Overview

Each year since 2011, the African Capacity Building Foundation (ACBF) has produced the *Africa Capacity Report* (ACR). The objectives of the ACR are to measure and examine capacity in relation to the development agenda in African countries by focusing on the key determinants and components of capacity for development. ACBF (2011) defines capacity as the individual, organizational, and societal ability to set goals for development and to achieve them.

As in previous ACRs, the first chapter is devoted primarily to Africa's capacity development landscape. It focuses on the Africa Capacity Indicators and the Africa Capacity Index (ACI). The ACI is a composite index calculated from four clusters covering the policy environment, implementation processes, development results, and capacity development outcomes. Results for this year indicate a good policy environment and good implementation processes for most African countries, although countries are not doing as well on development results. Notably, capacity development outcomes have deteriorated and remain the most pressing issue. Performance on the thematic indices is generally encouraging and particularly strong on gender equality and social inclusion.

This year's annual theme of key importance to Africa's development agenda focuses on the capacity development challenges in domestic resource mobilization. *ACR 2015* surveys the state of and trends in domestic resource mobilization and illicit financial flows across the continent, and it identifies capacity gaps and requirements for countries to mobilize more resources domestically and reduce illicit financial flows abroad.

A team of in-country data experts conducted a quantitative survey in 45 African countries through a questionnaire, complemented by a qualitative survey in 14 countries selected by the ACBF for case studies according to the following criteria: tax effort performance, size of the economy, linguistic line, and geographic coverage. Drawing on the findings of these country studies, *ACR 2015* provides key capacity building messages and policy recommendations.

The capacity dimensions of domestic resource mobilization are crucial today if African countries want to meet the ambitious Sustainable Development Goals and the goals of Agenda 2063. The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda (UN 2013) made it clear that domestic resource mobilization is a necessity and that a new global partnership is needed to fight illicit financial flows. Concerns have already been raised that the Third International Conference on Financing for Development—held in Addis Ababa, Ethiopia, on July 13–16, 2015—did not deliver much in additional financial resources for the Sustainable Development Goals, implying that most financing must come from domestic sources.

To the extent that aid and other flows from external sources will not be sufficient, domestic resource mobilization will be critical for achieving the Sustainable Development Goals and the African Union's vision of "An integrated, prosperous and peaceful Africa, driven by its own citizens and representing a dynamic force in the global arena" (AU 2014).

ACR 2015 complements the ACBF's capacity building initiatives on the continent. Since its inception, the ACBF has created think tanks and policy units to support the formulation and implementation of strategic national policies. The overall aim is to ensure economic prosperity, political stability, and social justice for all citizens, through efficient use of resources. The ACBF has also created training programs such as the Economic Policy Management Program to improve economic analysis, public administration, and research capabilities and to deepen the financial sector. In addition, the ACBF has worked with partners such the International Monetary Fund to support deepening of the banking and financial sector.

Highlights of the Africa Capacity Indicators 2015

Results are generally satisfactory. The ACI values range from 20.7 (Central African Republic; CAR) to 70.8 (Cabo Verde) (table 1).[1]

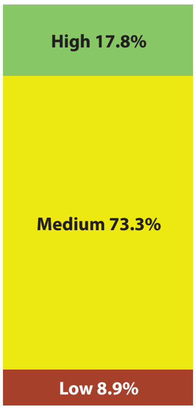
No countries are at the Very Low or Very High extremes of capacity. Eight countries are in the High bracket, and no countries are in the Very Low bracket (figure 1). More effort will be required for countries to move into the Very High bracket (ACI values of 80 and above).

Table 1 Africa Capacity Index 2015

Country	ACI 2015 value	Country	ACI 2015 value
1. Cabo Verde	70.8	24. Togo	52.0
2. Rwanda	67.9	25. Algeria	50.6
3. Tanzania	67.4	26. Democratic Republic of Congo (DRC)	50.1
4. Mauritius	66.4	26. Senegal	50.1
5. Gambia	64.6	28. Madagascar	50.0
6. Morocco	64.4	29. Ghana	49.9
7. Tunisia	60.7	30. Côte d'Ivoire	49.8
8. Mali	60.1	31. Djibouti	49.6
9. Malawi	58.5	32. South Sudan	49.2
10. Liberia	58.4	33. Guinea	48.8
11. Burkina Faso	57.3	34. Chad	48.3
11. Lesotho	57.3	35. Cameroon	47.0
13. Mozambique	57.0	36. Zimbabwe	46.7
14. Namibia	56.1	37. Nigeria	46.4
15. Ethiopia	55.0	38. Botswana	44.8
16. Sierra Leone	54.8	39. Gabon	43.4
17. Burundi	54.5	40. Comoros	41.9
18. Kenya	54.4	41. Congo (Rep. of)	40.4
19. Egypt	54.3	42. Swaziland	38.6
20. Zambia	53.8	43. Mauritania	36.1
21. Uganda	53.3	44. Guinea-Bissau	34.7
22. Benin	52.9	45. Central African Republic	20.7
23. Niger	52.6		

Source: Africa Capacity Indicators database 2015.

Figure 1 Africa Capacity Index 2015



Very High *(No countries)*

High *(8 countries)*
Cabo Verde, Gambia, Mali, Mauritius, Morocco, Rwanda, Tanzania, Tunisia

Medium *(33 countries)*
Algeria; Benin; Botswana; Burkina Faso; Burundi; Cameroon; Chad; Comoros; DRC; Congo, Rep. of; Côte d'Ivoire; Djibouti; Egypt; Ethiopia; Gabon; Ghana; Guinea; Kenya; Lesotho; Liberia; Madagascar; Malawi; Mozambique; Namibia; Niger; Nigeria; Senegal; Sierra Leone; South Sudan; Togo; Uganda; Zambia; Zimbabwe

Low *(4 countries)*
CAR, Guinea-Bissau, Mauritania, Swaziland

Very Low *(No countries)*

Source: Africa Capacity Indicators database 2015.

The bulk of countries have Medium capacity. Of the 45 countries surveyed, most (73.3 percent) fall within the Medium bracket, 17.8 percent are in the High bracket, and 8.9 percent are in the Low bracket.

Analysis by cluster indicates a pattern that has not changed significantly from year to year (table 2), an indication that countries are stagnating in those clusters. As in previous ACRs (2011–14), the policy environment cluster remains the strongest and capacity development outcomes, the weakest.

On the policy environment—underpinned by broad participation and good governance—most countries are ranked High or Very High. Even if excellent, these results are not as good as in 2014, when 91 percent of countries were in the Very High category. Processes for implementation are also impressive, with 87 percent of countries in the High or Very High brackets.

Only 6.7 percent of countries are ranked Very High on development results, while 13 percent are ranked Low or Very Low.

Table 2 Percentage of countries by Africa Capacity Index 2015 bracket and by cluster

Level	Policy environment	Processes for implementation	Development results at country level	Capacity development outcomes
Very High	80.0	37.8	6.7	—
High	17.8	48.9	44.4	—
Medium	2.2	13.3	35.6	8.9
Low	—	—	11.1	86.7
Very Low	—	—	2.2	4.4
Total	100	100	100	100

Source: Africa Capacity Indicators database 2015.

Capacity development outcomes are even worse: 91 percent of countries are in the Low or Very Low brackets.

Overall capacity scores improved from 49.9 in 2014 (ACBF 2014) to 52.0 in 2015. Only 8.9 percent of countries are now in the Low bracket, down from 13.6 percent in 2014. Countries with High capacity have seen an improvement in the average of their scores, and a higher percentage of countries are now in the Medium capacity bracket (ACBF 2014; figure 1).

Achievements on the four thematic indices (policy choices for capacity development, development cooperation effectiveness related to capacity development, gender equality and social inclusion, and partnering for capacity development) are encouraging overall. More than half the countries are in the High or Very High category on each of the four. The best performance by far is on the gender equality and social inclusion index, where all countries are at least in the Medium category.

More resources for capacity development initiatives are required so that countries can improve their capacity development outcomes, an area that remains very weak. The ACBF can thus make an important difference by funding and providing technical assistance for specific capacity building projects and programs to meet the needs of African member countries and nonstate actors.

Challenges in mobilizing domestic resources and curbing illicit financial flows

Discussions for the post-2015 agenda have set high expectations for domestic resource mobilization as a self-sustaining development finance strategy. A focus on domestic resource mobilization and illicit financial flows in the African context is required for several reasons. For a start, mobilizing domestic resources allows countries to reduce their dependency on foreign aid. Examples of successful cases of development in other low-income (developing) regions reveal that high domestic savings is necessary for high investment and growth. Further, an extensive literature documents the positive link between taxation and state building through creating a social contract between the state and citizens.

Domestic resource mobilization refers to generating savings and taxes from domestic resources—and allocating them to economically and socially productive activities—rather than using external sources of financing, such as foreign direct investment, loans, grants, or remittances. Even if domestic resource mobilization does not include remittances, the *ACR 2015* focuses on them as well; empirical and anecdotal evidence shows they can have a strong impact once they reach receiving countries. Illicit financial flows—resource flows that are "illegally earned, transferred or used" (AU and ECA 2015: 9)—are also discussed because they are a huge loss of domestic resources for Africa. According to the most recent data (for 2012), such flows from Africa were higher than remittance inflows ($82.5 billion versus $51.4 billion—chapter 2), and several countries are now losing large amounts to those flows relative to the tax revenues they collect.

The state of domestic resource mobilization and illicit financial flows in Africa

When compared with other developing regions—East Asia and Pacific, Latin America and the Caribbean, and South Asia—Sub-Saharan Africa has the lowest savings rate. And it has been trending downward (figure 2.3). Similar trends can be observed for investment and per capita growth rates, which to a large extent explain the persistence of absolute poverty in Sub-Saharan Africa. When North African countries are included in the mix, only Algeria has a very high savings rate. Overall, Africa's savings rate is lower than those of East Asia and Pacific and of South Asia.

The average tax-to-GDP ratio in Africa has crossed 20 percent of regional GDP in recent years, far higher than in South Asia but still lower than in Latin America and slightly lower than in East Asia (Bhushan, Samy, and Medu 2013). Tax revenues have surged in the last decade, from \$123.1 billion in 2002 to \$508.3 billion in 2013. But these numbers may not reflect the situation across the continent since the resource-rich countries skew the regional average and most African countries have tax-to-GDP ratios below the regional average. The increase in tax revenues has been driven by resource rents and by direct and indirect taxes; in countries such as Chad, Equatorial Guinea, and Nigeria, resource rents dominate the tax mix.

The increase in resource rents has caused a split between countries mobilizing high tax revenues thanks to natural resources and others making efforts but unable to mobilize revenues because of a shallow tax base. Results of a computed average tax effort index—the ratio of actual tax collection and taxable capacity—for 1996–2013 confirm this: 27 of 47 countries have low tax effort indices, and several of them are resource rich. Even if they had increased their tax revenues from direct and indirect taxes, it is quite possible that the availability of resource rents would still have distorted the incentive for more efforts. Further, the tax composition (in percentage terms) has continuously shifted from trade taxes because of trade liberalization. Tax performance metrics (such as the ratio of the budget of the tax authority and revenue collected by the authority) indicate that Africa has a very expensive and inefficient tax collection system.

Overall, several African countries have room for improvement—whether in savings and investment rates, tax-to-GDP ratios, the tax mix, tax effort, the disincentive effects of revenue from natural resources, tax performance indicators, or the nature and reach of financial systems. Too few countries are paying attention to the expenditure side—to whether taxation is leading to efficient service delivery. A credible fiscal pact between citizens and the state can work only if citizens can see their tax dollars being used effectively.

Remittances to Africa amounted to \$64 billion in 2014, or 14.8 percent of global inflows to developing countries (according to World Bank data). These are low set against other regions such as East Asia and Pacific (\$122 billion or 28.3 percent of global inflows) and South Asia (\$116 billion or 26.9 percent). Remittance inflows to Africa are now higher than official development assistance flows, even if not much higher than in other regions. However, more work needs to be done to ensure that remittances are not simply used for consumption; they should constitute investable resources with the potential to serve longer-term development needs (UNCTAD 2012a). Equally important is to ensure a competitive market for remittance flows to reduce the high transaction costs of money transfers.

But the most important challenge for most African countries is to curb illicit financial flows. Such flows stem from factors such as weak institutions and governance, lack of regulation and information, and external borrowing. The African continent lost \$60.3 billion to illicit financial flows on average over 2003–12 (calculated from Kar and Spanjers 2014), whereas average official development assistance for the period was $56 billion (OECD-DAC International Development Statistics online databases).

Strategies and initiatives for domestic resource mobilization

All 14 countries in the cases examined by the ACBF have, in one way or another, implemented policies to mobilize more resources domestically, especially since the Monterrey Consensus in 2002. Many countries have put in place initiatives to optimize tax revenues and reduce inefficiencies such as tax exemptions. To deal with illicit financial flows, measures have been introduced, for example, to prohibit the use of transfer pricing to evade taxes and to train staff to conduct forensic audits. Several African governments have liberalized their financial sectors and focused on product innovation and financial inclusion.[2]

Some examples of strategies and initiatives for domestic resource mobilization include integrating revenue collection agencies in one coherent institution; introducing a value-added tax (as in Ghana and Togo); optimizing revenue collection from the mining sector; introducing presumptive taxes on informal activities by using indirect methods (as in Zambia); introducing a housing savings scheme and issuing diaspora bonds (as Ethiopia); and adopting mobile banking (as with M-PESA in Kenya).

Challenges

- Several parts of the African Union's Agenda 2063 refer to Africa's need both to become self-reliant and finance its own development and to recognize the importance of accountable states and institutions at all levels. In its call to action, Agenda 2063 explicitly mentions strengthening domestic resource mobilization, building continental capital markets and financial institutions, and reversing illicit financial flows from the continent. However, the financing of Agenda 2063 has hardly been examined, even though it is known that more resources must be mobilized domestically to reduce external dependence and that in some countries the sources of revenue must be diversified. (Much of the same could be said about the post-2015 agenda and the recently concluded Financing for Development Conference.) The question remains: Who will finance the Sustainable Development Goals and how?

- To the extent that the bulk of financing will come from domestic sources, African countries must without doubt enhance domestic resource mobilization and curtail illicit financial flows. A raft of factors related to capacity building (human, technical, legal, regulatory, and financial) still prevent African countries from mobilizing more resources domestically and from fighting illicit flows.

- On the tax side, investing in the capacity of revenue authorities must be part of a broader fiscal reform agenda that includes simplifying and rationalizing tax systems (for example, reducing tax exemptions and dealing with corruption within tax administrations). The computed tax effort indices for African countries show that several countries, including resource-rich ones, are not making enough effort to collect taxes.

- More and better trained staff must be hired by the revenue authorities and retained with the right financial incentives, and they must be allowed to do their work without political interference. More needs to be done to build the capacity of revenue authorities to engage with taxpayers and foster a culture where taxation is seen as contributing to essential services. This means that governments need to be transparent and efficient on expenditures.

- Donors are potentially important in building tax capacity and enhancing domestic resource mobilization—including training staff, investing in infrastructure, and helping set up tax registries—but they allocate only a very small share of aid to these areas.

- The problem of illicit financial flows requires international cooperation and a global solution, but many African countries simply lack the capacity to deal with them. None of the countries surveyed showed evidence of successfully combating such flows. Substantial effort and political will are still required at the domestic level.

Key takeaways

- The African continent has made much progress in increasing tax revenues, but a number of countries lag behind. Compared with other regions of the world, tax collection systems in Africa remain expensive and inefficient. Several countries need to hire more and better trained staff members, who must be retained through financial and non-financial career-advancement incentives.

- The expenditure side is as important as the revenue side, if not more so. That is, citizens must be aware of what services they are getting in return for their tax contributions, and this means that governments must be transparent about program expenditures and must invest in awareness and education campaigns on taxation.

- Diverted public funds and wasteful government spending are serious problems in many African countries (ACBF 2013a, Ayee 2011), reflecting poor governance, public administration, and institutions, with major imperatives for building capacity to mobilize domestic resources.

- Far more effort and political will are required to address illicit financial flows. This again entails hiring better trained staff with specialized skills and ensuring the cooperation of the local, regional, and international organizations responsible for tackling such flows.

- Building capacity for domestic resource mobilization is not merely about increasing tax revenue or savings. It also encompasses promoting good democratic governance, financial inclusiveness, and social justice—and creating the conditions and incentives for productive investments. The type of tax systems and funds for administrative procedures and the choice of financial models must be adapted to the characteristics of African economies and their production structures. The time is now ripe for African countries to go beyond traditional domestic resource mobilization—which is about increasing revenues and (public and private) savings—and to emphasize broad-based resource mobilization, in a holistic, transformational approach that considers national systems of innovation, imitative learning, and special harnessing of human capital.

- More investments are required in financial inclusion and product innovation, and human resources must be mobilized for the innovations needed for broad-based domestic resource mobilization.

- It is necessary to build institutional and human capacity for scaling up domestic resource mobilization. The capacity of institutions in the resource mobilization chain must be reinforced. And rules and regulations must be in place to ensure sound public financial management so that domestic resources promote inclusive and sustainable development.

- It is important to enact legal system reforms aimed at law reform, especially where the laws are inadequate or poorly functioning. Countries need to undertake reforms in the areas of taxation, banking, and capital markets. They need to maintain flexible yet effective laws and regulations to access nontraditional sources of finance and curb illicit financial flows. And they need to further develop tax reforms that will ensure tax harmonization and a move away from tax exemptions, concessions, and holidays.

- Along with the required rules, regulations, and human capacities must be the capacity of key continental, regional, and national institutions to improve domestic resource mobilization. These include the African Union Commission and its organs (especially those that deal with legal, audit, tax, and parliament related issues). They also include such specialized institutions as the ACBF, the African Development Bank, the African Tax Administration Forum, the Collaborative Africa Budget Reform Initiative, and the UN Economic Commission for Africa. And they include regional economic communities, especially the African Union–recognized groups that will play a great role at the regional level in the domestic resource mobilization chain. At the core, however, are national tax administration and revenue authorities.

- There is a need to foster visionary leadership, to change mindsets, and to address other soft capacities. A key element for successful domestic resource mobilization starts with effective, visionary, committed, and accountable leadership that sets the right tone at the top. Positive social norms, values, and practices conducive to domestic resource mobilization are needed, but the ability and willingness to learn from experience is equally important.

Organization of *Africa Capacity Report 2015*

ACR 2015 is structured as follows. The first chapter describes the Africa Capacity Indicators and discusses the results from the Africa Capacity Index 2015 by highlighting the performance of countries across clusters and thematic areas. Chapter 2 examines the state of domestic resource mobilization and illicit financial flows in Africa, with a particular focus on their capacity dimensions. Chapter 3 discusses capacity building strategies and initiatives on domestic resource mobilization. Chapter 4 draws on lessons and stories emerging from the country case studies (successful and less successful) to identify efforts and achievements in building capacity for domestic resource mobilization and curbing illicit financial flows. Chapter 5 identifies lessons learned and capacity development imperatives for effective domestic resource mobilization through various players—civil society, government, the private sector, and cooperating partners. Chapter 6 concludes with a brief summary and highlights policy recommendations.