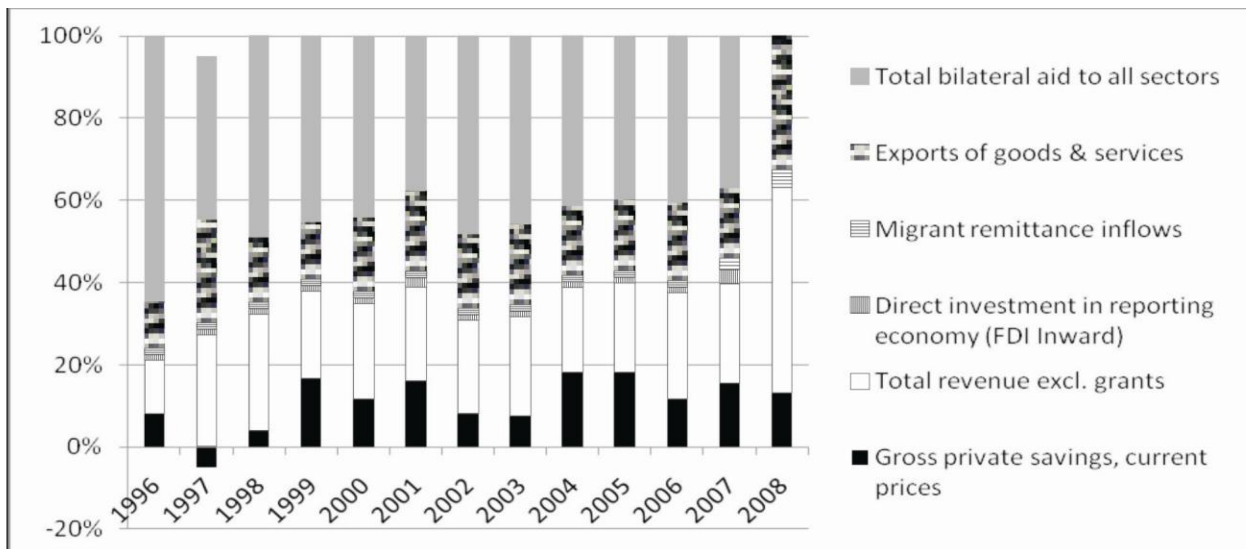
The fall in traditional tax bases of the local councils and the general lack of administrative and executive capacity has forced them to rely on levies and other business fees. These are far less efficient and equitable than normal tax types and cause significant compliance costs for businesses

5. Best Practices of Resources Mobilization

i. Institutional Reforms

To respond to the demand of increased revenue collection, most countries have created independent revenue collection agencies to collect tax revenues on behalf of government. These agencies have been delinked from the larger civil service and made autonomous in their revenue collection responsibilities. A number of countries in Southern Africa such as Rwanda, Kenya, South Africa, Zimbabwe and Mozambique have established independent revenue agencies and tax revenue collection has responded well. As at 2008, tax revenue contribution to the Rwandan budget increased to almost 60% from about 30% ten years earlier as shown below (AfDBG, 2010). The increase is largely due to the establishment of an independent revenue agency.

Figure 1.4: **Trends in Rwanda's overall development financing mix (1996 to 2008)**



Source: African Development Bank Group, 2010

A number of Country case studies done on a number of African countries by African Development Bank on Domestic Resource Mobilization reveals the important role that independent revenue agencies play in domestic resource mobilization. An autonomous revenue agency determines to a great extent how effective the tax policy in place will be implemented. A good tax policy or system with weak administration may not yield desired levels of revenues.

Secondly, creation of autonomous revenue agencies has been accompanied with major developments in tax policies such as Value Added Tax (VAT) that replaced sales tax, and informal sector taxes meant to broaden the tax base and building administrative capacity. For these tax policies to reflect broader national development objectives and priorities, they are formulated through a wide consultative process that involves non state actors and the wide community at large.

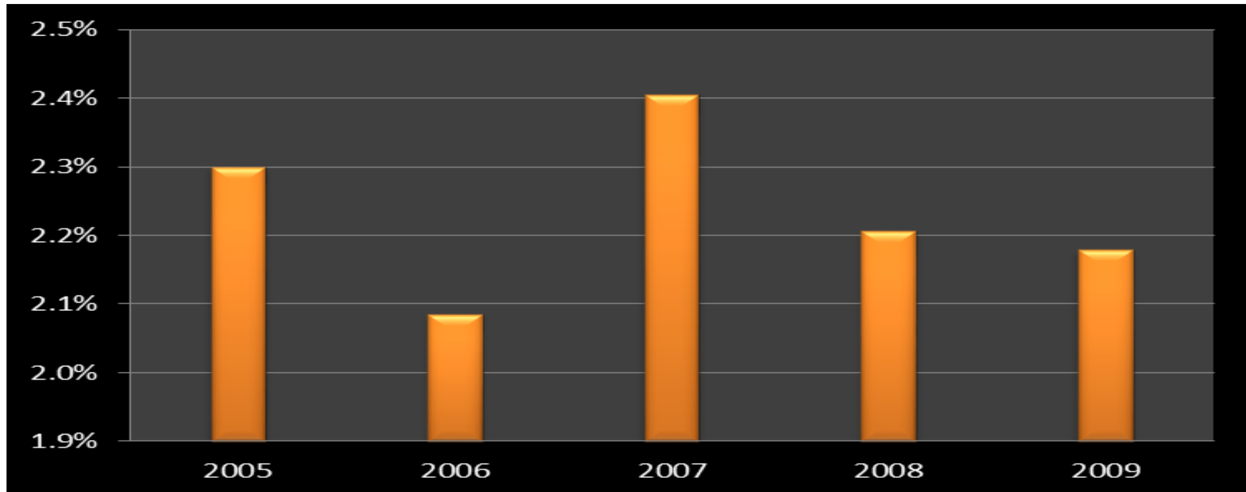
Governments have also improved financing of these revenue agencies to make them financially independent. For the Rwandan government, it has allowed its revenue agency to retain a 3 to 3.5% of its total revenue collection to meet its administrative costs.
Appreciating the concept of having an autonomous revenue agency, Zambia established Zambia Revenue Authority during its sweeping tax reforms in the early 1990s. The government further introduced new taxes such as VAT and other taxes targeted at the informal sector. These institutional reforms resulted in increased tax revenues raising the tax to GDP ratio to about 19% in 2000. The ratio however declined to about 15% in 2009, raising concerns about lack of administrative capacity of ZRA to collect tax.

There is urgent need for the Zambian government to consolidate tax reforms to make ZRA more autonomous, geared at broadening tax base, rationalizing taxes to improve the investment climate, enhancing compliance and improving other aspects of tax revenue administration such as technical capacity particularly in the area of tax investigation, internal audit and compliance which is currently lacking. Key changes to tax policy in most countries have revolved around pursuit of equity, further widening the tax base and promoting increased investment.

Government should further increase funding to ZRA, guarantee the institution's independence and address the need to maintain incentives for staff within the Agency to raise their commitment and discourage them from indulging in corrupt practices which undermines revenue generation. Government's funding of ZRA in the last few years has been erratic compared to when ZRA was just formed. The initial arrangement was similar to that of Rwanda where the

ZRA was allowed to keep 3% of the tax revenue collected. But since this arrangement was abandoned; government's funding of the institution has not been consistent and has adversely affected the performance of the agency. It is important for government to revisit the funding arrangement of ZRA.

Figure 1.5: Government funding as a ratio of revenue collection, 2005 to 2009



Source: JCTR Tax Study Report (2010)

ii. Fiscal Decentralization and Local Tax Mobilization

Local government revenues are a major source of revenue even though they are underutilized by most governments in developing countries. The importance of local government revenues to some extent depends on the local government functions. Local government revenue plays a more important role in Local governments that have exclusively been assigned traditional municipal functions such as South Africa and Kenya. On the other hand, local governments that only provide basic municipal functions such as those in Zambia are much more dependent on government transfers/ grants than on locally mobilized resources and thus do not fully utilize local government revenues.

It should however be noted that local governments are better placed to collect certain taxes than central government such as informal sector taxes. The Zambian government should therefore

speed up the process of fiscal decentralization that will empower local authorities to collect certain taxes beyond the levies they are currently collecting to make them financially sustainable.

Local government revenue mobilization however, has its own challenges which need to be addressed before fiscal decentralization can bear fruits. These include inadequate local government tax enforcement mechanisms and political interference. Markets and bus stations which are the major sources of local government levies for example are partly controlled by cadres of the ruling party there by limiting the amount of levies that local government can collect.

iii. Reducing the size of the shadow economy/ informal sector economy

The size of the Shadow economy or informal economy[5] varies widely. It is however more pronounced in developing countries than in developed countries. The Shadow economy poses a challenge to effective tax revenue mobilization. Transactions are usually concealed from tax authorities or sometimes only partly concealed and may be reported at lower than true values so as to reduce rather than entirely eliminate taxes. Shadow economy therefore acts as a conduit of tax evasion and avoidance.

While the correct size of the informal sector in Zambia is not known, it is widely acknowledged that a large size of Zambian labor force is involved in economic activities in the informal sector. With only around five hundred people of the around five million labor force involved in formal employment, it is estimated that over four million people (over 80 percent of the labor force) is involved in the informal sector.

There is urgent need to formulate appropriate policies and effective administration measures that will maximize the revenue risks posed by the informal sector economy, including formalizing the sector. Factors that hinder formalization of the economy include the overall tax levels and the effectiveness of the tax administration. The World Bank Doing Business 2010 report shows that

[5] An environment where businesses operating outside the tax system and registered businesses conceal transactions to avoid paying taxes

the cost of doing business processes such as registration and paying tax is significantly higher in developing countries than in OECD countries (IMF 2010). While Zambia has improved on this score, currently standing at number 76 out 183 countries, it can do better (World Bank 2011).

At the administration level, the large number of participants in the informal sector posses logistical challenges to the revenue agencies. Massive education campaign must be embarked on to reduce community tolerance for the shadow economy, provide targeted assistance to promote voluntary compliance, encourage self regulation among business associations etc. A number of countries have encouraged self regulation through the formation of partnerships with key industry and business associations which has proven very effective in countries such as New Zealand, Australia, Ghana and many other countries.

iv. Rationalization of Tax incentives

Tax policy measures which may include tax exemptions, deductions and tax credits, deferrals of tax payments or subsidies are provided to stimulate both domestic and foreign investments in the hope of mobilizing needed financial resources in support of government policy goals. While such incentives may promote investment in the short and medium term, their long term economic effectiveness can be limited as they tend to dampen tax efforts. Sometimes even the anticipated job creation, backward and forward linkages and knowledge transfer for which tax incentives are given are never realized for a number reason.

For Zambia, the sectors in which foreign capital is mainly invested such as mines are highly mechanized and thus create fewer jobs. Little of forward and backward linkages and knowledge spill over may be created as foreign investors keep outsourcing both labor and capital from abroad thereby creating little impact on the local economy. Therefore, excessive use of tax incentives can complicate tax administration, create distortions and save as a conduit of tax evasion and encourage corruption (Bird, 2008).

Tax exemptions and incentives may also just undermine equity and fairness in the way tax burden is distributed. The Zambian government should therefore review its tax incentives

including those earmarked for multi facility economic zones investment. IMF asserts in its 2008 assessment (IMF, 2008) of Kenya and Tanzania that investment incentives offered to firms in special economic zones "are not an important factor in attracting foreign investment". Rather they create distortions and result in the loss of tax revenues. The revenue loss might also be enormous. According to the JCTR tax study report (JCTR, 2010), the revenue loss from tax concessions offered and announced in annual budgets was estimated at K 803 billion (approximately US$161 million) between 2002 and 2009. In the 2009 budget alone, the tax foregone arising from tax concessions was estimated at K217 billion (approximately US$43 million).

Box 1.1

Revenue loss arising from tax exemptions is estimated at TShs 587 billion ((US$ 403 million) by the TRA between July 2008 and April 2009. Projects under the TIC accounted for the largest percentage of the total exemption. Other beneficiaries included state owned institutions, the Government of Zanzibar, religious and non-religious NGOs. In 2008 it is estimated that the government lost TShs 1.8 trillion (US$ 1.23 billion) or 6% of GDP through tax exemptions

Source: Policy Forum (2009)

Tax incentives must therefore be cautiously implemented considering the forgone tax revenue which these incentives bring about. A report from the conference on *Revenue Mobilization in Sub-Saharan Africa* hosted by the IMF and Kenyan government in March 2011 cites South Africa and Canada as countries that require, according to International Best Practices that full cost-benefit analysis for any major piece of tax legislation aimed at attracting foreign investors be done to assess the associated financial and economic costs, benefits and impact on various stakeholders and in particular on a country's long term tax revenues (IMF, 2008, P.3). Malawi and Mozambique are other countries that have taken the issue of tax incentives seriously by establishing a ceiling for the value of tax incentives that must be approved by government each year. Zambia should therefore review its tax exemptions and incentives policy in relation to the lost tax revenues otherwise it can negate domestic resource mobilization results.

v. Good Development Financing Mix

Taxation is just one mechanism that government can use to raise revenues. Other mechanisms such as those that have been highlighted in this paper must be promoted (taking into account their limitations) in addition to taxation in order to accelerate development. Zambia's increased inflow of Foreign Direct Investment particularly in the mining sector for example has had profound impact on the growth of the mining sector and the whole economy at large. This development has had in return positive impact on the tax revenue levels raising the tax to GDP ratio from 15% in 2009 to around 17% in 2010.

Kenya is another example where increased FDI inflow has had crucial impact on the development of the country's export oriented horticulture industry, which contributed to the revival of Kenya Airways and accelerated the development of the mobile telecommunications network (ADB 2010)

A good mix of resource mobilization mechanisms cited in this paper is therefore vital to increased revenue mobilization that results in sustainable development.

vii. Improved Fiscal Management

Taxation is governed by an implicit fiscal social contract between government and tax payers. Government collects taxes on the basis that it will provide specific socio-economic benefits to the people to justify taxation. This is true especially in a democratic dispensation like Zambia. Any mismanagement of public resources which might be revealed in corruption, lack of willingness to fight corruption, social economic decline and overall deterioration in public service undermines public confidence in a government and thus endangers tax compliance.

Zambia should therefore show great commitment to reducing waste in public expenditure management as a matter of priority not only to free up resources that can be devoted to productive public expenditures but enhance tax compliance. Public Resources should thus be applied to the best possible public benefit.

A case in point of fiscal mismanagement that undermines tax compliance is the recent case of MMD refusal to pay taxes on imported motor vehicles which they had imported for their campaigns[6]. The PF while in opposition took ZRA and MMD to court but the case was thrown out of court on technical grounds that the PF did not follow the right procedure in taking the case to court. ZRA should be seen to be firm and be able to collect tax revenue from whoever it is due from regardless of their status in society if people have to maintain confidence in the system and pay tax voluntarily.

viii. Arresting capital flight

Africa is estimated to lose hundreds of billions of dollars in domestic revenues annually through capital flight, tax evasion, the repatriation of profits by transnational corporations and high debt repayments. Indeed, empirical evidence suggests quite ironically that Sub-Saharan Africa is a "net creditor" to the rest of the world—in the sense that the private assets held abroad by Africans exceed the continent's liabilities to the rest of the world (UN LDC IV/ UN OHRLL, 2010). Zambia is not an exception as it has been experiencing capital flight in similar manner. Zambia has liberalized its current account and thus there is no limit to how much capital that investors can externalize. Secondly, there have been reports of illicit capital transfer in the mining sector through tax evasion. The problem therefore seems to be endemic and therefore needs urgent attention. This capital flight, which is very difficult to measure as it is partly illicit, deprives countries such as Zambia of a sizable portion of the resources they need for development financing. Some estimates indicate that capital flight exceeds the stock of external debt in a number of LDCs. It also undermines domestic investment and thus reduces long-term growth.

6. Conclusion

Well established mechanisms for raising domestic tax revenues are indispensable for a developing country like Zambia especially in light of recent developments including the global financial crisis. Declining external financing particularly donor aid can only be sustainably

[6] http://www.zambianwatchdog.com/archives/21403 Accessed on 16/12/2011

mitigated by improved domestic revenue mobilization. Zambia has the potential to mobilize more revenues if international best practices can be adhered to.

Developing a strategy of resource mobilization that uses a mix of different mechanisms suggested above can lead to positive results on the economy. Multiple sources of funding can increase a country's independence and flexibility to implement programmes and reduce reliance on external financing. Innovative strategies of resource mobilization outside the budget must be embraced including facilitating private sector participation and Public-Private Partnerships in the production and provision of infrastructure and services.

Zambia needs to strengthen its domestic revenue mobilization and public resource management systems for economic growth to trickle down to ordinary Zambians. When Zambia mobilizes its own resources, it has to strengthen its public finance management systems and governance system so that the resources that are mobilized are kept within the system and allocated where they are needed most, whether it is for infrastructure development, agriculture, or economic diversification.

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