

DOMESTIC RESOURCE MOBILISATION FOR SUCCESSFUL IMPLEMENTATION OF DEVELOPMENT PROGRAMS IN AFRICA

A focus on Ethiopia

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SYNOPSIS

Over the past decade, Domestic Resource Mobilisation (DRM) has increased in significance as a strategically important financing development approach. A number of African countries have recorded significant increases in DRM, resulting in corresponding increases in the resources available to their governments to drive their economic development agenda. Effective DRM can strengthen the continent's ownership over its development strategies and at the local level, enhance the social contract and accountability between governments and their citizens. This paper reviewed the key constraints for DRM in Africa and used a case study approach to analyse different DRM interventions, draw appropriate lessons and formulate policy recommendations.

Key findings: Addressing illicit financial flows is one important dimension for DRM. Based on evidence from the Ethiopia case study, the paper underscores the importance of adopting a multifaceted approach to curbing illicit financial outflows given the complexities and the diverse motivation of the actors. Furthermore, the paper highlighted the lack of capacity in tax collection as a major constraint for African countries in mobilizing domestic resources.

Main lesson: The key lesson learnt from the case study is that it is not enough to initiate policy reforms and rules without sustained leadership commitment and availability of the requisite capacity (both institutional and human) to implement and enforce the provisions.

Recommendations: Adopting and implementing tax reforms and related multi-faced approaches to curbing illicit financial flows, is critically important for African countries to improve domestic resource mobilization. Pan African institutions such as ACBF, AfDB, UNECA and AU as well as regional economic communities are expected to facilitate the development of fit-for-purpose policies and help build competencies and skills especially in tax collection and administration to ensure effective implementation of DRM policies and programs across Africa.

Introduction

Domestic resource mobilization (DRM) has generated a lot of interest and has become a central theme in a number of high level discussions in Africa. For instance, the African Union (AU) Agenda 2063, an overarching strategic framework for the transformation and sustainable development of Africa over the next 50 years, is explicit about the importance of DRM for effective implementation of the strategy and achievement of the intended results (AU 2014). A similar argument is advanced in the

report of the African Union's High-Level Panel on Alternative Sources of Funding chaired by H.E. Olusegun Obasanjo, the former President of Nigeria (AU 2012). This increased drive is underpinned by the fact that DRM is touted as having the potential to increase the resources mobilised internally by African countries thereby enhancing their self-reliance and weaning themselves from aid dependency (EU 2015). The increased capacity to finance the continent's development strategies from internal resources has potential to consolidate Africa's ownership over its development strategies

and enhance social contracts and accountability between governments and their citizens (Culpeper and Bhushan 2010).

According to Mubiru (2010), the increased interest and prominence of DRM as a reliable and predictable source of financing for development interventions in Africa is partly explained by: 1) the global economic crises; 2) the shifting aid paradigm; 3) lower export revenue; 4) the fiscal effect of trade liberalisation; and 5) the high level of indebtedness.

In recent times, a number of African countries have recorded an increase in DRM, which has resulted in corresponding increases in the resources available to governments to drive their development agenda (EU 2015). UNCTAD (2007) reported that these gains can be attributed to the positive economic growth, tax reforms and increasing resource revenue in resource rich-countries. Nonetheless, a significant number of countries in Africa still have challenges in mobilising adequate domestic resources to finance their development strategies. The inability of these countries to optimise the potential benefits of DRM is attributable to a number of structural, institutional and human capacity challenges. The ACBF Africa Capacity Report 2015 highlighted the following capacity challenges: a very narrow tax base and a huge informal sector; high levels of capital flight; tax evasion and avoidance; proliferation of tax exemptions; lack of legitimacy of tax administrations; relatively low penetration of the formal banking sector; and lack of human, technical, legal, regulatory, and financial capacity to deal with illicit financial flows. This reveals a strong need for capacity building but also shows an enormous potential to increase domestic resource mobilisation across the continent if those capacity challenges are addressed (Bird and Zolt 2005).

DRM is essential and critically important to the successful implementation of the Sustainable Development Goals (SDGs) and achievement of Africa's development priorities (EU 2015). Effective DRM increases the availability of internally generated resources, which in turn enhances the ability of African countries to initiate and manage

their development priorities (Culpeper and Bhushan 2010). Domestic resource mobilization thus: (i) enhances the legitimacy of African states and reduces dependency on external flows, thereby mitigating the negative impacts of resource volatility, and curtailing vulnerability to external shocks; (ii) enhances flexibility and greater policy space in African countries, (iii) increases ownership, accountability and capabilities of African States to drive their development agenda; and (iv) creates positive externalities and galvanize donor and investors support to complement local effort (North South Institute 2010). However, the realisation of these benefits will require the development and implementation of innovative, cost-effective and sustainable policies and programs.

Given the dwindling and unreliable external assistance and the resources required to implement the SDGs, it is imperative for African governments to adopt strategies that will enhance their capacity to mobilize adequate resources internally.

Objective

This case study, focusing on Ethiopia, aims to create awareness and to increase AfCoP members' knowledge and understanding of the DRM landscape and how DRM can be leveraged to support development strategies especially the SDGs. The manuscript throws light on the benefits of DRM in Africa using a case study on tax reform in Ethiopia. It highlights some of the challenges and strategies that can be leveraged by African countries to increase the mobilization of domestic revenue.

Methodology

The case study is based on a desk review and an assessment of secondary information on domestic resource mobilisation. It includes a review and documentation of international trade tax reform as a means of increasing DRM in Ethiopia. Drawing on evidence and approaches from the extant literature such as the Africa Economic Outlook Report (2010) and the Africa Capacity Report (2015), the document is crafted in a user friendly and easy to read manner. It uses simple and understandable language and is

presented in a format that is easy to understand and adapted to AfCoP members and the broader development community.

The resource mobilisation landscape in Africa

Domestic resource mobilisation (DRM) can be defined as the generation of resources from domestic sources and their allocation to economically and socially productive investments. DRM has become a mantra in Africa and other parts of the developing world because of its tremendous potential and vital role in successful implementation of the continent's development and transformative agenda (Kapoor 2015).

Over the past decade, Africa has enjoyed favourable economic growth which has outpaced most of the countries in the world mainly because of the increased demand for commodities and macroeconomic stability across most of the countries (NEPAD and UNECA 2014). This has led to significant increases in DRM across most of the countries, resulting in corresponding increases in the resources available to their governments to drive their economic development agenda. However, sustaining this growth is contingent on the continent's ability to mobilise adequate domestic resources especially taxes to fuel its development (UNTAD 2007). This need has revitalised interest and commitment of African governments to put systems and measures in place to ensure that they are able to raise adequate resources from internally generated revenue to meet the developmental needs and aspirations of their people.

The renewed DRM efforts in Africa is underpinned by the first of the six leading actions of the Monterrey Consensus which was reinforced at the 2008 Doha conference on Financing for Development (North South Institute 2010). Africa has put in place initiatives like the African Tax Administration Forum (ATAF) which was launched in November 2009 in Kampala, Uganda with the aim to enable the continent to respond to the growing urgency and commitment to increase DRM (OECD 2010). In addition, a number of key institutions on the

continent and globally, have focused their attention on DRM and are providing insights and stimulating discussions in Africa through the publication and dissemination of tailor-made knowledge products such as the United Nations Conference on Trade and Development (UNCTAD) report, the Africa Economic Outlook Report 2010 and the Africa Capacity Report 2015 all of which are dedicated to issues around DRM.

Overall, the record on DRM in Africa is impressive. For example, the total tax revenues collected in the continent increased four-fold from USD 138 billion in 2000 to USD 527 billion in 2012 which was 10 times larger than net official development assistance of US\$51.8 billion received in the same year (Kapoor 2015). This notwithstanding, the terrain is not even and the potential of the continent especially relating to mobilisation of domestic tax revenues has not been fully exploited. According to the African Development Bank (AfDB) (2010a), tax revenues as a share of GDP in sub-Saharan Africa increased from 22 percent of GDP to 27 percent in 1990 and 2007 respectively. However, the actual share of tax revenue to GDP varies significantly across the countries. Bird and Zolt (2005) posited that the averages mask the significant differences in the performance of individual countries. For example, low income countries mobilised, on the average, 13 percent of their GDP from domestic tax revenue which was lower than the 20 percent minimum level that was required for financing the Millennium Development Goals (MDGs) (OECD 2010).

In the same vein, tax per capita - a measure of all the annual total taxes collected divided by the number of inhabitants, have been increasing over the last two decades. However, significant differences exist among the different countries (KPMG 2014). For example, in 2008, Seychelles and Equatorial Guinea had an annual tax per capita of about USD 3,600 per inhabitant and Guinea-Bissau, Ethiopia, Democratic Republic of Congo, and Burundi, had an annual tax per capita as low as USD 11 per inhabitant. This clearly shows the heterogeneity of the tax per capita across the continent. The same type of variation is

evident when one considers the tax mix which indicates the purpose and magnitude of cost imposed on consumers, workers and capital owners. For example, Senegal and Uganda obtain most of their tax revenues from indirect taxes whereas South Africa depends mostly on tax revenues from direct taxation (AfDB 2010a). Other countries such as Kenya and Mauritania have a relatively balanced tax mix. On the other hand, countries such as Nigeria, Angola and Equatorial Guinea depend mostly on taxes from oil and gas.

However, the relative importance of the different type of taxes (especially trade tax) in the tax mix is changing given the world dynamics and impact of trade liberalization. For instance, on one hand taxes from trade are falling, direct taxes are increasing but at a slower pace and indirect taxes have stagnated. On the other hand, tax on natural resources as a share of DRM on the continent has almost tripled as a result of a remarkable increase in taxes on resource extraction. Oil exporting countries such as Nigeria, Angola and Chad have an unbalanced and narrow tax mix (North South Institute 2010). They depend almost entirely on taxes on natural resources with a very low and stagnant tax from other sources. In contrast, non-oil rich African countries tend to have a relatively balanced tax mix comprising of both direct and indirect taxes such as personal and corporate income taxes and value added tax (VAT).

The level of tax effort across the continent is generally increasing partly because of the potential and emerging significance of DRM as a key driver of the continent's development agenda. Countries such as Ghana, Liberia, Swaziland and Lesotho, have a high tax effort whereas Guinea, Madagascar and Mauritius were estimated to have a low tax effort. Other countries like Algeria, Angola, Congo, Equatorial Guinea and Nigeria tend to switch between low to high tax effort depending on the method of estimation - whether it excluded or included resource-related tax revenues (KPMG 2014). A computed average tax effort index of 47 African countries between 1995 and 2013 indicated

that 27 of the countries (mostly resource rich) showed a low tax effort (ACR 2015).

Additionally, Africa in general, has a low tax base and a very high informality that prevents most people from falling within the tax net. Across much of Africa the tax base is very narrow with the informal sector bearing the greatest proportion of the tax burden (Culpeper and Bhushan 2010). The situation is further exacerbated by inefficient and ineffective tax policies and collection mechanism, lack of productive incentives and illicit financial flows that deny the continent from its fair share of the benefits from the exploitation of its natural resources as well as corrupt tax system.

The above discussion shows that there is need for African governments to formulate and implement fit-for-purpose policies and capacity building initiatives that will strengthen their domestic resource mobilisation systems including plugging the leakages from illicit financial flow.

Case Study: Curbing IFFs as means of increasing domestic resource mobilisation in Ethiopia

Ethiopia is a large landlocked country with about 80% of the population employed in the agriculture sector. Ethiopia, therefore, has an extensive domestic resource mobilisation potential. However, the country has not been able to fully exploit this potential due to a number of structural and institutional constraints. The key constraints to DRM in Ethiopia include illegal financial flows (IFFs) emanating from money laundering, trade mispricing, corruption and other illegal activities such as human trafficking. According to NEPAD (2010) and ECA (2010), Ethiopia lost about USD 16.5 billion between 1970 and 2008 as a result of IFFs. The value represents about 2.3 percent of the total IFFs from the continent which was estimated to be a little over USD 854 billion during the same period. Further, the Global financial report, based on data from the World Bank and the International Monetary Fund revealed that from 2000 and 2009, Ethiopia lost 11.7 billion dollars due to illegal financial outflows.

Similarly, the report showed that Ethiopia lost USD 8.3 billion between 1990 and 2008 which represents 3.6 percent of the country's GDP.

Following the above observations, the Ethiopian government has implemented a number of reforms aimed at strengthening the countries capabilities in curbing illicit financial flows so as to increase DRM. Examples of the initiatives implemented by the government over the past decade are presented in the following paragraphs.

Strengthening the anti-money laundering framework

Ethiopia's anti-money laundering legal framework has improved in recent years (FATF 2014) although, until 2013 the anti-money laundering law was considered as highly inadequate and an incentive for illicit outflows (Center on Global Counterterrorism Cooperation 2013). In 2013, a new money laundering and terrorism financing law was enacted which has helped to improve the countries capability to counter the menace. This legal framework is consistent with international good practice and standards. For example, it includes provisions on customer due diligence by financial institutions and designated non-financial business and professions; requirements for legal entities to maintain information on beneficial ownership which can be accessed by legal authorities, and a definition of politically exposed persons (PEPs), among others.

Enhancing Accountability

In an attempt to root out corruption among duty bearers and their associates, the Government of Ethiopia in 2010 introduced a Proclamation on Asset Disclosure and Registration which required all "appointees, elected persons and public servants of the Federal Government and the Addis Ababa and Dire Dawa city administrations" to declare and register their personal assets and that of their family members. The asset disclosure requirements are among the anti-corruption measures adopted by the government to ensure that public office and duty bearers do not amass wealth through illegal means. The declaration and verification of the process is

managed by the Federal Ethics and Anticorruption Commission (FEACC).

Improving public financial management (PFM) and procurement

Ethiopia has implemented a number of PFM reforms over the past decade as part of the Expenditure Management Control Programme (EMCP) and the Public Sector Capacity Building Programme (PSCAP). Overall, the intervention has been assessed as successful. However, there is recognition among international organisations and the Ethiopian government that more needs to be done to improve transparency and accountability in the country (Alebachew and Alemu 2010). In addition, Ethiopia adopted a new public procurement law in 2009 intended, among others, to improve transparency and accountability in public contracting. (Freedom House 2012). The new procurement law facilitated the creation of an independent agency responsible for managing public tenders, and established requirements for the disclosure of key information related to public contracts. Furthermore, the government has also institutionalised electronic public procurement system which is intended to further boost the procurement system.

Improving tax administration

The government introduced a tax reform in 2008 aimed at simplifying the tax administration system through the establishment of a single body – the Ethiopian Revenues and Customs Authority (ERCA) – which is responsible for managing, investigating and prosecuting tax and customs offences. In addition, a special regulation on personnel administration was approved in 2008 to help address the challenges relating to dearth of personnel and technical expertise. To ensure effective delivery of the ERCA by attracting and retaining the qualified staff, the law established special rules for ERCA staff, including on recruitment, promotion and internal transfer, salary, allowances, training, evaluation and other benefits.

The law also includes other measures that target corruption prevention within Ethiopia's tax administration, such as the requirement for ERCA

employees to declare their assets, and severe penalties for bribery and illicit enrichment. It is, however, unclear whether this special regulation has helped to improve the quality of services provided and reduce corruption (Lencho 2012). This is because, in general, Ethiopia's civil service is highly politicised, and public jobs are often given on the basis of personal and partisan relationships (Bertelsmann Foundation 2014).

Strengthening inclusive monitoring and external oversight of non-state actors

The media and civil society freedom of expression and freedom of association are critically important for the identification and prevention of corruption and ultimately fight illicit financial flows. To help enhance the participation of non-state actors curbing IFFs in Ethiopia, the government adopted a proclamation on Media and Freedom of Information in 2008. This reform is considered as a positive step in comparison to previous legislation as it facilitates easy access to public information and prohibits the pre-trial detention of journalists without charges (Freedom House 2012). In the same vein, the government refined its policy on civil society participation aimed at making them more active and capable to effectively participate in national development and decision making processes. However, the 2009 Charities and Societies Proclamation tends to restrict the funding available to Civil Society Organizations and hence their ability to fully engage.

Although most of these policies have not been effective in achieving the expected results, they have however, engendered significant improvement in the fight against IFFs and thereby enhancing the country's ability to increase its DRM.

Lessons learnt from the case study

- The key lesson learnt from the case study is that it is not enough to initiate policy reforms and rules without sustained leadership commitment and availability of the requisite capacity to implement and enforce the provisions.

- It is also clear from the Ethiopian case study that it is essential to identify the driving forces and the key players involved in IFFs so as to be able to institute the appropriate checks.
- It is also evident that the availability of effective and resilient institutions coupled with highly skilled and well-motivated human resources is critically important to the fight against IFFs in Ethiopia.
- Last but not the least, fighting IFFs especially in Ethiopia will require a joint effort by all local and international stakeholders giving the international dimensions of IFFs.

Conclusions and recommendations

The potential benefits of domestic resource mobilization in helping African governments to mobilize adequate resources to finance their development strategies are enormous. It is therefore imperative for countries to develop capabilities including skills, system and processes that will improve tax collection, administration and utilization to fuel the continent's development. It is critically important for African governments to ensure that public resources are efficiently utilized to meet the needs of the people. They should put measures in place to stem out corruption and inappropriate practices that promote tax avoidance. There is also need to improve and modernize tax administration systems by computerizing the relevant processes to make it efficient and user-friendly as well as to motivate compliance. Out-dated tax policies should be reviewed to ensure that they are responsive to emerging tax collection and administration architecture and to plug the holes including illicit outflows. Furthermore, African governments need to create enabling and predictable policy environments, and increase incentives for effective mobilization of domestic revenues. Key decision makers within the development community must work in collaboration to ensure that the right capabilities including skills, competencies, tools and equipment are in place to support transparent and

accountable domestic resource mobilisation processes especially taxation.

Below are some key policy recommendations that can be leveraged to improve DRM in Africa especially through taxation:

- **Formulation and implementation of fit-for-purpose tax reforms:** tax reforms should be linked to the country's growth strategy and properly sequenced to ensure that they generate long term results that respond to the intended development results.
- **Improving tax collection and administration capabilities:** skills and competencies of tax authorities should be enhanced. The systems and processes should be improved and where relevant the processes should be computerised to improve the efficiency and user-friendliness. Tax administrators should be incentivised to mitigate corruption.
- **The tax base should be expanded** by motivating compliance and capturing more people and businesses into the tax net. Informality should be reduced and individuals, business owners and other stakeholders should be encouraged to register and pay their fair share of taxes. Tax preferences should be minimised and granted only sparingly and only in unique circumstances. Taxes should be fairer and concessions with multinational enterprises should be transparent.
- **Increase tax mix:** the balance between different taxes in the continent should be increased. Countries must ensure that there is a fair balance in the different taxes to avoid overdependence on only a narrow type of taxes that makes the country vulnerable to the changes in the global economic and trade dynamics such as trade liberalisation and the fall in the oil prices on the world market.
- Given the multidimensional nature of the factors that reduce the continent's ability to mobilise adequate revenues from domestic source, **there is need for all hands on desk to ensure that capacity challenges including loopholes are plugged** (AfDB 2010). In this regard, development partners should collaborate with African countries by supporting policy reforms, skills and systems development as well as support the fight against illicit financial flows such as transfer pricing abuses by multinational enterprises.
- **Efficient and effective use of tax resources:** greater attention should be focused on the expenditure side of revenues mobilisation to ensure effective and efficient use of the resources in line with the needs and expectations of the citizens. Governments must show the leadership and commitment to deal decisively with all corrupt acts that are made public and to lead by example by being prudent in its expenditures.
- **Facilitate convergence of the financial sector:** both the formal, semi-formal and the informal sectors should be linked to facilitate effective mobilisation of savings and to stimulate investment. The capital market should be developed and other forms of long-term financing made readily available and accessible to the citizenry.

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