



AFRICA'S AGENDA ON GOOD FINANCIAL GOVERNANCE

FROM HEILIGENDAMM TO L'AQUILA¹

Introduction and background

- 1. African countries have achieved significant progress in improving governance practices.** Governance performance across a large majority of African countries is improving, reflected in the progress being made across the continent against a range of key governance indicators.
 - According to the 2008 Ibrahim Index of African Governance measuring governance performance in sub-Saharan Africa (48 countries), almost two thirds of sub-Saharan African countries – 31 out of 48 – have recorded an improvement in governance performance between 2005 and 2006, across the various dimensions of governance. War-torn Liberia shows the most progress. The Horn of Africa was the only region to see deterioration during this period.
 - Notably, 30 countries have improved macroeconomic and fiscal management, strengthened economic governance and financial integrity, improving the investment climate and helping to stimulate higher levels of both domestic savings and investment, and of foreign investment.
 - The combination of economic growth and increased revenue effort led to an increased in domestic revenue for Africa as a whole, from US\$ 138 billion on average between 1997 and 2002 to US\$ 367 billion in 2007. Within this overall picture, the rate of increase in sub-Saharan Africa was slightly higher.
 - Remittances flows are becoming an increasingly important source of finance in Africa, increasing from US\$ 12.9 billion in 2002 to US\$ 36 billion in 2007.
- 2. The advances made by Africa are real but remain fragile and vulnerable; considerable challenges remain and new challenges have emerged.** The ongoing financial crisis, coming on top of the recent oil and food price volatility, poses more than a simple risk for African countries. The slowdown of growth and the weakening of commodity prices in the global economy will affect growth prospects and therefore put pressure on domestic revenues, remittances and private capital flows. The impact will increase as the full extent of the global slowdown becomes evident. The gains of the past decade are at risk. In such a volatile environment, strengthening good governance in Africa acquires a new sense of urgency. Only strong public sector institutions and improved country systems for managing public resources will allow the prospering of Capable States, which are accountable to engaged societies and provide an enabling business environment conducive to shared growth and economic development.
- 3. In recent years important changes have affected Africa's relation with the international system and aid architecture.** Most notably, the Paris (2005) and Accra (2008) agenda provide new goals, commitments and principles by emphasizing the need for more effective aid through greater ownership, alignment, harmonization, managing for results, and mutual accountability. The Monterrey Consensus (2002) and the Doha Financing for Development Conference (2008), as well as the important pledges for aid at the G8 summits in Gleneagles 2005 and Heiligendamm 2007 are additional cornerstones of the international development architecture in Africa.

¹ Paper produced by the Governance, Economic and Financial Management Department of the African Development Bank in preparation to the G8 Summit

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4. **The upcoming G8 Summit (2009) now offers an opportunity to reaffirm those principles and deepen those commitments.** More importantly, it offers an important milestone after Accra and Doha to demonstrate how these principles and commitments are being implemented. So far, the evaluation undertaken ahead of the Accra High Level Forum on Aid Effectiveness in September 2008 showed that progress on the targets for 2010 set out in the Paris Declaration has been insufficient and needed to be accelerated, most notably in key areas such as improving aid predictability, using country systems, and improving aid coordination across a fragmented aid architecture as well as a volatile international system.
5. **In the context of the Accra Agenda for Action, the AfDB emphasizes the need to balance aid predictability with the building of capable states in Africa through the effective management of public resources and the judicious use of export- and fiscal revenues.** This enfold public revenues from natural resources (i.e. extractive industries) as well as foreign aid or the mobilization of domestic revenues (i.e. taxes). Effective and accountable management of public resources is critical for building capable states and delivering services. The Bank also calls for an enhanced African voice on issues of Good Financial Governance, underscoring the specific challenges facing Africa countries, and the implementation of the G8 *Action Plan on Good Financial Governance* (2007) and the G8 *Action Plan for Fighting Corruption and Improving Transparency* (2003). The ultimate objective of Good Financial Governance in Africa should remain the reduction of poverty by creating capable states that implement country-owned and country-led development strategies.
6. Against this background, the Bank proposes that “Building Capable States and Managing Public Resources for Development in Africa” as a central theme for the G8 Italian Presidency, centered on the following 3 pillars.

1. Effective and sustainable management of natural resources in Africa

Extractive industries governance

7. **Effective management of natural resources and extractive industries, and in particular the revenues generated from those sectors, is critical for Africa’s development.** Foreign direct investment flows to Africa rose from US\$ 13 billion in 2002 to US\$45 billion (estimate) in 2007, in large part related to investment in extractive industries. African exports are still dominated by commodities and minerals. Ensuring sound revenue management and transparency in the governance of those sectors are critical challenges requiring concerted action by developed and developing countries, as well as private companies and civil society.
8. **The *Extractive Industries Transparency Initiative* (EITI) has been an important entry point to the sound management of natural resources in Africa.** While transparent reporting of extractive industries’ revenues is essential, sound resource revenue management is also needed both “upstream” and “downstream.” The entire chain of managing extractive industries resources is important for sustainable growth and poverty reduction – including balanced contract negotiations, fair fiscal regimes, effective oversight and regulation, sound expenditure management. This more comprehensive approach is referred to as “EITI++” or Extractive Industries for Development (EIFD). The focus of this work begins “upstream” by assisting in the development of institutions, legislations, legal systems, and licensing concession processes. It continues “downstream” with safeguarding and monitoring revenues, taxation, and redistribution. Governments, bilateral partners, civil society organizations, and the African Union are all important actors in this regard, and would be involved in the various aspects of this initiative, drawing on their comparative advantage.
9. **Recognizing this need, it is recommended that the G8:**
 - Support African countries to improve the governance of extractive industries sectors, support the EITI as an emerging global standard for revenue transparency and accountability,
 - Sign up for EITI and invite G8-based multinationals to endorse it, which would enhance the credibility of the initiative and encourage other countries to join;

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- Require that oil and mining companies listed on their stock exchanges publish their payments to governments (royalty, tax) as part of routine financial reporting, and ask credit rating agencies to take explicit account of a company's transparency record;
- Strengthen its partnership with AfDB and other institutions to improve resource revenue management, through such initiatives as the *African Legal Support Facility (ALSF)* and the provision of dedicated resources;
- Give special consideration to the contribution of mineral resources and the mining industry to sustainable development and the reduction of poverty; and
- Extend the principles and approaches to sound governance and transparent revenue management to other natural resources, such as forestry and water.

II. Effective management of public resources in Africa

Public financial management

10. **African countries have proved their awareness of the importance of sound public finances and made major progress in the last decade.** Sound, transparent and accountable management of public finances is at the core of what a capable state does. It determines to a large extent the government's capacity to implement policy and manage public resources through its own institutions and systems; it provides the foundations upon which to build effective, capable and accountable states, able to fulfill their responsibilities and deliver basic services to the poor.
11. **Public Financial Management (PFM) is the most important instrument for the creation of capable states.** It enhances the sound implementation of economic policy by influencing the allocation and use of public resources through transparent budget and fiscal policy. It improves the use of aid as well as overall budget performance, and thus contributes to macroeconomic stability and growth. Based on the *Accra Agenda for Action* and the *Paris Declaration on Aid Effectiveness*, the G8 could reinforce the efforts made by African countries to improve the management of their public finances by, *inter alia*:
 - Support and welcome efforts by AfDB and other partners to develop an African Agenda for Good Financial Governance, being endorsed by the AU;
 - Invest in developing country capacity in public financial management, aligned with African countries' policy priorities and trajectory of institutional change, and strongly directed towards the achievement of the country's own fiscal policy goals;
 - Scale-up support to the strengthening of country public procurement systems in Africa and improved transparency in international procurement and the awarding of concessions, through concerted efforts at the international, regional and country levels, including through support to specialized regional organizations;
 - Implement the 1997 *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* and support its extension to non-OECD countries (South Africa in 2007) through initiatives such as the OECD-AfDB Anti-Bribery Initiative launched in 2008;
 - Linking program-based aid more closely to further improvements in PFM and, where PFM is believed to be sound and there is a credible government commitment to reform, concentrate aid delivery through program-based approaches and, in particular, general budget support.

Domestic resource mobilization

12. **Strengthening domestic revenue mobilization is central for achieving fiscal independence and graduating from foreign aid.** If African countries are to become independent of external funding in the long term, it is essential they strengthen their own revenue base and diversify the sources of growth. Functioning tax and customs systems are key for building capable states and for improving governance based on own resources. The design of tax systems and the administration of tax collection are core tasks of governments.

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13. **In recent years, African countries have significantly reformed their tax policies and modernized their tax and customs administrations, contributing to improve the revenue effort and tax ratios.** African governments have succeeded in improving domestic revenue mobilization and raising the ratio of government revenue from an average of 21% of GDP in 2001 to over 25% in 2007, although the range of these ratios varies considerably. However, both resource-rich and non-resource rich countries have achieved higher revenue collection; while higher commodity prices account for most of the increase in the former group, for the others most of the improvement can be attributed to more effective tax systems and administration.
14. **The G8 could increase its support to the strengthening of revenue capacities and institutions in African countries and strengthen regional networks and international knowledge on tax policy and tax administration.** The 2008 Doha International Conference on Financing for Development underscore the 2002 Monterrey Commitments and the importance of mobilizing domestic financial resources for development, now more than ever. In 2006, only 0.07% (USD 88.0 million) of ODA (excluding IMF technical assistance) was dedicated to support to tax reform and revenue administration. Existing efforts to support bilateral and international initiatives, such as the International Tax Dialogue, the IMF African Technical Assistance Centers, and the African Tax Administrators Forum could be reinforced. Improving taxation in Africa also includes the fight against tax evasion and elusion. In this context the G8 could use their political weight to make progress against international fiscal paradises, which openly lure urgently needed resources away from Africa's development.
15. The G8 could further support this process in the following ways:
 - Invest in Africa's efforts to increase domestic revenue mobilization, to improve tax administration and enhance tax policy, and support the African Tax Administration Forum (ATAF), in line with the Pretoria Communiqué (August 2008);
 - Coordinate efforts to fight tax evasion and strengthen international action to combat harmful tax practices and tax fraud, through effective exchange of tax information and initiatives such as the International Tax Compact to fight tax evasion and tax avoidance; and strengthen African countries' capacities and instruments in their negotiations with tax heavens;
 - Cooperate in the repatriation stolen assets through full endorsement of UNCAC, enhanced international cooperation in criminal investigations (mutual legal assistance), strong support to initiatives such as the Stolen Asset Recovery Initiative.

Auditing and oversight of public finances

16. **The effective management of public resources rests on effective and independent auditing of government finances.** Sound and effective country auditing systems is critical to ensure that public resources are used for the purposes intended; they also provide reassurance son the proper use of aid resources, including those emanating from natural resources and extractive industries. Audit institutions are part of the country systems for public financial management and they not only increase the effectiveness of government spending, but also enhance citizens' trust in their governments. Internal and external audit institutions are central institutions of integrity in the management of public resources. However, they often lack capacity, autonomy and incentives to perform their duties effectively.
17. **The G8 could play a stronger role in supporting supreme audit institutions (SAI) and other integrity institutions in Africa,** in line with the *G8 Action Plan for Good Financial Governance* (2007). Strengthening government auditing also requires encouraging greater transparency and disclosure of public financial information, enhancing external scrutiny of public finances, and strengthening the demand for greater accountability in the management of public resources. The G8 could further support this process in the following ways:

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- Launch an Africa Integrity Compact to strengthen the accounting and auditing profession and to increase the capacity and autonomy of internal and external audit agencies in Africa;
- Support to regional organizations such as the African Organization of Supreme Audit Institutions (AFROSAI), to mainstream international standards, strengthen capacity, and share best practices in government external auditing;
- Promote concerted international efforts to support government auditing through closer international cooperation in the context of the International Organization of Supreme Audit Institutions (INTOSAI);
- Support African parliaments' capacity to scrutinize government finances and engage in the budget process through increased support to parliaments budget capacities at the national level and support to regional parliamentary organizations;
- Encourage the extension of freedom of information legislation to facilitate citizens' access to financial information and support civil society's oversight of the budget.

III. Effective management of aid resources in Africa

Use of country systems and aid effectiveness

18. **Improving aid effectiveness is intrinsically linked with the commitment to strengthen and use country systems in public financial management.** Improvements in aid quality cannot be separated from the channels through which aid is delivered. The use of country systems in all forms of development assistance is explicitly mentioned in the Accra Agenda, but lacks so far a roadmap for its implementation. Country systems for managing public resources include those systems for raising revenue (taxation and debt management), allocating resources (budgeting), managing expenditure (financial management and public procurement), accounting for resource use (auditing and oversight) and rendering account (legislative oversight and citizen scrutiny).
19. **The *Accra Agenda for Action* contains further commitments on the use of country systems for managing aid resources and improving aid effectiveness.** At Accra, donors agreed *"to use country systems as the first option for aid programs in support of activities managed by the public sector..."* However, while African countries have made important strides to improve economic and financial governance and strengthen country systems, donors have made less progress in using them more intensively. Even when there are good-quality country systems, donors often do not use them as much as they could.
20. **Improving the predictability of aid and mitigating the damages of aid volatility have acquired renewed importance in the global financial turmoil.** These shocks underscore the importance of increasing aid predictability and mitigating the risks of aid volatility, both of which adversely affect African countries' capacity to budget and adequately manage their public finances. The new challenges of the food, fuel and financial crises are causing inflationary pressures and balance of payment problems.
21. **Delivering existing commitments on increased aid volumes and improved aid effectiveness are more urgent than ever.** The current financial crisis and the slowdown of growth in the global economy are all bound to have important implications for Africa's growth prospects and domestic revenue, while the recent weakening of commodity prices will deteriorate Africa's terms of trade. Private capital flows are likely to come under pressure, at least in the short term, while tighter labor market conditions in OECD countries are likely to limit remittances. Local banking sectors and financial markets are affected by the global financial fallout.
22. The G8 could support a much stronger move towards the building capable and accountable states and thereby improving transparency and efficiency in the management of public resources. The G8 could further support its commitment to improving aid effectiveness the following ways:

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- Deliver existing commitments on increased aid volume and improving aid predictability, especially in times of turbulence;
- Commit to using country systems as first option, through program-based aid and budget support, including in fragile states, and develop plans for undertaking those commitments in all forms of development assistance.

Fragile states

23. **Sound financial governance, including effective mobilization of domestic revenues, is of particular relevance to fragile states.** Capable and sustainable systems of public finance should help reduce the risks of post-conflict countries or fragile states becoming dependent on external assistance over the long term. They also support the effective financial engagement of donors in the course of providing emergency assistance. Taking this into account the G8 could:

- Reaffirm its commitment to strengthen public financial management systems in post-conflict countries, hence helping those countries in their rebuilding efforts to prevent relapsing into conflict;
- Where conditions are conducive (especially in post-transition countries committed to reform), increase its support through country's own systems, notably program approaches and budget support.