



German Federal Ministry of Finance

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Report on Good Financial Governance in Africa

At their meeting in Potsdam in May 2007 G8 Finance Ministers agreed on the **Action Plan for Good Financial Governance in Africa**. The Action Plan outlines ten areas, drawing on the principles of the Paris Declaration on Aid Effectiveness and on ongoing initiatives to support reforms of public financial systems in Africa. These include: the promotion of effective and transparent budget processes at all levels of government, stronger engagement of civil society, a vigorous implementation of existing governance initiatives such as Extractive Industries Transparency Initiative (EITI), and an enhancement of reforms and capacity building efforts in the area of African tax systems, budgetary control, fiscal decentralisation, and debt management.

As stressed by the New Partnership for Africa's Development (NePAD) program, responsibility for good financial governance lies primarily with African countries. Regional initiatives to promote mutual support and learning should be encouraged. In addition, there are, actions that donors can take to support African authorities that demonstrate strong commitment and political resolve to reforming their public financial systems. Therefore, all G8 countries committed themselves in Potsdam to strongly supporting efforts to increase the effectiveness, transparency, and efficiency of public financial management in Africa. Moreover, the IMF, the World Bank and the African Development Bank were asked to do likewise and to engage actively in implementing the Action Plan.

Considerable efforts and resources have been invested by African countries and development partners in strengthening financial governance. In particular, an assessment of the key elements of the work programs of the international financial institutions (IFIs) reveals that the promotion of good financial governance is already a central element of their relationships with African countries. Nevertheless, the momentum on the part of African countries needs to continue, be stepped-up, and be supported by the G8 to secure significant progress in the area of good financial governance.

The following reflects reports to the G-8 by the IMF, the World Bank, and the African Development Bank on their efforts to implement the action plan.

1. International Monetary Fund

The Fund promotes good financial governance through policy advice, technical assistance, and collaboration with other multilateral organizations (in particular the World Bank) and bilateral donors. The Fund participates actively in the Strategic Partnership for Africa (SPA) forum, the Collaborative Africa Budget Reform Initiative (CABRI) and supports the implementation of the Paris Declaration on Aid Effectiveness. Reflecting the central importance of **public financial management (PFM)** reforms in Africa, the Fund has been working with governments and other donors to develop time-bound action plans based on diagnostics assessments, including the Public Expenditure and Financial Accountability (PEFA) assessments to diagnose weaknesses in existing systems. In addition to technical assistance missions on PFM, other technical assistance activities are ongoing including by the regional technical assistance centers in Africa (AFRITACs).

The Fund and World Bank have launched an initiative to strengthen their collaboration in **support of PFM reforms and natural resource management** in a group of pilot countries. The purpose of the initiative is twofold: (i) to achieve better outcomes by drawing lessons about what makes for more effective support of the authorities' goals; and (ii) to bring greater coherence and coordination between the Bank and Fund (and with other donors) in providing such support. A stocktaking of the pilots is planned in spring 2008. The initiative seeks to build on the authorities' existing strategies, objectives, and modes of engagement with the Bank and Fund. The authorities' ownership and ambition will determine the content of the pilots in each country, including the extent to which current plans are extended.

The Fund's fiscal transparency code is the basis for its work in **promoting accountability and transparency** in government operations. This includes the production of the fiscal Reports on the Observance of Standards and Codes (ROSC). The natural resource revenue component of fiscal transparency work is relatively recent, but is quickly gaining credit in the work of the Fund. The IMF supports the **EITI**, and assists with the organization of the EITI and in-country implementation. The Fund encourages members with considerable extractive industry revenues to sign up, and by now most African extractive industries countries have done so. The Fund's approach to fiscal transparency is broader than that of EITI, and involves monitoring natural resource management, publication of information, and government audits and revenue collection.

The **Debt Sustainability Framework (DSF)** for low-income countries developed jointly by the World Bank and Fund is now systematically used in Bank-Fund country work. The Fund and Bank are stepping up their outreach to major creditor groups, including multilateral development banks, traditional bilateral creditors, export credit agencies, and emerging creditors. However, more work needs to be done to step up outreach to commercial creditors, particularly as countries are increasingly gaining access to private sector financing. In addition, more work is needed to help countries develop medium-term debt strategies,

strengthen their debt management capacities, and develop domestic public debt markets. The Fund together with the World Bank is closely coordinating on issues relating to debt management and debt market development, including in the development of joint work programs. This initiative will also contribute to the **development of local bond markets**. The goal is to ensure that debt strategies are properly designed, sequenced, and implemented to provide the market with a choice of public debt instruments, and support other primary and secondary market-related initiatives needed for well functioning local bond markets. Moreover, the Fund and the Bank are continuing to use the Financial Sector Assessment Program as a platform for diagnosing development and technical assistance needs in financial markets.

The Fund is actively engaged in **assisting fragile states** through: policy advice on fiscal, monetary, exchange rate, and financial issues; identification of gaps in the related institutional and legal frameworks; and technical cooperation to follow up on this advice. Capacity building in the areas of the Fund's mandate, including in public financial governance, is thus given particular emphasis, with the Fund providing substantial technical assistance to these countries. The Fund also regularly plays a coordinating role in technical assistance in its core areas. In **post-conflict countries**, where institutional capacity is normally damaged or even absent, the focus of technical assistance usually includes the strengthening of revenue administration, the restoration or establishment of sound public expenditure management systems, and the revival of the financial system.

2. World Bank

Good financial governance is a key component both of the Bank's Governance and Anti-Corruption strategy and of the Africa Action Plan (AAP). This involves expanding the fiscal space for developing countries by increasing public revenue, creating a transparent budget system, establishing transparent expenditure mechanisms and appropriate implementation structures as a requisite for more harmonized provision of donor funds.

The Bank provides measures for **capacity development** through the Management Action Plan (CDMAP) that covers 20 actions focused on five goals and outcomes: (i) more reliable and accountable public financial management systems, (ii) improved capacity for effective delivery of public services, (iii) better skills, (iv) capacity to deliver essential services in post-conflict countries, and (v) improved capacity for management and monitoring for results. Lending operations to **strengthen tax systems** take various forms: tax administration reform projects to support private sector development or public finance management. There is a collaboration with the OECD on capacity building for tax authorities. Within the International Tax Dialogue (ITD) the World Bank emphasis lies on assisting African countries with weak revenue institutional capacity, by disseminating best practice on tax revenue mobilization.

The assistance to participative public financial management diagnostics that support government-led improvements in budget policy and management is a key feature of the Bank's work in Africa. Over a third of Bank credits to African governments include support to PFM reform, reflecting the importance of this issue for development impact. The Bank actively supports regional bodies and peer-led initiatives for capacity building in budget management, accounting and audit (e.g. CABRI).

Improvement of the effectiveness of public audit and **capacity building of Supreme Audit Institutions** is a core element of the Bank's support for PFM improvements. The Bank has provided financial and technical assistance to support capacity development and performance enhancement of Supreme Audit Institutions in several countries through investment projects and Institutional Development Fund (IDF) grants. The **StAR Initiative** being launched jointly by the UN Office on Drugs and Crime (UNODC) and the Bank Group intends to assist developing countries recover stolen assets and globally advocate for ratification, implementation and the monitoring of the United Nations Convention Against Corruption (UNCAC).

The World Bank actively supports country **implementation of the EITI** in the context of the Africa Action Plan to help resource-rich countries to adopt EITI and help governments to make related improvements in areas such as fiscal discipline and strengthened PFM systems. Challenges ahead include (i) in countries at initial stages of EITI, practical measures to help launch EITI (ii) ensuring sustained commitment by governments to the EITI process once launched; (iii) for countries further ahead in their application of EITI, building on EITI to embed EITI into national systems and begin to address the next tier of extractive sector governance issues.

The **Debt Sustainability Framework** is now the central tool for creditor coordination in addition to IDA's own grant allocations. Virtually all article IV documents concerning IDA-only countries now include a joint IMF/ World Bank debt sustainability analysis. Moreover, Bank and Fund staffs are pursuing outreach to official creditors. The G20 would be a key forum for going forward in the dialogue with emerging lenders. Bank and Fund staffs have also held discussions with the Export Credit Group of the OECD. Ultimately the key to debt sustainability is stronger debt management by borrowers – new Bank initiatives of technical assistance are necessary and will need G8 support. IDA's Debt Reduction Facility (DRF) is one of the most efficient ways to help HIPC countries to get debt relief from their private creditors. It also limits the scope for profiteering from debt relief by taking HIPC debt out of the secondary market, where it can be targeted by **litigating creditors**.

Support to **decentralization** and local government capacity building is a key component of the Bank's Capacity Development Management Action Plan under the umbrella of the AAP (accountability in the use of local government resources; intergovernmental transfer systems;

capacity of local authorities; participatory and transparent planning, budgeting, and monitoring systems, service delivery) and the development policy lending.

The Bank is actively encouraging the use of fiduciary diagnostics, including the **Public Expenditure and Financial Accountability (PEFA) indicators**. The Bank and PEFA Partners are heavily engaged in quality assurance for the PEFA reports. An extensive training program is underway on the PEFA Approach and assessment methodology. Assuring the understanding and skills of assessors is the first line of quality assurance. The Bank supports the Africa-wide ANSA (Affiliated Network for Social Accountability), to implement initiatives to **strengthen demand side voice** and **improve social accountability**. The Bank actively collaborates with AfDB and NEPAD to support initiatives to strengthen capacity for good governance and with donors to coordinate country-specific support for reforms.

Regarding **fragile states** the Bank approved a series of fundamental reforms to improve the speed of response and capacity to provide experienced staff to the field to work in these countries. These reforms include a specific work program to develop good practice in public finance management in fragile states, the ability to extend their public financial management work across the whole of government, including at the request of national authorities, political governance and security sector institutions, and mechanisms to rapidly deploy capacity-building assistance for economic governance and public financial management in fragile transition situations. Moreover, the Bank has established a working group with other MDBs, to report at the time of the 2007 Bank-Fund Annual Meetings, to strengthen and harmonise MDB collaboration in support of fragile states.

The Bank supports countries and sub-regional bodies in **developing local bond markets** and is working on a proposal of a bond market study within the region which will take stock of current bond markets and propose a prioritized list of intervention.

3. African Development Bank

Support to good financial governance in Africa is already an important feature of the Bank's lending and non-lending operations. The Bank provides support to regional members to implement economic and financial reforms through policy based operations as well as through institutional support projects. Budget support is primarily used to strengthen financial governance and budgetary systems, in particular **government auditing and public procurement**. Similarly, Bank's ongoing institutional projects are also significantly concentrated on public financial management issues, in particular, planning and budgetary systems, internal financial control, external auditing and public procurement.

The African Development Bank is working to strengthen its promotion of good governance including through its consideration of its Enhanced Engagement in Fragile States and its Governance Strategic Directions.

The Bank is also committed to increasing **transparency and accountability in the management of extractive industries resources**. The Bank follows a two-pronged approach to its engagement in the **EITI**: advocacy to create the political will among resource rich regional members that have not endorsed the initiative; and technical and financial assistance to regional members that have demonstrated political will by endorsing the EITI, but lack implementation capacity. In early 2007, a task force on bank engagement in the extractive industries sector was established. Based on the work of this task force the Bank will develop a full-fledged strategy to support regional members to increase transparency and accountability in extractive industries revenues.