Fiscal Policy and Domestic Resource Mobilization in Africa in the Face of the COVID-19 Pandemic

A Background Paper

COALITION FOR DIALOGUE ON AFRICA (CODA)
Technical Committee on Domestic Resource Mobilization

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INTRODUCTION

On 11 March 2020, the World Health Organization (WHO) declared COVID-19 a global pandemic. COVID-19 was first confirmed on the African continent on 14 February 2020. Since then, Africa has seen widespread rises in infection and death rates. As of 11 August 2021, the continent had recorded 7,136,140 cases and 179,986 deaths, and was battling a third wave of infections driven by more contagious and deadlier variants. The third wave has stricken the continent concurrently with the global COVID-19 vaccine rollout competition in which Africa seems to have been left behind. According to the WHO, African had administered less than 2% of the global COVID-19 vaccine doses by mid-August 2021.

Africa CDC estimates that only 1.75% of the African population had been fully vaccinated as of 11 August 2021. The continent is not faring better even with its share of population that has received only one dose of the vaccine. The following chart from the Washington Post shows that as of 23 July 2021, only 2.2% of the African population had received one dose of the vaccine, far lower than all other regions of the world.

VACCINATION RATES BY CONTINENT

Share of people who have at least one coronavirus vaccine dose

<table>
<thead>
<tr>
<th>Continent</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>47%</td>
</tr>
<tr>
<td>Europe</td>
<td></td>
</tr>
<tr>
<td>South America</td>
<td></td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
</tr>
<tr>
<td>Middle East</td>
<td></td>
</tr>
<tr>
<td>East Asia/Oceania</td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

Note: As of July 23  
Sources: Our World in Data and Post Reporting  
THE WASHINGTON POST
To many experts, if swift action is not taken, as was the case at the onset of the first wave, Africa may soon experience more catastrophic failures in its health systems. The evolution of the pandemic seems to involve recurring waves of infections with potential compounding waves of mortality and morbidity. The challenge for African health systems, therefore, is how to be prepared to provide the full range of services needed to prevent, diagnose, isolate and treat COVID-19 patients, while providing the full spectrum of health services, even with respect to other diseases like malaria and HIV/AIDS.

As the continent battles this third wave of COVID-19 infections, it must also gear up to push forward with relief, recovery and reform (the 3 Rs) efforts needed to return to “normal” in the economic, health and social status of its populations. To wit, the COVID-19 pandemic has had a debilitating impact on the African health systems and a devastating effect on socio-economic development of countries. The continent has suffered its first recession in 25 years. Several countries became even more indebted than previously; it is estimated that 43 million people are at the risk of extreme poverty because of the pandemic.

African countries have spent an additional 2.5% of their GDP on average on COVID relief, but substantial more funding is still required to invest in post-COVID economic recovery, rebuild national health and education systems, and strengthen the social safety net for the most vulnerable. The continent has received additional support from African and international financial institutions, including the African Development Bank, Afrexim Bank, the World Bank, and the IMF (through its Rapid Credit Facility under the Catastrophe Containment and Relief Trust for instance). However, those additional resources have not been sufficient to respond to the total estimated need for post-COVID relief, recovery and reform in Africa. Indeed, IMF has projected that Africa will face a post-COVID financing gap of US$285 billion through 2023.\(^1\)

The purpose of this background paper is to identify strategies and policies, and assess challenges related to enhancing domestic resource mobilization (DRM) to support Africa’s COVID relief, recovery and reform efforts. Section 2 assesses the pre-pandemic vulnerabilities faced by Africa in its growth performance and health systems. Section 3 reviews and analyzes the multiple development financing imperatives that Africa must confront even as it battles the COVID-19 pandemic. In section 4, the paper examines the sources and challenges of revenue mobilization in Africa, with a focus on potential new sources of revenue mobilization such combating illicit financial flows and strategic use of IMF’s special drawing rights. Section 5 concludes the paper.

\(^1\)However, it must be underscored here that this estimated financing gap can quickly climb even higher because this estimate does not consider the scenario of the third wave of coronavirus infections raging on the continent.
2.1. AFRICA’S PRE-PANDEMIC GROWTH PERFORMANCE: UPWARD BUT WEAK TREND

In the two decades prior to the outbreak of the COVID-19 pandemic, Africa had transitioned from a region with anemic growth performance to a continent with a relatively high growth performance, on par with the average low-income comparator regions, and the world. In sub-Saharan Africa alone, the average annual GDP growth rate was 2.2% during the 1990-2000 period, whereas in the 2000-2019 period it had increased to 4.6%, which compared favorably with the low-income countries performance, which similarly increased from 2.4% to 5% between the two periods. Noting that the world GDP growth performance remained the same at 2.8% between the two periods, Africa’s growth performance appeared to be on an upward trajectory in the period just prior to the pandemic.

The sectoral breakdown of the growth performance confirms this upward trajectory for Africa in all sectors, particularly in industry, manufacturing and services sectors. Thus, average annual industrial growth increased from a mere 0.6% in the 1990-2000 period to 3.1% in the 2000-2019 period for sub-Saharan Africa. The change in the manufacturing sector was even more stark, with the region posting a negative growth rate of -0.6% in the 1990-2000 period, but by the end of the 2000-2019 period Africa’s manufacturing growth rate was averaging 3.8%. Similarly, average annual growth in the service sector increased from 3.1% to 5.6% over the two periods. The agriculture sector showed the least performance, as average annual growth in the sector changed only by 1% over the two periods.

This growth dynamics notwithstanding, at 4.6% average growth rate in 2000-2019, the continent was far from posting a growth performance strong enough to achieve its development goals. Indeed, UNECA’s 2019 Economic Report on Africa (ERA) emphatically concluded that Africa needed double digit growth to achieve the Sustainable development Goals (SDGs). Furthermore, the report noted that boosting Africa’s investment up to 30-35% of GDP would have been necessary for the continent to achieve double digit growth. Overall, in the immediate period prior to the onset of the coronavirus pandemic, Africa was outperforming several regions of the world in GDP growth, yet the continent was subject to economic vulnerabilities due to the weakness of the growth performance.

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2The World Bank classifies North African countries in the Middle-East and North Africa (MENA) region
2.2. PRE-PANDEMIC HEALTH SECTOR AND SOCIAL VULNERABILITIES IN AFRICA

Health sectors in Africa were characterized by various levels of vulnerabilities and weaknesses even before the outbreak of the COVID pandemic, as measured by the 2019 Global Health Security Index (GHSI). Table 2 presents the 10 African countries that have scored the highest overall scores on the 2019 GHSI, with their overall rankings. The table also presents the score for each component of the GHSI for the countries.

South Africa is the only African country that broke the 50% mark on the overall GHSI scale. The vulnerability of African health systems was particularly stark in the category of health sector sufficiency and robustness. Indeed, on this component African countries generally achieved less than 30%, in demonstration of the general fragility of the continent’s health systems.

A further investigation into the factors that may affect the performance of health sectors helps to better understand the GHSI results. Such factors include the ratio of physicians, the ratio of hospital beds and the level of health expenditure. Table 3 shows that the average number of physicians per 10,000 people in sub-Saharan Africa (2.3) and North Africa (10.5) were below the world average (15.5) or the developing countries average (12.2) in the 2010-2018 period. The average number of hospital beds per 10,000 people was 9 for sub-Saharan Africa and 16.25 for North Africa, whereas the world average was 27 and developing countries 21 for the same period. Another indicator of the robustness of the health system is the level of health expenditure. Africa’s health expenditure to GDP ratio averaged 5-6% in 2017.

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4The index provides a comprehensive assessment of global health security capabilities in 195 countries and aims to assess the level of preparedness for pandemics and epidemics for each country. Countries are evaluated on six categories: 1. Preventing the emergence or release of pathogens; 2. Early detection and reporting of epidemics; 3. Rapidly responding to and mitigating the spread of epidemics; 4. Sufficient and robust health sector; 5. Commitment to improving national capacity, financing, and adherence to norms; and 6. Risk environment and vulnerability to biological threats. Each country is awarded a score out of a possible total of 100 on the overall assessment and on each of the components.
TABLE 2. GLOBAL HEALTH SECURITY INDEX FOR 10 AFRICAN COUNTRIES (2019)

<table>
<thead>
<tr>
<th>Country</th>
<th>GHSI score and rank</th>
<th>Components of GHSI (score out of 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall GHSI score (out of 100)</td>
<td>Overall ranking (out of 195)</td>
</tr>
<tr>
<td>South Africa</td>
<td>54.8</td>
<td>34</td>
</tr>
<tr>
<td>Kenya</td>
<td>47.1</td>
<td>55</td>
</tr>
<tr>
<td>Uganda</td>
<td>44.3</td>
<td>63</td>
</tr>
<tr>
<td>Morocco</td>
<td>43.7</td>
<td>68</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>40.6</td>
<td>84</td>
</tr>
<tr>
<td>Madagascar</td>
<td>40.1</td>
<td>86</td>
</tr>
<tr>
<td>Egypt</td>
<td>39.9</td>
<td>87</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>38.2</td>
<td>92</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>38.2</td>
<td>92</td>
</tr>
<tr>
<td>Senegal</td>
<td>37.9</td>
<td>95</td>
</tr>
<tr>
<td>World average</td>
<td>40.2</td>
<td></td>
</tr>
</tbody>
</table>

Sources: ghsindex.org

However, the challenge is not just about the level of expenditure, but the efficiency and effectiveness of health expenditure. It is estimated, for instance, that for every US$100 of government revenue in Africa, on average US$16 is allocated to health. However, only US$10 of the allocated health budget is in effect spent, and less than US$4 is directed to the right health services (ECA, 2017). Tables 1 and 2 illustrate that the pre-pandemic state of Africa’s health systems was weak and vulnerable. The COVID pandemic has further debilitated the continent’s health systems, with severe adverse consequences for the socio-economic fabric of African countries.

TABLE 3. AFRICA PRE-COVID HEALTH VULNERABILITIES

<table>
<thead>
<tr>
<th>Country</th>
<th>Doctors (per 10,000) 2010-2018</th>
<th>Hospital beds (per 10,000) 2010-2018</th>
<th>Health expenditure (% GDP, 2017)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>2.3</td>
<td>9</td>
<td>5.1</td>
</tr>
<tr>
<td>North Africa</td>
<td>10.5</td>
<td>16.25</td>
<td>6.02</td>
</tr>
<tr>
<td>Developing countries</td>
<td>12.2</td>
<td>21</td>
<td>5.4</td>
</tr>
<tr>
<td>World</td>
<td>15.5</td>
<td>27</td>
<td>9.9</td>
</tr>
</tbody>
</table>

Sources: 2020 UN HDR

Far from being just a health crisis, the COVID-19 pandemic has indeed heightened the need for countries to protect the poor and vulnerable, including women, children, the elderly, and the newly vulnerable. Countries were quickly faced with the need to scale-up and expand resilient and pro-poor social protection systems targeted to the micro, small and medium-sized enterprises (MSMEs), which are the most vulnerable productive segments of society. Additional resources were urgently needed to increase public-sector investment in labor-intensive development projects or immediate, short-term job creation schemes in sectors of high priority such as agriculture, rural infrastructure development and artisanal production.
3.1. AFRICA’S DEVELOPMENT IMPERATIVES AND FINANCING GAPS

The scope of the development funding requirements in Africa is beyond the COVID-19-related challenges. Prior to the COVID-19 pandemic, African countries had faced tremendous challenges in mobilizing sufficient resources to finance their development priorities. Indeed, estimates have shown that the incremental financial needs to achieve the SDGs was US$269–279 billion per year in African low-income countries, and US$345–359 billion per year in African middle-income countries, for a total gap of US$614–638 billion per year (UNCTAD, 2016).

The continent’s infrastructure such as roads, railways, ICT, is inadequate to support its growing economies, particularly in the rural areas. According to the African Development Bank (AfDB), Africa is characterized by minimal water storage capacity, inadequate energy supply, very low connectivity in paved road and rail network, lack of transport, processing and storage facilities, and limited capacity and technology. The lack of stable and reliable energy supply constitutes a major constraint on the continent’s agricultural and industrial transformation. For instance, in many African countries, access to electricity is less than 1%, and it is estimated that over 60% of people in sub-Saharan Africa still do not have access to electricity. The continent has a potential to generate up to 14,000 MWs from geothermal sources. Investments in these renewable sources of power will not only go a long way in meeting the need but to substantially raise the level of energy supply through sustainable and environmentally conscious energy systems.

In the agriculture sector, although Africa holds more than 60% of the world’s uncultivated arable land, and the agriculture sector employs about two-thirds of the continent’s working population, contributing between 20 and 50% of its GDP, only about 10% of its arable land is cultivated and only about 6% of its farmland is irrigated. Low productivity in the agricultural sector is largely due to limited investment. The Food and Agriculture Organization (FAO) estimates that in three decades, total agricultural investment, measured in gross capital formation, has only increased from US$20 billion to US$35 billion. Studies estimate that the total annual financing need in the agricultural sector in Sub-Saharan Africa amounts to US$48 billion and the need for climate adaptation will require that the continent raise an additional US$2.9 billion. Increasing investments in agriculture is therefore imperative for supporting employment creation and food security.

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1Rf “Scaling up Renewable Energy in Africa: 12th Ordinary Session of Heads of State and Governments of the AFRICA UNION” (2010)
2African Business (2021)
4Investopedia (2019)
5AgriHouse Foundation (2019)
Overall, AfDB (2018) has estimated that Africa’s infrastructure financing ought to have reached US$130-170 billion per year, with an estimated annual financing gap of US$68-108 billion. Importantly, AfDB notes that poor infrastructure development in Africa lowers overall productivity by 40% and costs the continent an average of 2% in GDP per year. 11

3.2. AFRICA’S DEBT BURDEN RESTRICTS ITS FISCAL SPACE

Africa’s debt burden had reached US$547 billion prior to the COVID-19 pandemic. The Brookins Institute estimates that, as of 2017, 19 African countries had exceeded the 60% debt-to-GDP threshold set by the African Monetary Co-operation Program (AMCP) for developing economies. Twenty-four countries had surpassed the 55% debt-to-GDP ratio suggested by IMF. Table 4 shows that African countries devoted 10-14% of their exports revenue on average to service the debt alone during the 2015-2018 period. An analysis by ONE.org suggested that part of the reason is the high cost of borrowing faced by African countries, including interest rates that are 5-16% on 10-year government bonds, compared to near zero or negative for Europe and America.

With the pandemic, African countries have faced even more severe budgetary pressures due to additional COVID-19 spending and have been forced to take more loans as alternative forms of financing beyond official development assistance (ODA). Along with the slowdown in economic activity and lockdowns, this has led to worsening debt situation in Africa, severely restricting the continent’s fiscal space. IMF estimates that government debt to GDP ratio in sub-Saharan Africa has increased from 25% in 2011 to almost 48% in 202112. Africa’s external debt to exports increased from 88% in 2009 to 153% in 2019. Africa’s fiscal situation further deteriorated as government revenue to GDP ratios decreased from 12.7% in 2019 to 11.4% in 202013, in the face of negative savings, severely dwindling foreign direct investment (FDI) and negative private capital flows (Table 4).

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>14.1</td>
<td>-0.8</td>
<td>1.8</td>
<td>-2.9</td>
<td>2.6</td>
</tr>
<tr>
<td>Developing countries</td>
<td>9.57</td>
<td>9.03</td>
<td>1.92</td>
<td>-2.8</td>
<td>0.75</td>
</tr>
<tr>
<td>North Africa</td>
<td>14</td>
<td>15.2</td>
<td>2</td>
<td>-1.3</td>
<td>0.3</td>
</tr>
<tr>
<td>World</td>
<td>14.5</td>
<td>10.8</td>
<td>1.7</td>
<td>-0.3</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Sources: 2020 UN HDR

13https://openknowledge.worldbank.org/bitstream/handle/10986/34588/9781464816109.pdf?sequence=4&isAllowed=y
Mobilizing sufficient resources, leveraging the synergies between them, and ensuring that investments of all types contribute towards achieving their development priorities are the overarching challenges currently faced by African governments. The COVID-19 pandemic has further widened the overall development financial gaps on the continent. Given the severely diminished availability of international resources because of the pandemic, the continent cannot rely on ODA alone as a sustainable source of resource mobilization. The challenge is to find the mixture of internal and external sources of financing that will maximize the chances of successful COVID-19 response and post-COVID-19 relief, recovery and reform in Africa.

**4.1. SOURCES OF FINANCING**

**4.1.1. Domestic Resource Mobilization**

Domestic resources remain at the core of overall resource mobilization strategy in Africa. They are more reliable; their relative variance is lower than that of ODA (ECA), and more adaptable to national priorities. Resources generated domestically are more significant than those generated from international or foreign sources such as ODA, FDI or remittances (Table 4). Table 5 shows that over the 2011-2016 period, for instance, tax revenues averaged US$510 billion in Africa, compared to ODA, which generated an average of US$52.65 billion during the same period. The decline of FDI flows to Africa and its unequal and unevenly distributed streams to the continent has had limited impact in terms of source of development financing to the continent. In fact, FDI flows to Africa slumped to US$42 billion in 2017, a 21% decline from 2016 levels. The level of resources generated domestically is more significant than those generated from international or foreign sources such as ODA, FDI and remittances.

This implies that an increase in the efficiency of their collection should yield much more additional resources. The challenge is that at an average of about 18%, tax-to-GDP ratios in Africa remain low compared to other regions such as Asia or Latin America and the Caribbean, where they are closer to 25%. This presents an opportunity, however, because increasing DRM and managing public debt effectively can create the fiscal space for African governments to invest more in the COVID-19 response strategies and in the post-COVID recovery and rebuilding priorities.

One way to improve their tax-to-GDP ratios is for countries to strengthen tax compliance measures. Although tax enforcement is part of this process, compliance is best achieved when a fair and efficient tax system is instituted, combined with effective service delivery and public accountability. When citizens’ trust in government is high, they are more likely to comply with tax payment obligations. The tax-to-GDP ratio can be improved through growth-promoting policies that serve to widen the tax base and yield higher tax revenue.
It can be further improved if countries institute effective mechanisms to fight illicit financial flows, including tax evasion (Section 4.2).

Regarding measures to strengthen public debt management, a real challenge for African countries is how to ensure that both the level and rate of growth in their public debt is fundamentally sustainable (IMF). Other effective means of strengthening public debt management include reducing the risk of instability in government’s portfolio management, reducing excessive reliance on foreign currency debt and improved management of contingent liabilities.14

### TABLE 5. TAX REVENUES AND EXTERNAL FINANCIAL INFLOWS TO AFRICA, 2011-2016 (US$ BILLION)

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>Tax revenue</td>
<td>512.7</td>
<td>561.5</td>
<td>541.0</td>
<td>506.4</td>
<td>436.8</td>
<td>500.0</td>
</tr>
<tr>
<td>ODA</td>
<td>51.6</td>
<td>51.8</td>
<td>56.8</td>
<td>54.3</td>
<td>51.2</td>
<td>50.2</td>
</tr>
<tr>
<td>FDI</td>
<td>66.0</td>
<td>77.5</td>
<td>74.6</td>
<td>71.3</td>
<td>61.5</td>
<td>59.4</td>
</tr>
<tr>
<td>Remittances</td>
<td>59.6</td>
<td>64.3</td>
<td>63.7</td>
<td>67.2</td>
<td>64.8</td>
<td>64.6</td>
</tr>
</tbody>
</table>

Sources: ECA, 2018c

### 4.1.2. THE ROLE OF THE PRIVATE SECTOR

The international private sector does not represent a reliable source of resource mobilization for Africa. In 2019, the net flow of private capital to (or from) Africa as a percentage of GDP was about -3% (Table 4), meaning that there was a higher outflow of international private resources from the continent than inflows.

However, new actors in the African domestic private sector are increasingly involved in development finance, including institutional investors such as pension fund managers, insurance companies and collective investment schemes. They have the potential to grow resources for long-term investment requirements of the post-COVID-19 recovery. In Ghana and South Africa, for example, national pension fund managers have been investing directly in infrastructure development. In Nigeria, the Pension Reform Act of 2004 established a contributory pension scheme, which now has over US$26 billion in assets under management and up to 20% of such funds can be invested in infrastructure.

Nigeria further stands out in its mobilization of private sector partners in the battle against COVID-19. Indeed, many of the country’s high net-worth individuals have formed the “Nigerian Private Sector Coalition Against COVID-19: CACOVID”. The coalition began with six of the wealthiest individuals in Nigeria, each pledging to donate N1 billion (US$2.8 m) to support Nigeria’s fight against coronavirus. The coalition has now grown to more than 50 members. In some countries such as South Africa and Egypt, for instance, domestic capital markets (including equity, bond and insurance markets) can now adopt a role in mobilizing private capital to finance domestic development (i.e. issuance of public debt in domestic currencies for infrastructure development).

4.1.3. INNOVATIVE APPROACHES TO FINANCING

Given the scale of financing needs for the post-COVID-19 reconstruction, African countries need to explore additional innovative mechanisms based on models combining public and private sources of finance and moving beyond the traditional public-private separation in development finance, i.e., private investments being funded exclusively by private investors and public projects being funded overwhelmingly with public resources. Some innovative approaches could include:

**Pension funds:** African pension funds offer enormous potential as a continental source for investment capital. In 2014, pension fund assets in Africa were estimated at US$334 billion, with growth variations across sub-regions and countries. This high growth trend was expected to continue as Africa moves towards increased coverage, and more inclusive and comprehensive systems.

**Blended finance:** Under the blended finance approach, concessional funds are mixed with those of commercial development institutions and private investors in a risk-sharing arrangement, such that a competitive risk-return package is offered to the private investors, made possible because the concessional investors are willing to accept a less-than-competitive package.

**Sovereign wealth funds (SWFs):** SWFs support the achievement of a country’s long-term strategies and financial goals through the acquisition of international equities, commodities and private fixed income securities. Through such vehicles, African countries can use their assets to invest in domestic companies, using public-private partnership approach, for example, to invest in infrastructure, boost economic growth and create jobs. Several African countries have established SWFs, including Angola, Gabon, Ghana, Morocco, Senegal, Rwanda, Djibouti, Nigeria, Namibia, Algeria, Uganda, Mauritania, and Zimbabwe, for a total of 21 SWFs. In 2018, African SWFs controlled US$89 billion worth of assets.

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15https://www.swfinstitute.org/profiles/sovereign-wealth-fund/africa
Impact investing: The idea of impact investing or ‘doing well by doing good’ is gaining ground. Such investments, which seek attractive financial returns as well as concrete social or environmental returns, are a good way to attract investible resources into African countries. The International Financial Corporation (IFC) estimates, for instance, that channeling just 10% of the US$269 trillion in financial assets held by firms and households into impact investments would go a long way to provide the money needed to achieve the Sustainable Development Goals (SDGs).

International and regional trade as sources of finance: Regional integration has a prominent role to play in boosting intra-African trade so that Member States can benefit from economies of scale and develop significant regional value chains. This is because trade flows have assumed increasing importance for resource mobilization in many developing countries. It is in this context that the African Continental Free Trade Area (AfCFTA) could encourage stronger FDI flows to Africa for national and regional infrastructure projects. Trade finance could be enhanced by promoting the standardization of trade finance instruments and the consistent implementation of anti-money laundering measures, countering the financing of terrorism and “know-your-client” regulations across jurisdictions (United Nations, 2018b).

Co-financing: Co-financing with development banks is another approach to mobilize funds and spread risks. In this approach, investors can gain a greater level of comfort via a lead development bank’s connection with governments, its financial strength, its willingness to remain through difficult economic conditions, and its financial imprimatur, all of which help attract other financiers.

Remittances: There are considerable opportunities to unlock additional value from remittance flows. For instance, the use of diaspora bonds specifically targeted at a country’s emigrant population is a time-tested but underused means to raise money to finance development. Several African countries have introduced diaspora bonds to help bridge financing gaps (i.e. Ethiopia, Egypt, Nigeria, etc.). These bonds are useful for tapping into the wealth of the diaspora for financing infrastructure, housing, health and education projects (Basu 2010). In 2018, the World Bank estimated that remittances to sub-Saharan Africa had grown to US$46 billion, representing a potentially substantial investment source for the continent.

4.1.4. The Role of the Central Bank

Insufficient capital threatens to undermine long-term socio-economic growth. Africa has yet to harness its increasing GDP growth to support sustainable and inclusive development due to low levels of domestic savings. The continent has the lowest savings rate in the world. In 2019, the gross level of domestic savings as a percentage of GDP for sub-Saharan Africa was 19%, compared to 34% for East Asia and Pacific, 29% for South Asia (2020), and 18% for Latin America and the Caribbean.  

interest rates on savings accounts compared to lending accounts. Indeed, The Economist suggested that in sub-Saharan Africa, the gap between deposit and lending rates is higher than anywhere else, citing a 2017 World Bank estimate that net interest margins in the median African country was 6.8%.

In this regard, African central banks have a key role to play in financing development in Africa. According to the standard paradigm (orthodoxy), which has defined multilateral relations since the 1980s, the role of the central bank should be primarily focused on maintaining price stability and overall macroeconomic stability. But according to D.I.E. (2015) this orthodoxy on the limited role of central banks was undermined by the 2008 financial crisis. Since then, a gradual paradigm shift has taken place regarding the role of the central bank in promoting economic development and stability, including taking an active role in financing development. The question for African policymakers is whether the time has come to seriously consider and expand the role of central banks to include aligning the financial system with the development priorities of countries.

4.2. ILLICIT FINANCIAL FLOWS AND THEIR IMPACT ON RESOURCE MOBILIZATION

The African Union High-Level Panel (HLP) on Illicit Financial Flows, chaired by President Thabo Mbeki, defines Illicit Financial Flows (IFF) as “money illegally earned, transferred or used”18. During the 2000-2015 period, net IFF between Africa and the rest of the world averaged US$73 billion per year from trade re-invoicing alone (ECA). Global Financial Integrity estimates that the amount of financial flows that left Africa by way of other channels averaged US$26.7 billion per year over the period 2005-2014 (Spanjers and Salomon, 2017). Taken together, this amounts to US$100 billion annually, or 4% of the continent’s GDP. Boyce and Ndikumana (2012) estimate that the capital stock of Africa would have expanded by more than 60% without these flows, and GDP per capita would be up to 15% higher. The HLP in its report on IFF stated that given the well-known dependence of several African countries on significant amounts of ODA, the loss of resources through IFFs can only serve to deepen reliance on donors.

Moreover, Cobham (2014) states that IFFs can generate environmental degradation, security concerns and conflicts over resources in Africa. In the same way as corruption, IFFs threaten and weaken public institutions and the rule of law. IFF from African countries have been shown to discourage value addition to the continent’s natural resources. This is particularly harmful to the continent given the important role that value addition plays in providing sustained, inclusive growth (ECA, 2017a; ECA and African Union Commission, 2014).

17https://www.economist.com/finance-and-economics/2020/05/21/why-interest-rates-are-so-high-in-africa
In this area, challenges include lack of knowledge on how IFFs operate at the national level, due to the hidden nature of such flows, and of their scale; persisting legal loopholes in many African countries that facilitate the continuation of IFFs, lack of capacity in relevant government agencies to effectively address IFFs, and gaps in the international architecture for tackling IFF persist.

4.3. SPECIAL DRAWING RIGHTS AS POTENTIAL SOURCE OF REVENUE MOBILIZATION FOR COVID-19 RELIEF AND RECOVERY

There is a growing interest in the international community, including IMF, for the use of Special Drawing Rights (SDRs) to bolster resource mobilization efforts of African countries. The most recent SDR allocations were completed on 31 March 2021, where a total SDR 204.1 billion was allocated, of which SDR13.145 billion (6.43% of the total) was allocated to African countries. This is equivalent to US$18.66 billion allocation for the entire continent. Given the estimated COVID-19 financing gap of US$285 billion for Africa, the current allocation of SDRs represents only 5.40% of the continent’s total financing gap, leaving 94.59% of the required total to be mobilized.

That is the context in which in March 2021, IMF declared its intention to boost total SDR allocation to US$650 billion to “add direct liquidity boost to countries without adding to debt burden”.

At the 2021 Spring Meetings, the International Monetary and Financial Committee (IMFC) expressed its support for the proposal by the managing director to raise the total SDRs allocation. With the new proposed allocation and applying the current proportion of the SDRs holdings of African countries in the world total, the continent’s US dollar equivalent of new SDRs would amount to US$33.20 billion. While this amount is certainly an improvement over the current situation, it would still only represent 11.65% of the total estimated financing gap for Africa.

The upshot of this analysis is twofold: first, SDRs can constitute an important strategic tool for widening the fiscal space for African countries as they seek to mobilize sufficient resources to jumpstart their economies. Secondly, however, the current or even new proposed levels of allocation are far below what would significantly alleviate the continent’s post-COVID financing needs (Table 6).

### TABLE 6. IMPACT OF PROPOSED SDR ALLOCATION ON AFRICA’S FISCAL SPACE

<table>
<thead>
<tr>
<th>Total allocation (US$ billion)</th>
<th>% Africa SDR holdings</th>
<th>Total Africa holdings (US$ billion)</th>
<th>% finance gap covered</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>290</td>
<td>5.11</td>
<td>14.81</td>
<td>5.20</td>
<td>Current as of 31 March</td>
</tr>
<tr>
<td>650</td>
<td>5.11</td>
<td>33.20</td>
<td>11.65</td>
<td>In process</td>
</tr>
</tbody>
</table>

Sources: IMF, and author’s calculations
4.3.1. Impact of Post-allocation Channeling of SDRs by High-income Countries

In its communiqué expressing support for the current proposed SDR allocation increase, the IMFC called on the “upper income Member States” to explore “ways for voluntary post-allocation channeling of SDRs to support Members’ recovery efforts.” This analysis will focus on two country groupings most representative of the “upper income Member States”: the G-7 countries and the G-20 countries, and will examine the potential impact of voluntary agreement on G-7 or G-20 post-allocation channeling of unused SDRs by their Member States on Africa’s fiscal position.

As of the March 2021 allocations, SDR holdings of the G-7 countries was about SDR92.46 billion, representing 45% of total allocations. Similarly, the SDR holdings share of 19 individual countries of the G-20 totaled SDR127.85 billion or 63% of the total allocations. This assumes that African countries continue their resource mobilization efforts, including taking advantage of the tentative return to global economic growth, to raise, eventually, 50% of the post-COVID recovery financing. Then, the proportion of the financing gap to be covered through SDRs channeling will be about US$142.5 billion. The scenarios of the effects of voluntary reallocations of unused SDRs are presented in the next sections.

**Effects of G-7 Countries Voluntary Channeling of Unused SDRs towards Africa**

Table 7 presents two scenarios: the impacts of voluntary channeling of 25% and 50% of the G-7 SDR allocations towards Africa. As already mentioned, the current total SDR allocation is US$290 billion, therefore, channeling 25% of the G-7 SDR proportionate holdings would raise the total available to African countries by an equivalent of US$32.83 billion, which would reduce the financing gap by 23% as already defined. If 50% of the G-7 SDR holdings were to be channeled, then this would raise the total available to Africa by US$65.66 billion, covering 46% of the financing gap. By the same token, with the newly proposed SDR allocation of US$650 billion, under the same scenarios, African countries would see their SDR allocations increase by US$73.59 billion, helping to reduce the financing gap by 51%, if 25% of G-7 countries allocations were to be channeled, and less than 50% of the G-7 allocations would need to be channeled to cover the totality of the remaining financing gap.
### Effects of G-20 Countries Voluntary Channeling of Unused SDRs towards Africa

Table 8 presents results with the assumption that 19 individual G-20 Member States agree to channel their unused SDRs towards Africa. Given the size of this country grouping and, therefore, the size of its total proportion of SDR holdings, the scenarios analyzed in this case involve assumptions of 25%, 35% and 50% channeling depending on the total allocations. At the current level of total SDR allocations of US$290 billion, 25% channeling of the G-20 SDRs would raise Africa’s total availability by US$45.40 billion, reducing the financing gap by 31%.

Fifty percent channeling of the G-20 SDRs would raise the African total by US$90.8 billion, reducing financing by 63%. When the total SDR allocation is increased to US$650 billion, then under the scenario of 25% channeling of the G-20 SDRs, the total SDRs available for Africa will increase by US$101.75 bn, reducing the financing gap by 71%. A 35% channeling under this scenario would almost cover the remaining financing gap, as defined in this analysis.

### TABLE 7. EFFECTS OF G-7 COUNTRIES VOLUNTARY CHANNELING OF UNUSED SDRS TOWARDS AFRICA

<table>
<thead>
<tr>
<th>Impact on Africa</th>
<th>TOTAL SDR ALLOCATION = US$290 BN; %G-7 = 45%; FINANCING GAP = US$142.5 BILLION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0% G-7 channeling</td>
</tr>
<tr>
<td>Increase in Africa SDR allocations (US$ billion)</td>
<td>0</td>
</tr>
<tr>
<td>% Reduction in financing gap</td>
<td>0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Impact on Africa</th>
<th>TOTAL SDR ALLOCATION = US$650 BILLION; %G-7 = 45%; FINANCING GAP = US$142.5 BILLION</th>
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<tbody>
<tr>
<td></td>
<td>0% G-7 channeling</td>
</tr>
<tr>
<td>Increase in Africa SDR allocations (US$ billion)</td>
<td>0</td>
</tr>
<tr>
<td>% Reduction in financing gap</td>
<td>0</td>
</tr>
</tbody>
</table>

Sources: IMF, and author’s calculations

### TABLE 8. EFFECTS OF G-20 COUNTRIES VOLUNTARY CHANNELING OF UNUSED SDRS TOWARDS AFRICA

<table>
<thead>
<tr>
<th>Impact on Africa</th>
<th>TOTAL SDR ALLOCATION = US$290 BILLION; %G-20 = 63%; FINANCING GAP = US$142.5 BN</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0% G-20 channeling</td>
</tr>
<tr>
<td>Increase in Africa SDR allocations (US$ billion)</td>
<td>0</td>
</tr>
<tr>
<td>% Reduction in financing gap</td>
<td>0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
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<td>% Reduction in financing gap</td>
<td>0</td>
</tr>
</tbody>
</table>

Sources: IMF, and author’s calculations
4.3.2. Access and Use of Additional SDR under Post-allocation Channeling Agreement

Post-allocation channeling of the upper-income Member States SDRs can buttress Africa’s fiscal position and make resources available for the most urgent post-COVID recovery needs faced by the continent. The two IMF-managed trust funds, Poverty Reduction and Growth Trust (PRGT) and Catastrophe Containment and Relief Trust (CCRT) could have their resources augmented with additional resources from IMF to serve this purpose. Such resources should be deployed urgently to ensure that Africa’s economic recession is not protracted to become depressions due to constrained fiscal resources and space.

Unused SDRs from high-income countries could be directed to eligible multilateral development institutions (MDIs), including (IMF is not an MDI) World Bank and African Development Bank. These can be used to enhance their lending facilities and intermediation capabilities, improving access to low-cost financing for African countries.


African countries have long been faced with the challenge of striking the right balance between attracting multinational corporations (MNCs) and taxing their earnings. The prevailing thought has been that by reducing corporate income tax and lifting regulatory barriers, a country is better positioned to attract foreign investment. However, when this behavior becomes widespread and turns into a competition among countries, MNCs can “shop around” for the lowest possible tax rates, leading to the “race to the bottom” phenomenon. From Figure 2, reproduced from the Tax Foundation, every region has seen its corporate tax rates steadily decline over the last 40 years due to tax competition to attract corporate investment.

**FIGURE 2. TRENDS IN CORPORATE TAX RATES SINCE 1980**

**CORPORATE TAX RATES HAVE DECLINED IN EVERY REGION OVER TIME**

*Average Statutory Corporate Income Tax Rate by Region and Decade*

![Corporate Tax Rates Graph](image-url)

Note: The number of countries included in calculated averages varies by decade due to missing corporate tax rates for years prior to 2020; that is, the 1980 average includes statutory income tax rates of 74 jurisdictions compared to 177 jurisdictions in 2020.

Source: Statutory corporate income tax rates were compiled from various sources.

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But for African countries, the problem is more insidious. Many MNCs enjoy market valuation that often surpasses the GDP of their host countries. For example, Amazon, Apple, Microsoft, and Google’s parent company Alphabet, each has a market valuation of at least US$1 trillion, whereas the total nominal GDP for Africa in 2019 was US$2.6 trillion. With their size, power and influence, many countries find it difficult to monitor the activities of MNCs and lack the ability to bring them to justice when they commit infractions or violate their terms of contract.

Often, countries grant tax incentives to corporations in the belief that such policies would lead to increased FDI, economic growth and jobs creation. Tax concessions and incentives to attract foreign investors include corporate income tax holidays, generous capital investment deductions, and exemptions from VAT payments, import duties and withholding taxes. However, a 2012 report issued by Tax Justice Network-Africa and ActionAid (TJN-A and AA) concluded that four members of the East African Community (EAC), including Kenya, Uganda, Tanzania, and Rwanda were losing US$2.8 billion each year for providing corporations with tax incentives without the expected investment in return. Many EAC countries suffered revenue losses in the wake of the tax concessions and incentives, including in Tanzania, where revenue losses from all tax exemptions and incentives related to trade and foreign investment was 6% of the GDP in 2008. In Kenya, the losses were estimated at around 3.1% of GDP annually; in Uganda, it was “at least 2%” in 2009/2010; and in Rwanda 4.7% in 2009.

In addition to revenue losses resulting from tax concessions and tax incentives, countries suffer losses due to the ingenuous ability of corporations to engage in a host of tax evasion and tax avoidance behaviors generally known as Base Erosion and Profit Shifting (BEPS) (OECD). This involves corporations using sophisticated tax planning strategies to shift profits from one country with higher tax rates to another with lower tax, thereby eroding the tax base of the so-called higher tax jurisdiction. BEPS behaviors are made possible by a combination of several factors: increased globalization, mismatches in the tax laws of different countries, and ease of transfer of “intellectual property”. The rise of corporate tax havens has also been a major factor in facilitating the ability of large corporations to transfer profit to avoid taxation from the host country.

The International Center for Tax and Development (ICTD, 2016) indicated that for Africa, the loss of tax revenue due to BEPS “leads to critical under-funding of public investment that could help promote economic growth, and it impacts negatively on badly-needed finances to fund public infrastructure such as roads, hospitals and schools.” ICTD suggests that BEPS “undermines the integrity of the tax system”, which, in turn, reduces voluntary compliance by all taxpayers. The paper suggests that BEPS undermines competition because MNEs have a competitive advantage over domestic companies, including SMEs.
All things considered, African countries have generally found themselves in a weak position compared to the large multinational corporations that they are trying to attract due to their limited capacity to monitor tax avoidance and tax evasion behaviors of these corporations, and the global “race to the bottom”. This is the context, from the African perspective, within which the recent G-7 agreement to establish a global minimum corporate tax should be examined to understand its impact on African economies.

4.4.1. How the Current International Tax System is Unfair for Africa

In its origin, the current international tax framework design was based on a “compromise” dating back to the 1920s, whereby active business income was to be taxed in the source country (where the production activity has taken place), whereas so-called passive income (including dividends, royalties, and interest) was to be taxed in the residence country, where the ultimate profit owner (corporate or individual) resides (N. Nersesyan, IMF 2021). In addition to source country and residence country, the current international tax system distinguishes the destination country, where the sales take place, and taxing right can be assigned to the source, destination or residence country. Currently, net profit arising from “active” income is allocated based on the “arm’s length principle”, where individual transactions between related entities can be priced as if they were taking place among unrelated entities in a competitive market (this is the basis for transfer pricing).

The current international tax system is a complex network of more than 3000 bilateral “double-taxation treaties”, which define the rules of how and where the taxation on active or passive income can take place (IMF 2021), in an effort to avoid a situation where corporate earnings are taxed twice by two different jurisdictions. Double-taxation treaties serve to allocate taxing rights between source and residence countries, but often assign more taxing rights over passive income to residence countries, for example, by setting maximum withholding tax rates on cross-border bilateral payments of interest, dividends and royalties from income earned in source countries.

Permanent establishment (PE) and double taxation agreements are instruments meant to moderate the allocation of taxing rights. Permanent establishment arises when a business that is not legally resident has a fixed place of business in the source country, which can give rise to tax liabilities and, as discussed before, double-taxation treaties are used to prevent business income from being taxed twice for the same activity. The determination of whether the business income should be taxed in the source or home country and the method of taxation is then made within the treaties based on the principle of permanent establishment.

These building blocks of the current international tax system put Africa in a fundamentally unfair position for the following reasons:
1. Given the current international tax rules, the primary taxing rights are allocated to the source country. This allows MNCs to “shop around” for the lowest tax jurisdictions, laying the groundwork for the “race to the bottom” behavior of countries, the effect of which is the transfer of taxable profits from one country to another that has a lower tax regime.

2. Many African countries have limited tax administration capacity. African countries have to spend a lot of money to enforce the current international tax system because of its complexities, which require a lot of information and technical skills. A further burden comes from the fact that tax authorities find it difficult to acquire the capacities required to manage international tax related processes such as audit, interpretation of tax laws, and establishment of transfer pricing units and large tax offices. Very often, therefore, they are not able to challenge tax practices by MNCs, as already explained.

3. Due to limited technical tax treaty negotiation capacity in many African countries, the tax treaty negotiation dynamics can contribute to exacerbating BEPS. For instance, some clauses in double taxation agreements restrict withholding taxes or allow large intra-company loans which facilitate loss of revenues to African countries. Indeed, tax treaties, if not properly negotiated, could enable double non-taxation because of differences in the treatment of financial items in different jurisdictions.

4. The current international tax architecture lacks adequate remedy for countries that have been negatively impacted by adverse tax behaviors by large corporations. There is lack of coherence in dealing with tax misbehavior at the international level as compared, for instance, to corruption and money laundering where there are global arrangements such as the UN Convention Against Corruption and the Recommendations of the Financial Action Task Force.

5. Given the ubiquitous nature of digital technology, establishing a large physical presence is no longer a requirement for production activity to take place. Indeed, digital companies may carry out significant economic activities in a country but with little physical presence (scale without mass). At the same time, many digital companies can generate value from selling data derived originally from users of their services in a country where they are not required to pay tax. For example, providers of search engines do not pay tax on the data gathered from users although they generate value by selling such information to advertisers. For these reasons, continuing to allocate taxing rights on the basis of the principle of “permanent establishment” has become anachronistic, resulting in substantial loss of revenue for Africa.

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19IMF 2019, Corporate Taxation in the Global Economy
4.4.2. The Need for Reform and the G-7 Agreement

There is broad consensus on the need to reform the current international tax system. Increasingly, income from intangible sources such as drug patents, software and royalties on intellectual property has migrated to low-tax jurisdictions, allowing companies to avoid paying higher taxes in their traditional home countries. To prevent and reduce corporate tax avoidance and tax evasion practices, OECD and the G-20 have launched a BEPS initiative that led to the development of a BEPS package consisting of 15 actions intended to equip governments with the domestic and international instruments needed to tackle tax avoidance. Over 130 countries and jurisdictions have agreed to collaborate on the implementation of the BEPS package (Box 1). With the G-7 agreement, a global minimum corporate tax of at least 15% will likely become one of the pillars of the BEPS reforms. Like the BEPS reforms, the general aim of the global minimum corporate tax rate is to discourage multinationals from shifting profits — and tax revenues — to low-tax countries regardless of where their sales are made.

4.5. POTENTIAL IMPACTS OF THE PROPOSED REFORMS ON AFRICA

There are many questions surrounding the practical application of the proposed global minimum corporation tax regime. For instance, given the current widespread abuse and sophisticated profit shifting techniques, there is real question on whether a global minimum tax will on its own deter all corporate tax avoidance and evasion. Many tax experts have questioned the efficacy and effectiveness of such a global minimum tax, as many businesses are concerned about impacts on their competitiveness, possible double-taxation and increased compliance costs (www.atlanticcouncil.org). Moreover, for African countries, there are questions on their capacity to enforce such a rule.

COMPONENTS OF THE OECD BEPS PACKAGE

| Action 1 | Addressing the tax challenges of the digital economy |
| Action 2 | Neutralizing the effects of hybrid mismatch arrangements |
| Action 3 | Strengthening controlled foreign company rules |
| Action 4 | Limit deductions for interest and other financial payments |
| Action 5 | Counter harmful tax practices |
| Action 6 | Prevent tax treaty abuse |
| Action 7 | Address permanent establishment status rules |
| Action 8 | Transfer pricing rules for intangibles |
| Action 9 | Transfer pricing rules for allocation of contractual risk |
| Action 10 | Transfer pricing rules for high-risk areas such as management fees and head office expenses |
| Action 11 | BEPS data analysis |
| Action 12 | Mandatory disclosure of aggressive tax planning arrangements |
| Action 13 | Country-by-country reporting |
| Action 14 | Mutual agreement procedure for treaty dispute resolution |
| Action 15 | Multilateral instrument for treaty modifications |

Effects of G-20 Countries Voluntary Channeling of Unused SDRs towards Africa

a. The level of political involvement of African countries in discussions around the international tax regime reforms.

b. The ability of African countries to set their priorities as they continue to work in global tax forums, most notably the BEPS inclusive framework. A Global Compact on Reform of International Tax System, similar to what exists at the international level on corruption and money laundering, would for instance better advance Africa’s position in these international tax reform processes.

c. The ability of African countries to substantially raise their negotiation capacity and domestic capacities for tax policy and tax administration.

d. Further commitment by African countries to pursue ongoing national and regional fiscal and budget reforms to strengthen their domestic tax systems, including substantially raising their levels of tax negotiation, tax administration and domestic resource mobilization capacities.

CONCLUSION

The COVID-19 pandemic has had debilitating impacts on the health systems of African countries, with potentially devastating effects on their socio-economic sectors. The continent has suffered its first recession in 25 years, with several countries in debt distress and millions of people at risk of extreme poverty. The third wave of the COVID-19 pandemic has compounded the effects of the first and second waves with the emergence of new strains of the coronavirus which are believed to spread faster and more deadly. The pandemic has upended the progress that Africa has achieved in the last decade in terms of growth and improvements in the lives of its people. In the global race to roll-out COVID-19 vaccines, Africa is being left behind, as less than 2% of Africa’s populations have so been vaccinated, against 50% or more in some advanced countries.

This paper analyzed the critical policy issues that affect resource mobilization in Africa to finance COVID-19 riposte efforts. It aimed to identify strategies and policies, and assess challenges related to enhancing domestic resource mobilization to support Africa’s COVID-19 relief, recovery and reform efforts, while continuing implementation of development policies by countries. The continent is facing a dire and extraordinary situation. Global action and affirmation of global partnership for urgent and significant international mobilization in support of the African continent in its fight against the coronavirus pandemic is essential.
REFERENCES


