African Financial Governance Outlook

EFFECTIVE PUBLIC FINANCIAL MANAGEMENT FOR SUSTAINABLE DEVELOPMENT

February 2018

AFRICAN DEVELOPMENT BANK GROUP

THE AFRICAN CAPACITY BUILDING FOUNDATION | FONDATION POUR LE RENFORCEMENT DES CAPACITES EN AFRIQUE

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FOREWORD

This first *African Financial Governance Outlook* provides a better understanding of the state of public financial governance reforms in Africa and how policies and institutional arrangements could be improved over time, offering benefits on various levels. It serves to enrich our understanding of public financial management (PFM) and the contributions to good financial governance with the aims of reducing poverty and delivering sustainable and inclusive economic growth as long-term goals of public policy.

The outlook shows that centers of power have a decisive impact on PFM performance and the viability of reforms. These centers of power are often linked to the dominant political forces.

Understanding which specific elements of the ruling party and government are interested in PFM issues is a prerequisite for changing a country's finances. In several cases, the dominant political party and government have embarked on a significant program of PFM reform, which has had a clearly visible impact as can be seen by the positive trends in financial governance revealed by trend data. Influence is exerted through both formal and informal channels, which should be part of the strategy for any intervention to further PFM reforms, to clearly identify the centers of power and where they are located. The aim is to enlist their support, which is crucial for enacting further reforms in financial governance. Working with stakeholders who occupy these positions and enlisting their support for PFM reform is one key to success.

Greater reform efforts need to be directed to make good financial governance a long-term sustainable phenomenon. The challenge is to devise strategies to implement reform without alienating or provoking resistance from the centers of power that might undermine any such attempt at reform. The paradox is this: in the short run, working with the centers of power is important for ensuring political and institutional support for PFM reforms, but in the long run countervailing checks on these power centers need to ensure that good financial governance is built into the financial architecture and not dependent on changing political fortunes.

Establishing successful accountability mechanisms within PFM systems requires not only having external oversight and regulatory institutions but also internal mechanisms and procedures within PFM systems and within ministries, departments, and government institutions. Both are essential to ensure the accountability, transparency, and monitoring of financial activities by enabling effective control and maintaining a check on the potential for any misuse of funds or misapplication of administrative procedures. All parts of the PFM system must function effectively and efficiently—from formulation and planning, through to implementation and practice and oversight and monitoring/accounting elements to ensure a high level of good financial governance.

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PREFACE

This *African Financial Governance Outlook* (AFGO), "Effective Public Financial Management for Sustainable Development," is a new flagship report to enrich understanding of public financial management and its contribution to good governance, with the ultimate aim of reducing poverty and delivering sustainable and inclusive economic growth. It complements quantitative indicators with qualitative analysis to show trends over time and to explain the drivers of change in financial governance across AFGO pilot countries.

Covered in this outlook are 10 African countries that have participated in the African Peer Review Mechanism—Burkina Faso, Ethiopia, Ghana, Kenya, Mali, Mozambique, Rwanda, Senegal, Tanzania, and Uganda. The countries were drawn from the different regions and represent different political and administrative traditions (Anglophone, Francophone, and Lusophone) to ensure a wide range of countries. They were analyzed using a financial governance matrix that combined five financial governance arenas of Budget Governance, Revenue Governance, Internal Controls, Public Procurement, and External Audit as well as five political governance variables of Inclusiveness, Openness, Rule Compliance, Oversight, and Capability. The quantitative results in chapter 3 show a wide variety of performances for different countries in different arenas and indicators.

To explain this performance and to go beyond surface explanations, a comprehensive political economy analysis using stakeholder mapping to determine the influential actors and their role in the financial architecture was applied in chapter 1. This was supplemented by a further level of analysis that categorized stakeholders as change Facilitators or Dissenters according to their financial governance arena. The stakeholder mapping gave insights into who the major relevant stakeholders are and the reasons for their influence and interest. And categorizing them into change Facilitators and Dissenters enabled understanding where in the financial architecture they operated and whether their influence was positive or negative for good financial governance.

Also to be considered is the future direction of research for the Outlook and its expansion. A pilot exercise tested and applied the new Outlook methodology to country case studies and evaluated the results. The basic structure of the methodology has been found to be robust and to yield key insights about PFM for African countries. But it is possible to build on this model and improve its scope and depth. More detailed and more recent data will greatly improve the quantitative analysis, which already is very strong and pools almost all the primary survey data on PFM in the region. Further refining and improving the model will sharpen the quantitative analysis and provide more detailed results.

To provide a really holistic picture of financial governance and PFM issues facing African states, it will be necessary to expand AFGO coverage to include more African countries, including the larger economies, which have a significant impact on the continent's growth and development prospects. Periodic updates of the reports for countries already covered will keep the picture current.

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ACKNOWLEDGEMENTS

The African Financial Governance Outlook (AFGO) was prepared by the African Capacity Building Foundation (ACBF) with financial support from the African Development Bank (AfDB) under the overall guidance of the office of the Executive Secretary (ACBF).

The preparation of the report benefited from the tutelage of the ACBF team led by Thomas Munthali, Director for Knowledge and Learning Department (K&L), assisted by Robert Nantchouang, Senior Knowledge Management Expert (K&L). Other key ACBF staff included Coffi Noumon, Roger Atindehou, and Dickson Antwi. The drafting of the report was substantially supported by the team from Governance and Management Services International (GMSI), led by Victor Ayeni, assisted by Conrad Barwa and Joseph Ayee, with data support from Gemma Ahaibwe.

The work on the country case studies benefited from contributions from local consultants in the selected ten AFGO pilot countries, namely: Guèda Jacques Ouedraogo and Mathurin Kone (Burkina Faso); Abdu Muhammed Ali, Asnake Kefale, Kassahun Berhanu, and Wollela Abehodie Yesegat (Ethiopia); Kwame A. Ninsin and Robert Darko Osei (Ghana); Michael Chege and Stephen Wainaina Chege (Kenya); Seydou Sogodogo, Marimpa Samoura and Youssoufou Sega Konate (Mali); Thomas Selemane (Mozambique); Alioune Badara Diop and Abdou Aziz Kebe (Senegal); Lonzen Rugira and Charles Gasana (Rwanda); Mohammed Ali Bakari and Ammon Mbelle (Tanzania); Fred K. Muhumuza, Bernadette N. Kizito and Julius Kiiza (Uganda)

The team wishes to thank the Governments of the ten AFGO pilot countries for the support provided in the completion of the country case studies, with special thanks to Albert Kan Dapaah (Ghana); Boubacar Macalou (Mali); Sebastiao Carlos Dimene (Mozambique); Richard Tweneboah Kodua (Ghana); Mamadou Niang (Senegal) for their active participation in the validation workshop of the final draft report.

We acknowledge the contribution and review of the AfDB team comprising of Bernadette Kamgnia, John C. Anyanwu, Jacob Mukete, Issa Faye, Abdoulaye Coulibaly, Floribert Ngaruko, Evelynne Change, Kalayu Gebre-selassie, Wilfrid Abiola, Patricia Laverley, Baboucarr Koma, Nkoanyane Sebutsoe and Jacqueline Odula.

We are thankful to far too many people to name all of them here. For editing the report, Bruce Ross-Larson led a team at Communications Development Incorporated in Washington, DC, including Jonathan Aspin, Joe Caponio, and John Wagley

ABBREVIATIONS

ACBF	African Capacity Building Foundation
AfDB	African Development Bank
AFGO	African Financial Governance Outlook
APRM	African Peer Review Mechanism
CSO	Civil society organization
DAC	Development Assistance Committee
EPRDF	Ethiopian People's Revolutionary Democratic Front
GI	Global Integrity
GIR	Global Integrity Report
HoPR	House of People's Representatives
ICT	Information and communications technology
IIAG	Ibrahim Index of African Governance
IMF	International Monetary Fund
KRA	Kenyan Revenue Authority
MDA	Municipal and District Assemblies
MFPED	Ministry of Finance, Planning and Economic Development
MINECOFIN	Ministry of Finance and Economic Planning
MoFEC	Ministry of Finance and Economic Cooperation
MTEF	Medium-term expenditure framework
OAG	Office of the Auditor-General
OBI	Open Budget Index
OECD	Organisation for Economic Co-operation and Development
PAC	Public accounts committee
PEFA	Public expenditure and financial accountability
PETS	Public expenditure tracking survey
PFM	Public financial management
PFMA	Public financial management act
SAI	Supreme audit institution
UNCAC	United Nations Convention against Corruption
UNECA	United Nations Economic Commission for Africa
VAT	Value-added tax
WEF	World Economic Forum

OVERVIEW

Good governance is important for Africa's equitable and sustainable development. It is critical for sustainable economic growth (high per capita income), and for high foreign direct investment. The evidence also confirms the causal link between good governance and the decline in absolute poverty, infant mortality, and illiteracy; the move toward gender equality; and the increased access to clean water and other Sustainable Development Goals.

The Policy on Good Governance of the African Development Bank (AfDB) defines governance as “a process referring to the manner in which power is exercised in the management of the affairs of a nation, and its relations with other nations.” It identifies the key elements of good governance as: ensuring accountability, transparency, and participation; combating corruption; and promoting an enabling legal and judicial framework.

The Outlook treats financial governance as a fiduciary relationship between states and citizens in how public resources are managed. This relationship is critical in Africa as countries try to transform from discretionary to rule-based and transparent public financial systems. This transition depends heavily on the quality of public institutions, the capabilities of the state, and the fiscal foundations of state–society relations.

Public financial management (PFM) is defined here as “the effective management of public resources to meet the long-term goals of sustainable economic growth and poverty reduction (within the African context). It carries out this objective in a transparent, accountable, and participatory manner within a clearly defined legal and procedural framework that minimizes corruption and maximizes impact.”

Some conflicts in Africa are grounded in mismanaged public resources, undermining service delivery, with some citizens failing to access their benefits, fueling discontent. This is all the more reason why the future use of revenues from natural resources, and the use of local content have attracted the attention of Africa's natural resource countries. These are intrinsically PFM strategies.

Even in peaceful countries, Africa lacks local and national capacity in PFM, despite capacity interventions by bilateral and multilateral organizations, and this lack has retarded effective PFM.

Why Africa needs the *African Financial Governance Outlook*

The Outlook is designed to add value rather than duplicate existing African governance assessment tools. It provides a coherent qualitative and contextual explanation of how and why individual countries perform as they do in financial governance. It examines interest group dynamics and identifies drivers of, and obstacles to, change by analyzing stakeholders' incentives and institutional constraints. It brings added value to the Bank's operations through assessment of country financial governance assessment at country level to inform country policy and institutional assessment (CPIA) and Bank's interventions in Regional Member Countries (RMCs), and bring knowledge and ideas to international governance platforms. It establishes broad and balanced ownership between the AfDB and the African Capacity Building Foundation and its national and regional development partners (Box O.1).

Box 0.1
The Outlook's mission and strategic objective

The Outlook's mission is to contribute to the overarching goal of poverty reduction and sustainable development in Africa. Its strategic objective is to increase accountability and transparency—when governments and civil services administer and manage public financial resources in Africa—by:

- Providing a platform for a better understanding of the processes of public financial policies and practices, helping to set the region's governance agenda.
- Integrating information from multiple sources in a coherent framework, using analytical tools.
- Developing analytical space for evidence-based policy dialogue.
- Sharing best practices on institutional reforms.
- Advising stakeholders of AfDB's policies and its country and sector strategies and operations.

The intention is to shed light on the underlying issues and factors that shape PFM outcomes in African countries by using a political economy approach, one that drills down to reveal underlying political and economic factors, that explains PFM performance and outcomes, and that shows what works—and what doesn't for financial governance. The aim is to yield a deeper and more comprehensive understanding for policymakers on how to deal with PFM reforms for better financial governance.

The value added of the Outlook's research stems from the analytical effort to understand the political economy dimensions of the state of public financial governance reforms in Africa and how such policies and institutional arrangements could be improved. The Outlook offers benefits on several levels:

- It enriches our understanding of PFM and the contribution to good financial governance, with the aim of reducing poverty and delivering sustainable and inclusive economic growth as long-term goals of public policy.
- It complements quantitative indicators with qualitative analysis to show trends over time and to explain the drivers of change in financial governance across 10 countries.
- It promotes evidence-based policy dialogue for policymakers on the trajectory of change, on reform constraints, and on feasible reform options among countries.
- It informs country strategies and programming for financial governance to strengthen operational effectiveness.
- It provides an informed African voice, building on data and analysis from external agencies and on in-depth qualitative field research from specialists in political economy and public finance.
- It seeks to go beyond conventional policy prescriptions in recommending ways to build capacity for improving PFM and to deliver good financial governance. Indeed, it looks at how the architecture of influence in finance can be changed, and the stakeholders and drivers of change mobilized to ensure positive outcomes. This involves examining the structural, political, and economic factors that need to change for progress in good financial governance in African countries.

The main findings

- **Progress in African financial governance.** Over the last 20 years, interventions by national governments and external institutions have boosted country performance, whether at a single point in time (snapshot) or over multiple points (trends). Areas of gain include building regulatory institutions, creating greater transparency for budgetary and revenue expenditure, recognizing the need for greater accessibility of information and public participation, and using modernized accounting and record-keeping systems. Much room for improvement remains, however.
- **More public participation needed.** Where the budgetary and revenue processes include civil society organizations, ordinary citizens, and other key actors in the private sector, these external agents help formulate policy, provide feedback, and take part in the general process of governance, with a positive impact. Not only does this engagement strengthen the fiduciary relationship between citizens and the state—the heart of good financial governance—but it also improves the effectiveness of state policy, increases compliance, and enables the government to reach its PFM targets. Exclusion leads to resentment, less understanding of governmental aims and priorities, and a reluctance by citizens to fully engage in financial governance. In turn, this affects compliance and the state's ability to collect revenue and carry out its expenditure programs.
- **Need for internal accountability mechanisms in PFM systems.** Internal as well as external oversight and regulatory institutions are vital. PFM systems and ministries, departments, and other government spending and collection bodies need such internal mechanisms and procedures to ensure accountability, transparency, and the monitoring of financial activities to check misuse of funds or administrative procedures leading to rent-seeking. These mechanisms and procedures are the first line of defense protecting PFM systems.
- **Independence of key regulatory institutions.** Independence of institutions responsible for monitoring, overseeing, and enforcing rules is critical to good financial governance. Where these institutions—including audit authorities, finance inspectorates, tax and revenue authorities, and procurement agencies—are protected from political interference and can carry out their duties unimpeded, the beneficial impact on financial governance is notable. Where their independence is curtailed, overtly or covertly, the regulatory system is weakened and malpractices and rent-seeking proliferate. Ensuring the robust independence and strength of these regulatory institutions is a major work in progress in Africa.
- **Preponderance of the executive.** The executive is usually dominant in administering and managing PFM systems. This can be positive, when the ruling party or group in power shows a strong commitment to improving financial governance, like Ethiopia and Rwanda. But in the longer term, an overweening executive is damag-

ing, since entropy is a characteristic of all political regimes, and those that remain in power for a long time are vulnerable to such degradation. It also means that the success or failure of PFM reforms depends heavily on the orientation of the leading group in the executive, and this can change with the political wind. Addressing this ultimately dangerous weight of the executive is crucial to ensure long-term success.

- **Importance of legislative oversight.** It is crucial that the legislature holds the executive to account over the budget and uses bodies such as public accounts committees to monitor government spending and taxation and to bring government malfeasance to light, dealing with it appropriately. The legislature remains a check on the financial power of the executive.
- **Greater transparency required in government procedures.** PFM is complex and requires specialization and access to information about government administration. Improving public awareness about the procedures, and making public financial information on government spending and taxation easily and widely available, will improve the public's ability to participate in financial decisionmaking and engender transparency. This will help reduce corruption and increase citizen confidence in PFM public institutions.

The main recommendations

- **The need for coordinated capacity building in PFM is critical for African countries.** Capacity development is not a standalone training intervention but is instead a strategically coordinated set of activities. It is much more than improving the abilities and skills of individuals but ensuring their retention and utilization on the continent as well as improving the institutional environments in which they work. For Africa's capacity development efforts in PFM to be sustainable and contribute to sustainable development, PFM must be owned and managed by African countries as well as African institutions with the experience and knowledge of the African PFM landscape—not just by development partners, who should play only a supporting role.
- **Identify the key centers of power.** These are often stakeholders who operate behind the scenes and are not part of the formal process of financial governance. Yet they have a crucial impact on determining policy, allocating resources, and ensuring bureaucratic compliance with government policies. Identifying stakeholders and enlisting their support is essential for improving financial governance and PFM outcomes.
- **Strengthen countervailing institutions to deal with an overmighty executive.** Legislatures and regulatory institutions are vital to ensure that PFM reforms are long-lasting. Building up the strength of counterbalancing and independent institutions, as well as alternative centers of power, can ensure more sustainable commitment.
- **Enhance the effectiveness of all parts of the PFM system.** All parts of the PFM system and financial architecture must mesh well, from formulation and planning, through to implementation and practice and oversight, monitoring, and accounting. A comprehensive approach that addresses all aspects and parts of PFM systems is critical to ensuring good financial governance that can be sustained.
- **Design country-specific interventions.** The political and economic conditions for each country vary, as do the structure of their financial architecture and the priorities of their stakeholders. To ensure that PFM reforms receive enough political and administrative support, interventions must be tailored by country, to meet or face down the demands of reform facilitators and dissenters.
- **Deal with the challenge of data and statistical records for the future of PFM and the Outlook project.** The country reports revealed a worrying lack of data because of poor data sources or because countries were undergoing conflict or instability. For some financial governance dimensions, such as public procurement, difficulties in having regular surveys to provide up-to-date data were also significant. While several stop-gap measures were used for this pilot flagship report, a more rounded strategy will have to resolve this issue in later editions of the Outlook.
- **Devote greater resources to capacity development, grounded in a coherent plan.** Many African states suffer from severe capacity development deficits, impinging on their effectiveness in PFM reforms. For example, the lack of technical capacity at key institutions responsible for audit and oversight have led to weak regulatory structures and practices that have not acted as an effective check on the executive. Increasing their capacity will hence improve PFM outcomes.
- **Sustaining the AFGO as a unique approach to the assessment of financial governance in Africa.** The Bank can use the AFGO as an enabler to play a pivotal role and become the prime voice on financial governance in Africa – one that reflects African realities while

also fostering positive changes, in line with the Bank's High Fives especially the one on improving the quality of life for the people of Africa. The AFGO can also be used to foster ownership by the AfDB's senior management to effectively use findings to inform the design and implementation of PFM reforms in RMCs. An inter-departmental Task Force could be institutionalized as an Advisory Panel to ensure Bank wide ownership and utilisation of the AFGO recommendations.

- **Highlighting and fully exploiting linkages with other ongoing Bank analytical efforts**. Some examples of potential use of AFGO include: (i) Use of the AFGO as a central diagnostic instrument in the design, monitoring and evaluation of Bank operations in the area of financial governance, including for results reporting; (ii) Use of AFGO analysis to inform the Bank Country Policy and Institutional Assessment (CPIA); (iii) Use of AFGO to develop synergies with other flagship publications such the African Economic Outlook (AEO) and the Africa Capacity Report (ACR).