DRM Pilot Program Description

Background. Developing countries continually struggle to find the resources necessary to meet the needs of their people – for basic education, clean drinking water, health care and other important sectors. For years, USAID and other donors have helped partner countries to meet these needs, but this assistance is just a fraction of the overall need. Indeed, one of the greatest constraints to achieving development goals in priority sectors is often the lack of budget resources for partner governments, even after factoring in private sector investment.

Increasingly, countries are looking to **Domestic Resource Mobilization (DRM) —** the process by which countries raise their own funds to provide for their people, while also reducing fraud, waste and abuse. In its broadest usage, DRM includes both public (e.g., government revenues) and private sector (e.g., Public-Private Partnerships, domestic pension funds and/or investment) resources. DRM is an effective and sustainable way to independently raise domestic revenue/investment and achieve a country's own development goals. In the arena of public resources, this does not have to mean new or higher taxes. In most cases, it focuses on better tax administration — there are some cases where better, more widespread enforcement drives lower rates. Under the right circumstances, successful DRM programs have proven to be extremely cost-effective, returning many times their original investment.

Program Overview. Based on AID/W consultations with House and Senate appropriators during the summer and fall of 2015, USAID is developing a pilot program that will enable select missions to provide DRM assistance. Beginning in FY 2016, on a limited basis, USAID missions will have the ability to use a fraction[1] of their directive and Feed the Future (FTF) funding for DRM activities. These multiyear activities will be designed to support selected partner country governments to increase domestic resources by increasing revenue, improving spending efficiencies, and enhancing transparency in the use of those resources. Ultimately, this pilot program is expected to help partner countries raise domestic revenue and spend that revenue on development priorities. As noted below, to participate in the pilot program, a partner country must commit to spend an equivalent amount of funds in the sectors for which the directed funds were designated once their domestic revenues rise. In other words, the partner government is basically "repaying" the funds used for DRM back to the directive sectors – and all other increases in their domestic revenues can be distributed in accordance with regular budget processes.

This program is also expected to yield returns many times greater than if USAID funding had solely been used for direct service provision within those same development priorities. Participation in this pilot program is strictly optional for the relevant USAID mission and partner country government.

[1] The fraction, not to exceed 2.5 percent, will be applied across applicable directives and initiatives exceeding $2 million annually, which are allocated to the USAID Mission's Country Operational Plan.

The Office of Economic Policy within the Bureau for Economic Growth, Education and Environment (E3/EP) will oversee the general parameters of the pilot program to ensure that the program remains consistent with the concepts of this program description, which has been discussed with Congress and stakeholders from relevant sectors. Participating missions will be responsible for the design and implementation of DRM programs, and all funding will remain at the mission level. Operating units may utilize the technical expertise and procurement mechanisms of E3/EP when appropriate for designing and implementing programs, but accessing these services will be optional. E3/EP will also compile and make available a guide that shares best practices employed by the missions.

Country Selection. Research shows that many of the most successful DRM projects have depended on partner country commitment to those projects, so missions and partner governments need to demonstrate how they will make that commitment. Countries selected to participate will be those that demonstrate a willingness to meet the following conditions:

1. **DRM commitment and aspiration.** Does the partner country government commit to providing high-level support to the medium-term goal of increased national tax revenue and other domestic resources? Do the prospective cooperating revenue agencies have an appropriate and credible plan to achieve such an increased level of public revenue?

2. **Commitment to key sectoral goals and delivery of public services.** Does the partner country government share the U.S. Government's commitment to the target goals[2] in the respective key sectors? Is the partner country government willing to increase its national budget allocations in amounts equal to or greater than the DRM project assistance provided by USAID to those key sectors? Is the partner government taking adequate steps to provide good financial governance, transparency, and accountability for delivering needed public services?

3. **Measurement and monitoring of progress.** Are the partner country counterparts willing to join in developing and tracking specific indicators and targets for revenue collection and other aspects of tax system performance?

Potential candidate countries for DRM programs include:

- The developing countries that join the Addis Tax Initiative Declaration – including Cameroon, Ethiopia, Ghana, Kenya, Indonesia, Liberia, Malawi, the Philippines, Rwanda, Senegal, Sierra Leone, and Tanzania; and
- Additional countries in Africa, South Asia, or other regions where consultations at the field level and with other donors, the IMF, multilateral development banks, and regional organizations indicate that the partner government shows high potential for meeting the three conditions noted above, and are 'early movers' in setting ambitious, national-level Sustainable Development Goals (SDGs).

[2] "Sectoral goals" refers to the goals the USG, USAID and/or Congress establish for USAID's work in the affected sectors. For example, improved quality of reading in the primary grades, per the USAID Education Strategy.

Scale of the DRM Program. During the five-year phase of the DRM pilot program, USAID will seek to negotiate agreements with approximately six partner countries and will limit the aggregate use of directive resources in all such DRM assistance activities to a maximum of $40 million annually[3].

Source of Funds. The funds used by participating missions shall come by taking a set percentage of applicable funding directives exceeding $2 million and FTF funding up to a maximum percentage of 2.5 percent in a given fiscal year.[4] Each mission will determine a percentage (up to the 2.5 percent limit) to apply across all applicable funding streams. While specific sectors included will vary according to an individual mission's budget, the sectors most likely to be impacted include health, basic education, water and Feed-the-Future. This pilot program will start with FY16 funding. DRM activities funded with those resources will be tracked as a 'key issue' by the mission's reporting system.

By committing to allocate at least an equivalent amount to the sectors for which the directed funds were designated when domestic revenues rise, the partner government is effectively "repaying" the funds used for DRM back to the directive sectors. Because of this arrangement, there may be cases in which sectoral goals or targets applied to those directed funds may have to be adjusted, or in which time lines for their achievement may have to be modified.

Use of Funds. Participating missions may use pilot program funds in support of DRM activities—projects that strengthen the revenue-raising and budgetary capacity of governments, reduce losses from corruption and graft, and counter tax-avoidance practices in participating countries. To participate in the pilot program, a partner country must commit to spend an equivalent amount of funds in the sectors for which the directed funds were designated once their domestic revenues rise. In other words, the partner government is agreeing to allocate a like amount of the funds used for DRM back to the directive sectors – and all other increases in their domestic revenues can be distributed in accordance with regular budget processes.

USAID and partner country government will document the project expectations to ensure that an appropriate portion of the increased domestic revenues are used to support the areas targeted by U.S. Government directives and initiatives in the year after the partner country's revenues increase as a result of this DRM work. While these commitments may be expressed in different ways among the pilot countries, E3/EP will review these commitments to ensure that they provide sufficient assurances of the partner country's intent to spend increased revenues in the relevant sectors.

Because well-conceived and successful reforms of tax administration business processes, organizations, and IT systems typically take several years to accomplish, the pilot project is expected to continue in each partner country for up to five years.

Monitoring and Evaluation. USAID and the partner country (generally the Ministry of Finance) will establish an evaluation system that will identify indicators relating to the agreed commitments regarding

[3] This $40 million limit is separate from amounts spent pursuant to the PEPFAR Sustainable Financing Initiative and/or via other unrestricted DA/ESF funds. (USAID currently has active DRM assistance activities under way in 12 countries and the total level of spending to implement such activities amounted to approximately $20 million in FY2014 using such unrestricted DA/ESF funding).

[4] Note that amounts redirected to DRM will generally not include funds that are received by USAID from other USG agencies via Interagency Agreements (e.g., PEPFAR).

both the revenue mobilization activities and support for the targeted development sectors. This system will monitor progress – including by reference to a set of objective, quantitative indicators – and will be used during an annual consultation between USAID and the partner country to assess progress toward attainment of the strategic objectives and results as well as the reinvestment of increased revenues into priority sectors.

In addition, USAID will identify relevant, emerging best practices for tracking performance and outcomes at the project level where lower-level goals of tax-mobilization and targeted development directives are being addressed, and will agree with the responsible partner country agency (revenue authority, ministry of health, etc.) to prepare supplementary monitoring reports to include in the annual consultation on DRM between USAID and the partner country.

To guide the pilot program's implementation, an Advisory Council will be created, which will consist of representatives from the various funding streams contributing to the program, as well as other relevant Agency stakeholders. The Advisory Council will meet quarterly to review and opine on strategic matters such as preliminary plans for country and project selection, draft statements of work, plans for monitoring and evaluation, and, the program's progress toward intended results.

Whole-of-Government Approach. The Millennium Challenge Corporation (MCC) and the U.S. Department of Treasury's Office of Technical Assistance (OTA) also have considerable expertise in DRM. Good division of labor is important. The Assistant Administrator of E3 has agreed with OTA leadership that in general, provision of intermittent or single resident policy advisors working under this program will be handled by OTA, while complex projects involving multiple advisors, equipment, software, etc. will be managed by USAID. Participating Missions will be expected to align their plans with this agreement or to seek an exception from the E3 Assistant Administrator or Senior Deputy Assistant Administrator, if a different approach seems advisable.

Process. Missions and partner countries that wish to participate will be asked to indicate their interest in participation by completing a simple form and submitting it to E3/EP. E3/EP will work with regional and pillar bureaus to make preliminary decisions on participation. Selected Missions and E3/EP will then work rapidly with the partner government to finalize the terms of the project and then undertake design work. USAID centrally-managed mechanisms will be available to assist with assessments (e.g., an assessment for tax administration in a partner country) and E3 staff may assist with design of interventions, but Missions will be free to use whatever contracting/grant mechanisms they deem appropriate.