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The Politics of Domestic Resource Mobilization for Social Development

At a time when the development community is grappling with the challenge of raising the required investment to achieve the Sustainable Development Goals (SDGs) and to address the socio-economic consequences of the Covid-19 pandemic, countries' mobilization of their own domestic resources for social development is more important than ever. This Brief summarizes UNRISD research showing that while increased international solidarity is indispensable to help shoulder the financial burden of crisis response and of investment in the socio-ecological transformation required to truly meet the SDGs, expanding fiscal space and capacity in the global South will be key for building a new social contract that is inclusive and sustainable.

The Issue

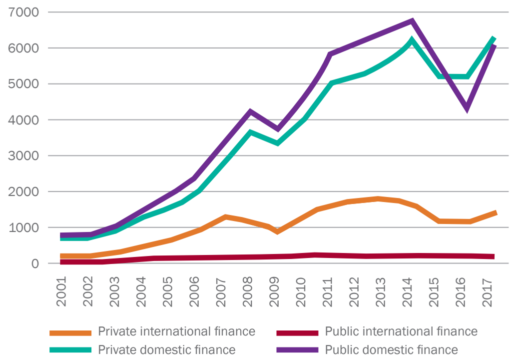
Putting development strategies into practice and responding effectively to crises rests on states' capacity to design and implement transformative policies, create stable institutions, garner the political support and trust of citizens, and mobilize the required financial and administrative resources. Domestic resources are key for financing the SDGs and national development priorities. Domestic resources—public domestic resources, in particular—are the most important source of development finance, exceeding private flows as well as international aid (figure 1). And while external resources such as aid, loans or foreign direct investment continue to play an important role, for example as a catalyst for social protection reforms (Cherrier 2020), they imply significant transaction costs, volatility, reduced policy space through donor conditionality, and skewed accountability as citizens are less engaged. On the other hand, domestic resource mobilization (DRM) has the potential to positively impact state-citizen relations, economic stability and growth, and redistribution (UNRISD 2016; see also figure 2).

This brief summarizes results and insights from an UNRISD research project (see box 2) which analysed the political processes around domestic resource mobilization in four diverse case study countries in the global South. After outlining some recent trends, it then discusses the findings related to the three main themes that guided the research:

(i) contestation, bargaining and outcomes;
(ii) key relationships; and
(iii) institutional development.

The brief concludes with four policy recommendations to enable developing countries to raise more and better domestic resources for sustainable development and inclusive societies.

Figure 1. Financing trends in developing countries
(USD billions, constant prices, 2001–2017)



Source: Hujo and Bangura 2020

Box 1. The impact of Covid-19 on fiscal space

The Covid-19 pandemic that hit the world in 2020 has led to immense fiscal challenges, in particular in developing countries. State revenues such as tax have been adversely affected by the economic recession unleashed by lockdowns and interruptions in international trade, travel and tourism as well as falling commodity prices, capital inflows and remittances. While rich countries have been able to resort to fiscal stimulus packages of unprecedented size, poorer countries have struggled to support citizens who lost their livelihoods and employment, and have been largely unable to help local businesses. As countries worldwide announced fiscal stimulus measures of USD 11.7 trillion by September 2020, or 12 percent of global GDP (IMF 2020), the ILO nevertheless estimated the fiscal stimulus gap for low-income and lower-middle income countries at USD 982 billion for 2020 (ILO 2020).

While the future impact of fiscal measures taken during the pandemic is still uncertain, depending on the timing and strength of economic recovery, it has broadened a consensus on the need to mobilize more resources to invest in a universal social contract. This new contract needs to be underpinned by resource bargains where high-income earners and profitable corporations contribute a fair share while international solidarity steps up to support countries with limited revenue capacity and little access to financial markets.

UNRISD 1963–2018 55 YEARS Research for Social Change

Box 2. The project

With a focus on domestic resource mobilization as a promising pathway for financing policies for social development and transformative change, the UNRISD project *Politics of Domestic Resource Mobilization for Social Development* aimed to provide research insights on how to:

- bridge the funding gaps for meeting key global development targets and social programmes in developing countries;
- enhance national ownership of development programmes and policy space, which is linked to improved fiscal capacity;
- improve understanding of the politics of revenue and social expenditure bargains and effective accountability of governments to citizens; and
- connect the literatures on the politics of resource mobilization and the politics of social provision in developing countries.

This brief is based on four in-depth case studies carried out by multidisciplinary teams in Bolivia, Nicaragua, Uganda and Zimbabwe, as well as thematic, cross-country and regional studies covering Argentina, Brazil, Chile, Colombia, Ecuador, Guatemala, India, Mexico, Peru and sub-Saharan Africa.

The project received funding from the Swedish International Development Cooperation Agency (Sida) and UNRISD institutional funds. More on the project and access to publications at www.unrisd.org/pdrm

Recent Trends

Domestic resource mobilization in the global South is strongly influenced by global policy models and international economic trends. The turn toward neoliberal policies in the early 1980s resulted in lower public revenues and redistribution of the tax burden from corporations and higher income groups to consumers and lower income groups.

Trade liberalization, which has reduced tariff rates worldwide, is making it difficult for countries to rely on trade taxes to finance development programmes. Governments have been increasingly forced to raise consumption taxes (such as VAT), which, though regressive, reach a large section of the population and thus have the potential to substantially increase state revenues. Consumption taxes have been complemented by user charges and increased levies on utilities and other services.

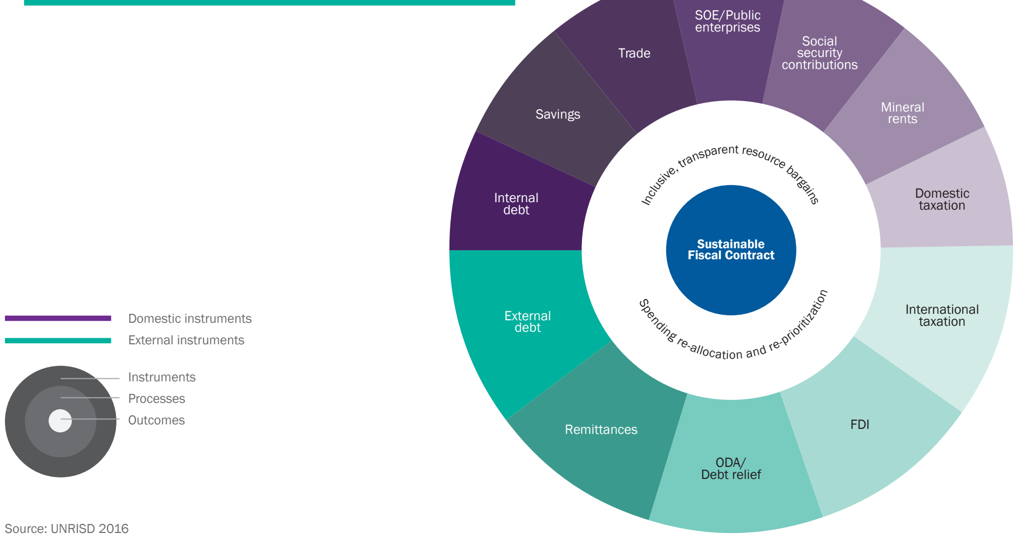
However, most developing countries have made little progress in more progressive instruments such as taxes on income and profits—which reach only 5.1 percent of GDP on average in low-income countries (Akitoby et al. 2018) compared with 33.6 percent in OECD countries (OECD 2018)—or raised property taxes. Carbon pricing and environment-related taxes, while still limited, are slowly increasing, in particular in OECD countries, with governments raising nearly USD 45 billion in carbon pricing revenues in 2019 (World Bank 2020). Reforms of corporate income tax, on the other hand, have followed a downward trend with few exceptions (OECD 2020).

Many of the countries that managed to scale up domestic revenues over the last decade, including several of the case studies in the Politics of Domestic Resource Mobilization project (see boxes 2 and 3), benefited from a booming natural resource sector and rising international prices for agricultural, mining and fuel products, in particular between 2003 and 2010. Natural resource rents present opportunities for development, especially in contexts where financial and fiscal resources are otherwise scarce, but the sector involves many negative environmental impacts, including the destruction of ecosystems and traditional livelihoods (Gutiérrez Elizondo 2015) and the loss of biodiversity, high levels of pollution, increased risk of natural disasters, and global warming resulting from fossil fuel production and consumption. This raises the question of how mineral wealth can be harnessed for development that is sustainable, socially inclusive and minimizes adverse environmental impacts.

Resource Bargains: A Useful Research Lens

Incentives to mobilize resources do not only come from countries' international development commitments and calls to increase DRM from the donor community, for example in the Monterrey Finance for Development Consensus (2002), the Addis Ababa Action Agenda (2015) or commitments to consider tax performance in aid allocation decisions (Bhushan and Samy 2020). Governments have also come under pressure from citizens to provide more and better services and basic social protection, and to finance them in a sustainable and equitable way. To raise revenues, governments need to engage in *resource bargains* with key actors like citizens, donors or corporations. Resource bargains are processes of contestation and negotiation around revenue policies and related social development policies, connecting resource mobilization and public spending. Unpacking the political economy of resource bargains can improve understanding of how to overcome obstacles to reform towards progressive revenue policies, and to allocate resources in ways that are conducive to transformative change.

Figure 2. Mobilizing fiscal space for the SDGs



Source: UNRISD 2016

Research Findings

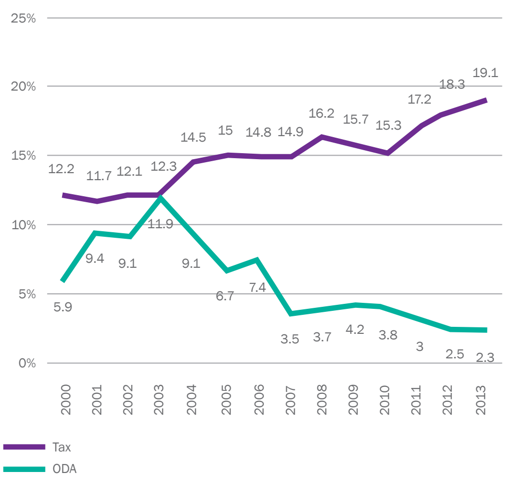
Who pays: Contestation, bargaining and outcomes

Domestic resource mobilization is a political process of contestation and bargaining over who pays and who benefits. This process is marked by differences and asymmetries of power at different levels, from the local to the global, which are in turn shaped by historical legacies and economic and political contexts. Resource bargains struck with donors usually display power asymmetries skewed to the benefit of the creditor, typically involving little engagement with civil society. To the contrary, DRM processes linked to tax reform or the extraction of mineral rents are often important public policy issues and can provoke contestation, social mobilization and even violent conflict. There are a number of examples in the countries studied: In Bolivia, there were tax riots by police and military personnel after a personal income tax, supported by the International Monetary Fund (IMF), was announced (Paz Arauco 2020); in Uganda, there was opposition to coercive enforcement practices related to a tax on the informal sector (Kjaer and Ulriksen 2020); in Nicaragua, a local social movement opposed mineral extraction in a rural community (Gutiérrez Elizondo 2015); and in Argentina, business groups opposed a further rise in export taxes on agricultural commodities (Delamonica et al. 2020). Power asymmetries also loom large between state and business actors regarding bargains about levies on productive activities, profits and capital rents, as evidenced by successful business lobbying in Chile and Uganda (Delamonica et al. 2020; Kjaer and Ulriksen 2020). The research confirms that successful revenue bargains reduce donor influence in policy-making processes of recipient states (figure 3). However, while improved fiscal capacity has the potential to reduce dependence on foreign aid, this new autonomy is often time-bound, and the need to access external credit can re-emerge in times of crisis or structural shifts in the world economy.

Structural determinants of tax take, such as per capita income level, urbanization, the size of the non-agricultural sector and international trade, have to be factored in when evaluating revenue performance (Moore and Prichard 2020) as well as **historical legacies**. Former labour reserve economies of Southern Africa display higher tax takes based on direct tax as well as higher social expenditures, compared with, for example, Western African cash-crop economies with lower tax takes and reliance on trade taxes, a legacy from colonial times (Mkandawire 2020).

In addition to tax bargains, the project focused specifically on resource bargains related to **natural resource rents**. These have been linked with improved social development outcomes in some cases, such as in Bolivia. This was aided by booming commodity prices between 2000 and 2014, which allowed Bolivia to reap the benefits of nationalizing its hydrocarbon sector and to finance an ambitious extension of social protection and social services. Mineral-led resource bargains have been less inclusive in Nicaragua, Uganda and Zimbabwe, where business and elite-dominated state interests prevailed over public interest. Finally, resource bargains are not only negotiated between the state and citizens, donors or the business sector, but also between different levels of state governance, often with the objective of sharing revenues more equitably between producing and non-producing regions (Arellano-Yanguas and Mejía-Acosta 2020). Findings demonstrate that political factors, such as the nature of the relationship between national and subnational political actors and the related degree of bargaining power of subnational actors, shape the outcomes of bargaining processes about rent distribution between different state levels, sometimes leading to regressive outcomes.

Figure 3. Bolivia: ODA and direct and indirect taxes as percentage of GDP (2000–2013)



Source: Paz Arauco 2020

Changes in key relationships

DRM processes lead to changes in key relationships between the state, civil society, donors and business actors. But these changes are not only driven by DRM processes; they also depend on key features of governments and political leaders and how they relate to key stakeholders. Brazil and India are examples of how citizenship regimes determine revenue and expenditure policies (Schneider 2020). In the case of Brazil, both the middle classes and popular sectors were incorporated into a new social contract during the successive governments of the Workers' Party (Partido dos Trabalhadores / PT) from 2003 to 2016, which channelled increased revenues into social expenditure to share some of the benefits of commodity-led export growth. Despite this stable cross-class coalition, economic and political elites have blocked efforts to reverse patterns of inequity in the tax system such as regressivity and a lack of universality. In

Box 3. The case studies: Bolivia, Nicaragua, Uganda and Zimbabwe

The four in-depth case studies in the project comprise low-income (Zimbabwe and Uganda) and lower middle-income countries (Bolivia and Nicaragua), and represent different types of economies, in order to investigate how the structures of economies and development paths may have a bearing on tax strategies and resource mobilization in general.

In terms of economic structure, Bolivia follows a mineral-dependent growth path, with hydrocarbons and minerals driving growth rates and constituting the main revenue source for the state, while the low-productivity agricultural and service sectors still account for the bulk of employment. Nicaragua, the poorest country in Central America, is a small commodity-exporting economy and financially dependent on ODA and remittances. Zimbabwe's crisis-ridden economy is built on agriculture and mining, with strong dependence on migrant remittances and aid (in particular emergency and food aid), whereas growth in Uganda, one of the biggest aid recipients in sub-Saharan Africa, is largely driven by the service sector, with industry and agriculture remaining important, the latter in particular in terms of exports and employment. Mineral rents are already highly important in Zimbabwe, and likely to play an increasing role in Uganda following the discovery of oil.

Concerning the political context, the selected countries represent a range of democratic/participatory and elite-dominated frameworks; post-conflict transitions play a role in Nicaragua, Uganda and Zimbabwe. Regimes are relatively open in all four countries to allow for contestation and bargaining around revenue and expenditure policies, and DRM is high on political agendas in all countries.

To raise revenues, governments need to engage in *resource bargains* with key actors like citizens, donors or corporations. Resource bargains are processes of contestation and negotiation around revenue policies and related social development policies, connecting resource mobilization and public spending.

the case of India, low tax take is associated with political coalitions that largely favour the middle classes and internationally dynamic economic sectors, limiting the redistributive capacity of the state. The result has failed to produce a coalition in support of increased revenues, with the middle classes particularly opposed to using tax to redistribute the benefits of growth driven by the technology and service sectors in which they are central players. Bolivia is another example of a new citizenship regime which has successfully incorporated the historically excluded indigenous majority population under the government of the first indigenous Bolivian president, Evo Morales, funding new social benefits with mineral rents and increased tax revenues.

In Nicaragua, key relationships have changed over the country's turbulent history from dictatorship to socialist revolution to market-oriented reforms, with a recent deterioration of state-citizen relations under President Ortega as a result of violent confrontations between the government and social movements protesting against a planned pension reform, as well as against state repression and lack of transparency and accountability in politics. Tax policy reforms and tax legislation implemented over the last decades have not succeeded in creating a sustainable and equitable fiscal contract in support of social policy reforms which would move the country towards a more comprehensive and universal system of social provision. Relations with traditional donors have soured as a consequence of "bad" governance, while new donor alliances with Venezuela and China are affected by political and economic instability, in particular in Venezuela (Carrión 2020).

In Uganda, the National Resistance Movement government enjoyed high legitimacy after the end of the civil war. With the introduction of competitive elections in 1996, it has been increasingly responsive to citizens' demands for social service delivery such as universal primary education and abolition of health user fees, as well as eliminating the unpopular Graduated Tax levied on the informal sector. Big national and international enterprises wield both considerable structural power, as they contribute disproportionally to a narrow tax base and can therefore credibly threaten disinvestment, and instrumental power through political lobbying and influencing activities. Small- and medium-sized firms are able to pressure the government through public protests, as demonstrated by the strike of import-export traders against the introduction of VAT in 1996 (Kjaer and Ulriksen 2020).

Key relationships in the context of DRM policies in Zimbabwe show some similarities with Uganda. During the initial post-conflict, post-independence state-building period, the ZANU-PF government enjoyed legitimacy and credibility vis-à-vis civil society, business actors and external donors thanks to strong social investments put in place to counteract the adverse impacts of economic crisis and the structural adjustment policies that had been implemented in the 1990s. State-citizen bargains in Zimbabwe have been weak in the mining sector, especially in the 2000s when the sector became the key contributor to the country's GDP, exports and fiscal revenue, though the sector was bedevilled by state capture, lack of transparency, and secret bargains struck with powerful mining companies. Other financing instruments, such as the Aids Levy, displayed greater stakeholder inclusion, citizen engagement and oversight, effectively contributing to the financing of important health interventions in a period of continuing fiscal constraints and volatile donor support (Saunders 2020).

Upgrading institutional capacities for revenue mobilization and service delivery

The third theme explored in the PDRM project was institutional development—or capacities for revenue mobilization and service delivery. It examined the extent to which the politics of domestic resource mobilization generated pressures not only to create new or better institutions which would raise revenues more effectively, but also to upgrade the institutions entrusted to deliver services, reflecting a resource bargain which provides social services and benefits in exchange for financial contributions by citizens, business and donors.

One key finding emerging from the project is that upgrading institutions for DRM and service delivery goes beyond technocratic capacity building: the political capacity of the state (that is, its ability create political consensus and generate support for reforms) needs to underpin technical reforms in order to make them work. As the case of the Uganda Revenue Authority shows, institutional strength and organizational performance are ultimately a function of linkages with political leadership, because such links guarantee greater financial and political support (Katusiimeh and Kangave 2015).

Zimbabwe's post-independence experiences with revenue mobilization raise questions about the impact of institutional capacity on resource strategies and social service delivery. While state programmes were weakened, first, by resource constraints in the 1980s, then by neoliberal austerity and state cutbacks in the 1990s and a full-blown economic crisis in the 2000s, the effectiveness of state institutions was also undermined by intensifying elite domination and state capture. This reduced the policy and administrative autonomy of state institutions, and limited the extent of public oversight and accountability, with highly detrimental impacts on revenue performance—especially from the mining sector—and on public services (Saunders 2020).

Finally, the Bolivian case is an example of both positive institutional spillovers from successful DRM strategies in a context of deepening democratization and improving state-citizen relations, as well as less successful attempts to overcome administrative capacity constraints at the local level, which undermine service delivery in poorer localities, reinforcing existing inequalities in a context of ambitious governance and institutional reforms (Paz Arauco 2020; Jiménez Pozo 2017).

Policy Recommendations

Inclusive and transparent resource bargains

Actual and potential taxpayers and other relevant stakeholders need to be involved in transparent and inclusive revenue bargains that establish links with social policy. They need to hold governments to account for the agreed distribution and allocation of resources. The links between revenue mobilization and social spending are most visible in taxation and social contributions. Taxation can embody a purposeful and mutually accountable state-citizen relationship where public services are provided in exchange for the payment of taxes by citizens and corporate actors. Bringing more citizens into such bargains with defined benefits is therefore crucial for strengthening state-citizen relations. Resource bargains enhance transparency and legitimacy in the use of revenues, which can yield positive governance returns and claims making on public policy. Such resource bargains can also raise tax collection through building a tax culture and expanding the pool of taxpayers, and they provide incentives for citizens to hold governments to account on revenue distribution and allocation, contributing to greater budget transparency and spending efficiency.

Diversified and sustainable financing mix

Countries should diversify the financing mix and move towards sustainable instruments. The different financing instruments implemented at the national level, while context-specific and shaped by historical legacies and economic structures, can be diversified in view of minimizing negative environmental or socio-economic impacts. Taxation systems, if progressively designed (so that tax rates increase with income level), can contribute to redistribution and improve equality, including gender equality. They can be used to provide incentives for more sustainable consumption and production patterns, and they contribute to inclusive growth and human rights by financing income guarantees and universal social services. **Mineral rents** provide resources for developing countries which are often stripped of other types of funding sources. However, mineral-led development poses risks and challenges regarding structural change, employment, gender equality and environmental protection. While improving the governance of rent distribution and allocation is crucial for harnessing the transformative potential of these resources, the ultimate recommendation is to diversify away from mineral dependence, in order to avoid revenue volatility, to develop more dynamic economic sectors with greater employment and innovative potential, and to safeguard the environment.

International solidarity and global governance

National resource bargains need to be complemented by global bargains such as official development assistance and improved global governance. While there is no conclusive evidence whether aid undermines efforts to raise taxes, it can have a catalytic effect on mobilizing additional domestic resources for social policies, especially in low-income settings. This has been the case where foreign aid actors supported national actors in investing in social policy, and helped upgrade public institutions entrusted to deliver social services. Whether aid has a transformative effect depends on how sustainable and reliable it is, how it is distributed and allocated, and whether it enhances state accountability and institution building. Furthermore, global governance is important to guarantee macroeconomic stability and crisis prevention, curb illicit financial flows, and promote developing countries' access to external finance and markets.

Enabling environment for DRM

Public policies need to support an enabling environment for DRM. While many revenue sources have the potential to contribute to social and sustainable development, realization of this potential depends not only on the specific design of policies, but also on whether financing strategies are supported by an enabling policy environment. Enabling factors at the national level include economic policies which support labour-intensive growth, are conducive to structural change, and lead progressively to higher levels of formalization, household income and equality. Other enabling factors are investments in state capacity—both in terms of capacity to create political consensus and support for progressive reforms, and to broker investment deals with transnational corporations that are favourable for the country—and administrative capacity to implement reforms and enforce compliance with tax law and regulation, especially by high-income earners and big corporations. And, last but not least, democratic, transparent and accountable institutions and political processes provide an environment where citizens, business actors and donors are most likely to collaborate effectively and to deliver on their commitments.

Unpacking the political economy of resource bargains can improve understanding of how to overcome obstacles to reform towards progressive revenue policies, and to allocate resources in ways that are conducive to transformative change.

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For a full list of the project publications, visit **www.unrisd.org/pdrm**.

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This Research and Policy Brief was prepared by Katja Hujo. The opinions expressed do not necessarily reflect the views of UNRISD.

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