The Bank Group's Contribution to Governance in Africa: Strategic Directions (2008-2010)

Background Paper

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Executive Summary

This paper provides strategic orientations for the African Development Bank's contribution to good governance and anti-corruption in Africa during the period 2008-2010. It is an opportune time for the Bank to re-focus its governance agenda and carve out a distinctive role for itself in the global aid architecture. African countries have achieved significant progress in improving their governance practices, but considerable challenges remain to anchor good governance and root out corruption. Furthermore, global developments in aid policies and donors' governance strategies have altered the aid landscape in which the Bank operates. The Bank has embarked on a new phase of institutional development to consolidate its role as Africa's premier development finance institution.

These *Governance Strategic Directions* are based on the *Bank Policy on Good Governance* of 2000 and the lessons learned captured in the *Bank Review of Governance Activities* of 2006. They provide a rationale for greater strategic selectivity in the Bank's governance work, defining guiding principles for delivering results and achieving impact in a narrower set of governance priorities. The criteria guiding the Bank's strategic focus in governance are: (i) the Bank's mandate, portfolio profile, staff skills, and track record (*selectivity*); (ii) the need to create positive interactions with the rest of the Bank portfolio (*synergy*); and (iii) the Bank's relative strengths and its ability to complement other donors (*complementarity*).

Within the overall objective of poverty reduction, the Bank's main objective in governance is to assist African countries to build capable and responsive states. Operationally, the Bank's strategy in governance will focus on strengthening transparency and accountability in the management of public resources, at the country, sector and regional levels, with a special attention to fragile states and natural resources management. By strengthening public sector governance and reinforcing country systems for managing public resources, the Bank will contribute to open governments and engaged societies. It is uniquely positioned to address these challenges and add value. The choice and mix of instruments will be tailored to country circumstances (*country focus*), combining budget support, institutional strengthening projects, non-lending operations and analytical and advisory work.

This strategic focus on good financial governance considers the budget process as a key lever of pro-poor change and citizen empowerment. It is based on four pillars:

- ***Pillar I: At the country level,*** the Bank will focus on helping RMCs build robust financial control and budget oversight institutions.
- ***Pillar II: At the sector level,*** the Bank will concentrate on the prevention of corruption and waste in the infrastructure sector through stepped up support to country procurement systems.
- ***Pillar III: In fragile states,*** the Bank's enhanced engagement will strengthen capacity, transparency and accountability in financial governance in particular in the management of natural resources.
- ***Pillar IV: At the regional level,*** the Bank will encourage and support regional initiatives and organisations promoting regional charters, standards and codes of good financial governance.

Following the endorsement of these *Strategic Directions,* the Bank will undertake to develop a *Governance Action Plan* (GAP) in 2008, delineating a results framework for their implementation.

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THE BANK GROUP'S CONTRIBUTION TO GOVERNANCE IN AFRICA: STRATEGIC DIRECTIONS (2008-2010)

1. Introduction

1.1 This paper provides medium-term strategic orientations for the Bank Group's support to good governance and anticorruption in Africa during the period 2008-2010.[1] It provides a rationale for greater strategic selectivity and focus of the Bank's work in governance. Its purpose is to define a distinctive role for the Bank in the global aid architecture. It takes into account recent global developments in aid policies and practices, the evolving governance challenges and opportunities of African countries, and the new phase of the Bank's institutional reform.

1.2 In order to make a distinctive contribution to governance in Africa (the Bank's 'footprint'), the Bank needs to select a number of governance priorities in which it has the most potential to deliver results, build excellence, and add value. The Bank's medium-term strategy for the period 2008-2010 is based on the lessons learned and recent developments globally. Some of these lessons are captured in the *Review of Governance Activities* in 2006[2] and reflected in the institutional reform of the Bank. The Bank has a clear mandate to help African countries strengthen governance and combat corruption and enjoys the support of development partners. In 2000, the Bank adopted the *Good Governance Policy* to support RMCs' governance reform in a more pro-active and purposeful manner. In 2004, it made a commitment to scale up its governance work.[3]

1.3 The responsibility for the Bank's contribution to governance is a shared one, cutting across all departments of the Bank. Governance, as a crosscutting theme was reflected as a resource priority in the Bank's *Strategic Plan for 2003-2007*.[4] The 2006 restructuring of the Bank established the Governance, Economic and Financial Management Department (OSGE) as the anchor and catalyst for the Bank's work on governance. This paper is based on the shared conviction that the credibility of the Bank ultimately hinges on its capacity to deliver results and demonstrate impact, based on clearly defined objectives and matching ambitions with resources.

1.4 Following this introduction, Section 2 discusses the centrality of governance for Africa's development and provides the policy context for the Bank's refocused engagement in governance and anticorruption. Section 3 defines the guiding principles and explains the rationale for greater selectivity and strategic focus of the Bank's work on governance, Section 4 describes the ways in which the Bank will deliver its governance priorities. Section 5 identifies some of the institutional reforms necessary to support the delivery of the Bank's governance priorities, while Section 6 presents the key steps for implementing these strategic orientations.

2. Context and Recent Developments

2.1 This section provides the strategic and policy context in which the discussion of the Bank's enhanced approach to governance is cast.

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1 Good governance is defined in several ways. For the purpose of this paper, governance uses the definition of the *Bank Group Policy on Good Governance,* approved in 2000, 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." p.2. The policy identifies the key elements of good governance as: accountability, transparency, participation, combating corruption, and the promotion of an enabling legal and judicial framework.

2 However, the 2006 *Review of Governance Activities* took stock of the Bank's support to governance in RMCs through institutional strengthening projects and non-lending activities, including Economic and Sector Work (ESW), based on the pre-2006 institutional set-up of the Bank.

3 ADF, *Report on the Tenth Replenishment of Resources of the African Development Fund*, ADF/BD/WP/2005/06, January 2005.

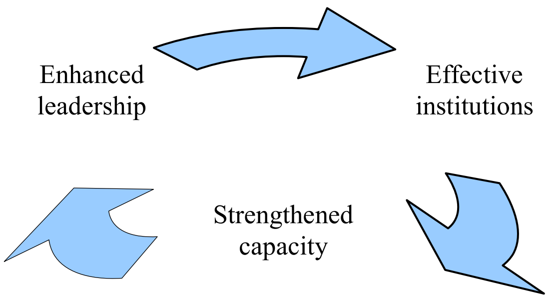
4 The *Strategic Plan* delineated a division of labour with other international development finance institutions, where the Bank would concentrate its contribution on improving economic and financial governance.

2.2 It is an opportune time for the Bank to re-focus its governance agenda and carve out a distinctive role for itself in the global aid architecture. In recent years, African countries have made considerable progress in improving their governance practices, but considerable challenges remain to anchor good governance and eradicate corruption in the management of public resources. Furthermore, global developments in aid policies and donors' governance strategies designed to improve aid effectiveness have altered the aid landscape in which the Bank operates. Lastly, the Bank has embarked in a new phase of institutional development, with the objective of strengthening its role as Africa's premier development finance institution.

2.3 There is general consensus in Africa that good governance underpins sustainable development and poverty reduction. Achieving good governance faces difficult challenges in Africa, but empowered Africans are at the forefront of demanding better governance and more accountable states. African leaders are also committed to strengthening good governance and combating corruption. The African Union's *New Partnership for African Development* (NEPAD) identifies good governance as a basic requirement for peace, security and sustainable growth and development. For this purpose, NEPAD has set up the African Peer Review Mechanism (APRM) as an innovative tool for improving governance through peer review and the design of national actions plans for better governance. The Bank has been given a central role in promoting better governance and combating corruption in Africa.

2.4 Three defining challenges of governance in Africa are to enhance visionary leadership, build inclusive institutions, and strengthen African capacities (Figure 1). The Bank will collaborate closely with governments, civil society and other development partners to address those key challenges.

Figure 1: Key governance challenges in Africa



2.5 In particular, achieving good financial governance is a central challenge for Africa's development, a challenge that the Bank, as an African development finance institution, is uniquely positioned to address. Sound public finances are critical for reducing poverty and improving aid effectiveness, in the context of rising aid flows and increasing revenues from natural resources. Improving transparency and accountability in the budget process is a key lever of change for empowering the poor. Sound financial governance, in terms of increased transparency, accountability and responsiveness, is critical for ensuring that public resources are managed for the benefit of the poor. Economic development and poverty reduction is also based on national budgets that adequately reflect country policy priorities. In May 2006, the African Finance Ministers stated their intention to redouble their efforts to develop transparent, accountable and reliable budgetary systems, as stated in the Abuja Commitment to Action.

2.6 Good financial governance is also critical to improving aid effectiveness. The international community is committed to supporting African countries to further good financial governance and reforming public financial systems; as shown in the G-8 Summits of Gleneagles (2005) and Heiligendamm (2007), as well as the Paris Declaration on Aid Effectiveness.[5] In May 2007, the G-8, in cooperation with African countries, outlined an *Action Plan for Good Financial Governance in Africa*, which provides a roadmap for good financial governance in

[5] The first clause of the Paris Declaration underscores the need to increase aid to support developing countries' efforts to strengthen governance and improve development effectiveness.

Africa, and a framework for carving out the Bank's distinctive contribution (Table 1).[6]

Table 1: G8 Action Plan for Good Financial Governance in Africa
Contributing to good financial governance through bilateral and multilateral development assistance; Strengthening African tax systems; Establishing transparent and comprehensive budgetary procedures; Promoting accountability and transparency and enhancing budgetary control; Increasing accountability for revenues from extractive industries; Securing public debt sustainability; Supporting fiscal decentralisation; Promoting donor harmonisation through knowledge management; Enhancing capacities for governance in fragile states and situations; Developing local bond markets in emerging market economies.

2.7 The Bank is working to harmonise approaches to governance and anticorruption with other development partners. The Bank actively participates in the Multilateral Development Banks' Roundtable discussions and technical working groups. It also participates in the various working groups of the OECD-DAC Working Party on Aid Effectiveness and the OECD-DAC Governance Network, in the areas of public financial management, public procurement, antic-corruption, and managing for development results. For example, in February 2006 the Bank joined with other MDBs to establish a Joint International Financial Institutions Anti-Corruption Task Force.

2.8 It is an opportune time to sharpen the Bank's comparative advantage and add value in the global efforts to support good financial governance in Africa. Important changes have occurred in aid policies and governance strategies of key development partners since the Bank adopted its own governance policy in 2000. Governance is a pillar of the World Bank's *Africa Action Plan* (AAP) and, in March 2007 the Board of Directors of the World Bank approved a new *Governance and Anticorruption Strategy* to increase and upgrade its assistance to improving governance and fighting corruption. Half of the new FY2006 lending operations by the World Bank were dedicated to supporting the strengthening of governance. Several multilateral banks (Asian Development Bank in 2006 and Inter-American Development Bank in 2003)[7] and bilateral donors, such as France (2006), the United Kingdom (2007) and the United States (2006), have also revised their governance and anticorruption strategies.

2.9 The governance mandate of the Bank is well established. Given the link between good governance and aid effectiveness, the Bank's Vision Statement of 1999 identifies governance as one of the Bank's four key areas of focus in both ADB and ADF countries.[8] In particular, the African Development Fund (ADF) allocates resources to countries based on country governance performance, especially financial governance.[9] An independent evaluation of ADF VII-IX concluded in 2004 found that the Bank had a substantial prospective role in support to good governance in Africa.[10] As a result, the *Statement of Conditions* underpinning the Tenth Replenishment of Resources of the ADF (ADF X) committed the Fund to scale-up

6 The Bank is also cooperating with initiatives such as Making Finance Work for the Poor (MFW4P) and the African Investment Climate Facility (ICF).

7 The consensus on the centrality of governance for improving the effectiveness of multilateral aid is also reflected in the fact that regional development banks in other regions have developed a strong focus on governance. Governance is one of the three pillars of the Asian Development Bank's poverty reduction strategy. The AsDB reviews the implementation of its governance and anticorruption policies regularly, particularly in infrastructure. It has recently produced its *Second Governance and Anti-Corruption Action Plan* in 2006. The modernisation of the state, by strengthening the efficiency and transparency of public institutions, is also one of the four priority areas of the IADB.

8 *Vision de la Banque Africaine de Développement. Plan d'Action pour une Banque Revigorée*. 1999; and High Level Panel, Shanghai, 2007 (preliminary observations).

9 Governance has an important influence on the Bank's allocation formula (PBA) through the Country Policy and Institutional Assessment (CPIA) and the Governance Factor (GF) introduced in 2002 in the adjusted country performance assessment (CPA*).

10 ADB, *Stepping up to the Future: Independent Evaluation of ADF VII – IX,* ADB OPEV, July 2004.

its support to improving governance and combating corruption in RMCs.

2.10 However, a review in 2006 found that the Bank's priorities in governance and anticorruption have not been sufficiently focused. While the Bank increasingly recognises the centrality of governance concerns, governance has not yet been sufficiently mainstreamed throughout the institution.[11] The Bank's new phase of institutional reform provides a unique opportunity to rationalise, streamline and refocus its contribution to good governance in Africa. As a response, the restructuring of the Bank in 2006 established a dedicated operational department, OSGE, as the anchor and catalyst for the Bank's work on governance, in close cooperation with other departments involved in governance work, including ORPC, ORPU, EDRE, GECL, OPSD, PSDU, EADI and JAI.[12]

3. Guiding Principles and Rationale

3.1 This section discusses the principles that will guide the Bank's approach to promoting good governance in Africa and the rationale for greater strategic selectivity and focus. These guiding principles and strategic rationale are derived from the lessons learned from the implementation of the *Bank Policy on Good Governance,* captured in the 2006 *Review of Governance Activities,* and are informed by strategies of other development partners and global debates on development results, aid effectiveness and donor harmonisation.

Guiding principles

3.2 African countries have the primary responsibility for improving governance. The Bank's work on governance must therefore be guided by a country focus, working with governments, civil society and the private sector to further good financial governance.

3.3 Bank activities in governance will be tailored to country circumstances. Every RMC has a unique combination of governance features, strengths and vulnerabilities. Not one size fits all. The Bank's approach will therefore be tailored to meet the specific developmental needs and governance challenges of middle and low-income RMCs.

3.4 The Bank will pursue a strategy of constructive and systemic engagement, including in high-risk governance environments. The Bank's engagement in difficult environments will be predictable and consistent, so as to avoid punishing the poor twice and the existence of "aid orphans." Potential for progress, rather than initial conditions, will guide its engagement in governance, based on countries' commitment to reform and direction of change. A typology of country situations will guide the choice and mix of aid instruments deployed by the Bank.[13]

3.5 The Bank considers corruption as a symptom of broader governance dysfunctions. Therefore, the Bank's approach to fighting corruption will focus on deterrence by strengthening country systems in financial governance, especially financial accountability and budget oversight.

3.6 The Bank will strengthen country systems, rather than bypass them. To optimise *development objectives*, the Bank will endeavour to strengthen and use country systems, in particular public financial management and accountability systems.

3.7 Internally, the Bank will strengthen transparency in its own operations through enhanced information disclosure. To address its *fiduciary concerns* and fulfil the due diligence provisions of its Establishment Agreement, the Bank will enhance its safeguards and integrity mechanisms, as well as its financial management and procurement systems,[14] to ensure that the funds it provides are used for the purposes intended and are properly accounted for. [15]

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[11] ADB, *Final Report of the Review of Governance Activities of the African Development Bank,* April 2006.

[12] Annex E of the 2006 *Bank Review of Governance Activities* summarises other organisational units of the Bank that are involved in governance-related activities, prior to the 2006 restructuring.

[13] In governance terms, a four-category classification has been advanced in terms of quality of policies (good, bad) and corruption risk (high, low). ADB, *Engaging Constructively in High-Risk Governance Environments – An Orientations Paper*, draft, 2006.

[14] ADB, *Restructuring Procurement and Financial Management Services, ADB, ORPU, draft August 2007.*

[15] In 2006, the Bank established an anti-corruption and fraud investigation function and an Anti-corruption and Fraud Division was set-up in the Office of the Auditor-General.

3.8 Bank activities in governance must be focused on delivering results, demonstrating impact and adding value compared to other donors. Delivering results will require enhancing operational effectiveness, i.e. quality-at-entry, right sizing the portfolio and adopting a results framework for measuring progress.

3.9 The Bank will work with and through development partners to achieve common objectives. This approach will be based on a division of labour seeking to enhance synergies and complementarities, consistent with the Paris Declaration commitments on aid effectiveness.

Rationale

3.10 The criteria guiding the Bank's strategic orientation in governance include:

- The Bank's mandate, its portfolio profile, staff skills, and areas of success (***selectivity***);
- The need to create positive interactions with the rest of the Bank portfolio (***synergy***); and
- The Bank's relative strengths and its ability to complement other donors (***complementarity***).

3.11 There is a strong demand from RMCs for Bank support in financial governance. This demand is reflected in the Bank's results-based country strategy papers (RBCSP) and the Bank's "multi-sector" operational portfolio. Most RBCSPs include governance as a strategic pillar of Bank support to RMCs and a significant proportion of the Bank's multi-sector operations are aimed at supporting structural reforms, improving economic management, and strengthening financial governance.[16]

3.12 The Bank has a comparative advantage to support financial accountability and oversight institutions. As an African institution, the Bank is able to address the politically sensitive challenges of enhancing transparency and accountability in the management of public resources in RMCs. The Bank's internal audits have recommended a greater focus on country systems in public financial management as a way to minimise fiduciary risks.[17]

3.13 The Bank has an established track record in promoting good financial governance. The Bank provides significant support to both ADF and ADB countries to implement economic and financial reforms, through budget support and policy-based operations and institutional support projects. A recent Bank review suggests that budget support helps strengthen good financial governance. About 60% of the ADB's budget support conditions relate to governance, 80% of which are linked to public financial management (esp. budget planning, external auditing, and public procurement).[18] Similarly, about 65% of institutional strengthening projects focus on public financial management (esp. internal controls and external auditing).[19]

3.14 Financial accountability and budget oversight are the weakest and riskiest links in public financial management.[20] Country systems in public financial management in Africa remain particularly weak and need substantial improvement.[21] According to the IMF, out of the 26 HIPC countries, 24 require some or substantial upgrading in the public financial management systems.[22] The budget process is critical in determining the allocation and use of public resources. Budget formulation and execution are the areas that have improved most in recent years and those that receive most donor support. Financial control, public procurement and

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16 "Multi-sector" operations are an increasing share of the Bank's portfolio, representing 15.4% of cumulative loans and grants approval between 1967 and 2006. In 2006, "multi-sector" activities received the third largest share of loan and grant approvals (totalling UA 708.6 million), 75% of which related to governance (institutional support, 2.5%; governance institutional strengthening and capacity building, 11.3%; budget support, 27.8%; and public sector management 33.4%. ADB, *Annual Reports*, 2005 and 2006.

17 ADB, Internal Audit Department, *Annual Report to the Board,* 2004.

18 ADB, *Retrospective of ADB Budget Support*, draft, 2007.

19 ADB, *Review of ADB Institutional Strengthening Projects*, draft, 2007.

20 Public Expenditure and Financial Accountability Programme (PEFA). *Report on Early Experience from Application of the Framework*, PEFA Secretariat, 2006.

21 World Bank, *Public Financial Management: Strengthened Approach*, World Bank, OPCFM, 2006.

22 IMF. *Update on the Assessment and Implementation of Actions Plans to Strengthen Capacity of HIPCs to Track Poverty-Reduction Public Spending.* IMF, 2005. In the region, 7 out of every 10 RMCs are deemed to be vulnerable to high corruption risk, and 3 out of every 4 RMCs have low CPIA ratings for public sector governance. ADB, *Engaging Constructively in High-Risk Governance Environments – An Orientations Paper*, draft, 2006.

external auditing are the weakest, riskiest and the most politically sensitive stages in the budget process. They are also the most difficult areas for donors to support, but these areas are crucial to ensure development impact and to minimise fiduciary risks.

3.15 To ensure high impact and mitigate corruption risks, the Bank's governance work will seek to improve the governance of sectors, in particular infrastructure. The Bank is strongly committed to improving African infrastructure.[23] Infrastructure is already the largest sector in the Bank's portfolio (46% of the portfolio in 2006). Infrastructure is particularly vulnerable to corruption risk.[24] The Bank has a zero tolerance policy on corruption in its own projects. In this context, the Bank's focus on country public financial management and procurement systems at the sector level would contribute to both maximising development impact in RMCs and mitigating fiduciary risk to the Bank.

3.16 In fragile states, greater transparency and accountability in the management of public resources, in particular natural resources, is critical to sustain peace and reduce poverty in war-torn countries. Post-conflict countries present the greatest challenges in terms of risk of relapse into conflict, and, at the same time, the greatest opportunities in terms of potential for progress. Restoring basic systems for the open and sound management of public resources is essential for rebuilding government capacities and delivering essential services. Capable and accountable systems for managing public finances help reduce the risk of post-conflict countries becoming overly dependent on foreign aid. Good financial governance is both as a condition and an objective of the Bank's enhanced engagement in fragile states.[25]

3.17 At the regional level, the adoption of international charters, standards and codes is considered a cost-effective mechanism to build incentives for better governance and deeper regional integration. These charters, standards and codes are largely voluntary and enforced by peer pressure.[26] They often involve partnerships not only with governments, but also with the private sector and civil society across national borders. The APRM process, for example, is a regional charter-type mechanism that aims to strengthen governance practices through the peer review of governance standards and the implementation of National Plans of Action (NPoAs).

4. Strategic Objectives and Priorities

4.1 This section discusses the Bank's strategic objectives in governance and the justification that underpins the choice of concentration areas, in the wide field of governance and complex aid architecture.

Objectives

4.2 Within the overall objective of poverty reduction, the Bank's main objective in governance is to assist African countries build capable and responsive states that facilitate economic growth, poverty reduction and social cohesion. The overarching objective of the Bank is to contribute to the economic development and social progress in RMCs, individually and collectively.[27]

4.3 Operationally, the Bank's strategy in governance will focus on strengthening transparency and accountability in the management of public resources, at the country, sector and regional levels, with a special attention to fragile states and natural resources management.

4.4 The Bank contribution will concentrate on promoting good financial governance and sound public finances in RMCs, with a distinctive focus on budget oversight institutions and financial accountability systems. This strategic focus considers the budget process as a key lever of

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[23] The Bank has received a mandate to lead on infrastructure development (APRM) and it hosts the *Infrastructure Consortium for Africa* (ICA) and the *African Water Facility* (AWF).

[24] Transparency International (TI), *Preventing Corruption in Construction Projects*, 2004.

[25] The Bank's strategy to *Enhanced Engagement in Fragile States*, under consideration, establishes a country's commitment to sound financial management practices and transparency of public accounts as a criterion for increased Bank support. The Bank will "assess this commitment based on progress made by a country to reforming its public expenditure management system, minimising corruption and reviving or strengthening its revenue mobilisation institutions" (p.5).

[26] Paul Collier proposes charters on political democracy, budget transparency, natural resource revenues, conflict resolution, and investment. See Collier, 2007, *The Bottom Billion.*

[27] Article 1, *Agreement Establishing the African Development Bank*. 1963.

change. Increased transparency in public finances and greater accountability in the management of public resources will ultimately contribute to more open governments and engaged societies. The Bank is also committed to mainstreaming social and gender concerns and encouraging domestic accountability to the poor.[28]

Priorities

4.5 The Bank's governance strategy will be based on ***four pillars:***

- **Pillar I: At the country level**, the Bank will focus on helping RMCs build robust financial control systems and budget oversight institutions;
- **Pillar II: At the sector level**, the Bank will concentrate on the prevention of corruption and waste in the infrastructure sector through sharper assessment of risk and stepped up support to country procurement systems;
- **Pillar III: In fragile states**, the Bank's enhanced engagement will seek to strengthen capacity, transparency and accountability in financial governance; particularly in the management of natural resources; and
- **Pillar IV: At the regional level**, the Bank will encourage and support regional initiatives and organisations promoting regional charters, standards and codes of good financial governance.

Pillar I: Increased transparency and accountability in the management of public resources at the country level

4.6 At the country level, the Bank will focus on strengthening transparency and accountability in the management of public resources. To complement the work of other partners, the Bank will focus on areas of the budget process not sufficiently attended to (e.g. financial transparency, budget planning and preparation, government accounting, internal controls, public procurement, external auditing, and parliamentary oversight). This approach allows for important synergies and complementarities, particularly with the World Bank and the European Commission.[29]

4.7 The Bank will seek to strengthen both the "supply" (leadership and institutions) and the "demand" (engaged civil societies and checks and balances) for improved financial governance. The African character of the Bank allows it to address some of the political economy constraints to good financial governance and accountability. The Bank recognises that the budget is inherently a political process and that reforms require sustained political commitment, as they reflect delicate political arbitrages.[30]

4.8 At the central government level, the Bank will support government institutions tasked with managing public resources in an effective, transparent and accountable manner. These institutions include Finance and Planning Ministries (including central budget and debt management offices), Accountant Generals, Procurement Tender Boards, Tax and Customs Administrations, Regulatory Agencies, and Aid Coordination Offices. The Bank will support greater alignment between policy and budget priorities (Poverty Reduction Strategies, Medium Term Expenditure Frameworks and annual budgets).

4.9 The Bank will scale up its support to budget oversight and financial control institutions, within and beyond central government. These include Inspector Generals, Internal Auditors, and External Auditors, as well as greater freedom of information. As an African institution, the

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[28] This strategic focus will also contribute to improving the enabling environment for private sector development and foreign direct investment, including through good corporate governance, anti-money laundering, and the rule of law. See: ADB, *Bank Anti-Money Laundering Strategy,* draft, 2007; ADB, *Private Sector Development Strategy,* 2004; ADB, *Corporate Governance Strategy*, 2005; ADB, *Bank Group Financial Sector Policy*, 2003; ADB, *Bank Group Strategy on Law for Development*, 2001.

[29] For example, as indicated in its *Governance and Anticorruption Strategy*, the World Bank will work closely with others to "more systematically help legislatures, supreme audit institutions and other formal oversight institutions develop the capacity to oversee public expenditures" (para 25, page 14).

[30] See: OECD-DAC *Guidelines and Reference Series Harmonising Donor Practices for Effective Aid Delivery: Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management,* 2005; and World Bank, *Institutional and Incentive Issues in Public Financial Management Reform in Poor Countries,* 2004.

Bank is well positioned to strengthen oversight institutions and checks and balances in financial governance, in particular internal and external audit offices. The Bank will gradually enhance its support to parliaments in the oversight of the budget process, through stepped-up support to parliamentary budget, finance and public accounts committees, and parliamentary budget offices.

4.10 The Bank will also strengthen good financial governance at the local level. Its contribution in this area will focus on fiscal decentralisation, municipal finances, and civil society budget oversight. Special attention will be paid to the social and gender impact of budgetary policies, including through community empowerment and gender sensitive budgeting. Support to innovative initiatives to improve financial transparency and accountability at the local level will be increased (e.g. report cards, participatory budgeting, and access to information).[31]

Pillar II: Enhanced transparency and accountability in the management of public resources in key sectors of Bank operations

4.11 The Bank will work with governments and other development partners to identify and minimise sector corruption risk and improve service delivery to the poor. By addressing governance dimensions and corruption concerns in key sectors, the Bank's governance work will help improve the efficiency of sector spending and the effectiveness of Bank sector operations in RMCs. Mainstreaming governance in Bank sector operations will focus on prevention, incentives and working with partners in and beyond government. A strategy to mitigate risks in sector projects will require an assessment of country risk, minimising opportunities for corruption through better project design (mapping risks), and realigning incentives facing the Bank's clients and staff (audit reports, due diligence, management signals).[32]

4.12 The Bank will focus its governance activities at the sector level to strengthen the accountability, and transparency in the management of public resources. Governance is a transversal concern cutting across sectors but consistent with its corporate focus on infrastructure, the Bank's work on sector governance shall focus on *infrastructure* (e.g. energy, roads and transportation, sanitation) and *natural resource management* (e.g. extractive industries, water, forestry). For instance, OSGE, in close cooperation with relevant departments, will develop diagnostic tools to assess corruption vulnerabilities in key sectors and further strengthen country public procurement systems. Bank support to improving the investment climate, the enabling environment for private sector development, and good corporate governance will also increase the effectiveness of Bank sector operations.

4.13 To improve its understanding of sector governance and corruption risks the Bank will use a variety of approaches. Bank engagement in a sector will be preceded by an assessment of sector governance risk (*Sector Governance Risk Mapping)* through which the Bank will assess the nature of the risks facing the sector and design mitigating measures, including through the provision of technical assistance and institutional strengthening projects. The *first* objective is to identify the corruption and governance risks, design sector interventions and craft mitigation measures. The *second* is to reduce opportunities for waste and corruption (including cost over-run) through risk assessment and smart project design. The *third* is to realign the Bank's incentives to focus on results and lower corruption risk.

4.14 The Bank will enhance its support to the strengthening of country public procurement systems and mitigating corruption risks in public procurement. The Bank's focus on country procurement systems at the sector level would contribute to both maximising development impact in RMCs and mitigating fiduciary risk to the Bank. Bank projects supporting country and regional infrastructure should include governance components to promote better policies, minimise corruption risk, and improve transparency of sector spending.

4.15 As part of this engagement, the Bank will further strengthen the transparency of its own

[31] In supporting the accountability capacity of civil society, the Bank should benefit from the implementation lessons provided by the Nordic Trust Fund for Governance (NTFG). However, the Bank is aware that support to these actors has high risks, particularly given that the Bank does not have extensive experience in this area. Therefore, the Bank will follow a cautious approach and will seek to assess and minimise risks while it gradually builds staff and knowledge.

[32] For example, the requirement that mineral rights should be sold through auctions or the policing of mineral rights during the transition phase. See: Paul Collier, *The Bottom Billion*, 2007

operations through greater disclosure of information, providing accessible information on its operations, including disbursement data, and implementing the *Bank Group Policy on Disclosure of Information,*[33] including through a more effective use of the web.

Pillar III: Fragile states' capacities to manage public resources soundly and transparently is strengthened

4.16 The Bank's support to fragile states will strengthen their institutional capacities for good financial governance and sound public resource management. Support to fragile states will be at the core of the refocused strategic approach to governance and efforts have been made to harmonise the Bank's governance and fragile states strategies.[34] The choice and mix of instruments deployed by the Bank in fragile states will reflect the country's commitment to reform and potential for progress. The Bank's support to building capacity for good financial governance in fragile states will follow the three-pronged approach outline in Pillar I.

4.17 Special attention will be paid to the good management of natural resources in fragile states, in particular extractive industries. The Bank endorsed the Extractive Industries Transparency Initiative (EITI) in 2006 and collaborates closely with the World Bank and other partners in this area. The Bank will focus its work on advocacy in the resource-rich RMCs that have not yet endorsed the EITI and the provision of technical assistance to RMCs that have endorsed it but lack implementation capacity.[35] The Bank shall also mainstream EITI principles in its own sector operations (e.g. energy, natural resources, and extractive industries). For example, the Bank is updating its 1994 energy policy. The *Bank Policy on Environment* (2004) underscores the governance dimensions of good natural resources management, through improved environmental governance.

Pillar IV: Regional standards and codes of good practice in the management of public resources support regional integration

4.18 The Bank will support, jointly with other donors, international and regional charters, standards and codes to improve financial governance. Through multinational projects, the Bank will enhance its support to regional initiatives and institutions promoting standards and codes of good financial governance. Standards and codes have a potentially important role to play in supporting post-conflict RMCs to better manage their natural resources, including through the negotiation of concessions.[36] The Bank will seek to form strong partnerships to work in support of these innovative initiatives.

4.19 The Bank will facilitate the introduction and adoption of regional and international standards and codes that contribute to greater transparency, and accountability in the management of public resources, including in natural resources. This entails active participation in initiatives such as the Extractive Industries Transparency Initiative (EITI), the Construction Sector Transparency Initiative (COST), or of the setting international standards by the African Organization of Supreme Audit Institutions (AFROSAI). The Bank will consider supporting similar transparency and certification initiatives.[37]

4.20 The Bank will continue and expand its role of supporting the APRM process. It will seek synergies between its support to good financial governance and its support to the APRM. The APRM assessment includes a comprehensive review of the progress on the implementation of different governance standards and codes in corporate governance, and banking and

[33] ADB, *The Bank Group Policy on Disclosure of Information*, 2004.

[34] The strategy for *Enhanced Engagement in Fragile States* (under consideration) focuses on two thematic pillars: reconstruction of basic infrastructure and good economic and financial governance. The strategy further stipulates that: "specific attention will be paid to the challenges of resource-rich fragile states, lack of transparency, and corruption as contributors to state fragility" (p.9).

[35] The Bank's Legal Department (GECL) is considering establishing an African Legal Support Facility (ALSF) to provide legal assistance and advice to African fragile states and post-conflict countries in a variety of areas, including in the negotiation of natural resources concessions and the fights against corruption.

[36] Paul Collier, *Post-Conflict Recovery: How Should the Strategies of the African Development Bank be Distinctive?* June 2007.

[37] Such as the Forest Law Enforcement and Governance (FLEG) initiative in the forestry sector or the Kimberley Process Certification Scheme in the diamond industry.

financial regulations.[38] Where applicable, the Bank's country governance assessments and activities should be aligned to the APRM and support the implementation of National Plans of Action (NPoAs).

4.21 The fight against corruption is a global effort requiring international cooperation. Regional codes in support of governance include the AU Convention on Preventing and Combating Corruption (AUCPCC) and the UN Convention against Corruption (UNCAC). A majority of African states have already committed themselves to implementing these conventions, which include provisions for enhanced international cooperation in anti-money laundering and the recovery of stolen assets. In 2007, the Bank developed an anti-money laundering and counter-terrorism financing strategy.

4.22 The Bank will develop the capacities of regional networks and institutions to anchor regional standards and codes of good financial governance. Examples of such support include:

4.23 Support to international standards in government auditing (AFROSAI), regional payment systems (ECOWAS, COMESA), regional harmonisation in public procurement (UMEOA, COMESA), and regional anti-money laundering organisations (GIABA; ESAAMLG); and

4.24 Support to regional networks of senior budget officers, accountants-general and auditor-generals, for example the Collaborative Africa Budget Reform Initiative (CABRI), and strengthen Africa's accounting and auditing professionals in collaboration with other donors.

Instruments

4.25 The Bank's governance activities in the four pillars will be guided by a careful assessment of country needs, corruption risks, and potential for success. The Results-Based Country Strategy Papers (RBCSPs) will guide the approach to strengthening accountability and transparency in the management of public resources.[39] The RBCSPs will include an assessment of governance and corruption risk, undertaken with other donors, and an evaluation of RMC's governance and anticorruption strategies. The Bank's participation in the APRM provides an additional entry point to strengthen governance in RMCs.

4.26 Upstream analytical and advisory work on governance will be substantially enhanced and refocused on financial governance. These analytical and advisory activities include joint governance assessments,[40] public financial management reviews,[41] and public procurement reviews.[42] The Bank will revisit its approach to assessing governance performance and trends in RMCs through an enhanced approach to Country Governance Profiles (CGP), better aligned with the APRM framework.[43] The focus on good financial governance will have positive interactions with the Bank's corporate processes (for ADF resource allocation, country strategies and operational programming).

4.27 The Bank will use budget support, policy-based lending and institutional grants to provide long-term support to promote good financial governance. The Bank's policy-based lending on governance, budget support and institutional strengthening projects are key instruments for supporting accountability and transparency in the management of public resources. This is particularly relevant, if the Bank scales up its budget support (the current ceiling is 25% of the ADF allocation).[44] Greater use of budget support is consistent with the Paris Declaration's targets on programme-based approaches and use of country systems and processes.

4.28 The Bank's focus on good financial governance will add value to the work of other

[38] ADB, *Corporate Governance Strategy*, 2005; ADB, *Bank Group Financial Sector Policy*, 2003; ADB, *Corporate Governance Implementation Framework*, draft, 2007.

[39] ADB, *Annotated Format for Bank Group Results-Based Country Strategy Paper* (RBCSP), ADF/BD/WP/2004/179/Rev.4/Approved 2 October 2006 (especially section 2).

[40] Including Joint Governance Assessments (JGA), Country Governance Profiles (CGPs), and Institutional and Governance Reviews (IGRs).

[41] Including Public Expenditure and Financial Accountability (PEFA) assessments, Country Financial Accountability Assessments (CFAAs), and Public Expenditure Reviews (PERs).

[42] Country Procurement Assessment Review (CPARs).

[43] ADB, *Review of Country Governance Profiles 2002-2006*, ADB, ORPC, 2006.

[44] An increase in the use of budget support would also contribute to the Paris Declaration commitments on programme based approaches, placing the Bank as one of the top 5 donors in the use of this instrument. OECD Development Assistance Committee, *Baseline Survey on Monitoring the Paris Declaration*, 2007.

development partners through enhanced partnerships. A strategic focus on good financial governance will enhance the capabilities of the Bank to actively engage in policy dialogue as part of multi-donor budget support. The Bank's focus on financial accountability (ex-ante and ex-post), public procurement, and external auditing will complement the International Monetary Fund and the World Bank's focus on building the capacity of the executive.[45] For example, the Bank is working with the World Bank towards a joint strategy and initiatives to support auditors-general in Africa.

4.29 Taking forward these strategic directions will require enhanced capacities to manage partnerships at global, regional and sub-regional level. *At global level*, key partner institutions include the World Bank, the International Monetary Fund (IMF), the European Commission (EC), regional development banks, the United Nations system, the Organisation for Economic Cooperation and Development (OECD), and bilateral partners. At *regional and sub-regional levels*, key institutions and processes include, *inter alia*, the African Union (AU), the NEPAD-APRM, the United Nations Development Programme (UNDP-RBA), and the United Nations Economic Commission for Africa (UNECA).[46]

5. Institutional Reforms

5.1 This section outlines some of the institutional reforms necessary to deliver the Bank's governance strategic orientations in 2008-2010. The challenge is to match ambitions to resources and to adopt a results-framework to monitor the implementation and assess results.

5.2 The implementation of these governance strategic directions will be a shared responsibility all Bank departments. The Governance, Economic and Financial Management Department (OSGE) will anchor the Bank Group's support to country systems in financial governance. It will also support other departments in the implementation of the orientations herein. The implementation of financial governance at sector and project levels will require strengthening capacities in the sector operational units of the Bank. Strengthening the Bank's own transparency and accountability is central to its corporate governance, including financial management, procurement, information and communication systems.[47] The decentralisation process will also contribute to a better understanding and mitigation of governance risks at both country and sector levels.

5.3 These strategic directions entail enhancing the Bank's knowledge base, staff resources, and skills mix related to financial governance at the country and sector levels. The Bank will need to enhance its engagement in upstream analytical work, strengthen its knowledge base in financial governance, and encourage learning from independent evaluations. This enhanced capacity will help the Bank:

- Crystallise and advocate an African voice in the international governance debate and encourage the adoption of global and regional charters in Africa;
- Inform the Bank's policy dialogue, risk assessment, and resource allocation, as reflected in country strategies and operational programming; and
- Strengthen capacity internally to improve operational effectiveness and in RMCs to increase development effectiveness.

5.4 The Bank will develop, in the medium term, an annual Bank flagship report, the ***African Governance Outlook*** (AGO), in close cooperation with key African partners.[48] This report will

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[45] World Bank, *Development Policy Lending Retrospective*, 2006; IMF, *Update on the Assessment and Implementation of Action Plans to Strengthen the Capacity of HIPCs to Track Poverty Reducing Public Spending*, 2005.

[46] Other partners include: the African Capacity Building Foundation (ACBF), the African Training and Research Centre in Administration for Development (CAFRAD), the African Governance Institute (AGI), the African Economic Research Consortium (AERC), and African civil society organisations and policy think tanks.

[47] The Bank's legal (GECL), audit (OAGL) and procurement and financial management (ORPU) departments will play a lead role in furthering transparency in Bank's corporate governance. See: ADB, *Restructuring Procurement and Financial Management Services, ADB, ORPU, draft August 2007*

[48] Through the proposed AGO, the Bank will have a more robust and consistent approach to the assessment and monitoring of governance performance, which will inform the Bank's country allocation system (PBA), through the governance factor (GF), the PCEF, the CPIA, and adjusted CPA.

strengthen Africa's voice internationally, highlight progress in African governance (especially financial governance), identify drivers of governance reform, and contribute to mutual accountability. The Bank together with other development partners will support African policy think tanks and research institutes on the Bank's governance priority areas, as provided for in the Bank strategy for supporting research in Africa.[49]

5.5 Lastly, implementing these strategic directions will require a framework for monitoring results. A key challenge of working on governance is to demonstrate impact. It is also contingent on developing a corporate culture using evaluation findings to improve performance and fine-tuning strategies. Accordingly, a results-monitoring framework for governance, to be developed in close consultation with OPEV, will look at two sets of issues:

- How is the Bank enhancing the design of its operations to better focus and address the governance dimensions and corruption risks at the country, sector and regional levels?
- What are the improvements, results and impact of the new Bank's operations in priority areas of financial governance (e.g. internal controls, public procurement, external auditing and broader financial oversight)?

5.6 The Bank will monitor progress in implementing this results-framework and adjust it accordingly. The Bank will assess its results and impact in the context of international financial governance standards, e.g. the monitoring framework of the Paris Declaration (based on the 2007 Baseline Survey) and the Public Expenditure and Financial Accountability (PEFA) framework (based on the 2007 PEFA assessments) (see Annex).

6. Next Steps

6.1 Following the endorsement of these Strategic Directions, the Bank will undertake to develop a *Governance Action Plan (GAP)* in the first quarter of 2008. As part of this process, the Bank will hold internal and external consultations to identify a realistic set of sector targets, expected results, measurable benchmarks, and time-bound activities for the implementation of the four main pillars of these Strategic Directions. It should however be stressed that a three-year timeframe provides limited scope to deliver robust results. Nevertheless, the proposed results-framework will provide the Bank with a renewed sense of purpose in its governance work.

6.2 Key features of the *Governance Action Plan* (GAP) are:

- Delineating the roles and responsibilities of the Bank's various departments (including country offices) to improve Bank's institutional capacities to deliver and further good financial governance in RMCs;
- Further rationalising the Bank's governance portfolio and scaling-up the Bank's budget support and governance policy-based lending in order to strengthen country systems, enhance transparency and accountability in the management of public resources;
- Enhancing and streamlining Bank support to institutional development and capacity building in public financial accountability (at country and sector levels), in particular in external auditing and public procurement;
- Increasing internal capacities in financial governance, for example through the establishment of a cross-departmental network of public financial governance experts; consolidating the Bank's knowledge base in financial governance and public financial accountability;
- Ensuring that the on-going institutional reforms mainstream governance concerns in sector operations and operational staff, enhance institutional learning capacities (through independent evaluations), and implement a communications strategy that enhances the transparency and disclosure of information of Bank's activities.

[49] ADB, *Bank Group Strategy and Framework for Support to Research and Capacity Building Institutions in Africa*, ADB ORPC, 17 October 2006, ADB/BD/WP/2006/110 and ADF/BD/WP/2006/128.

Annex 1: Indicative Results Framework

Table 1: NEPAD African Peer Review Mechanism: Areas of Assessment
Democracy and Good Political Governance
1. Intra and inter-country conflicts 2. Constitutional democracy 3. Promotion of economic, social, cultural, civil and political rights 4. Separation of powers; independent judiciary and effective parliament 5. Accountable, efficient and effective public office holders and civil servants 6. Fighting corruption in political sphere 7. Rights of women 8. Rights of child and young persons 9. Rights of vulnerable groups, inc. displaced persons and refugees
Economic Governance and Management
1. Macroeconomic policies that support sustainable development 2. Transparent, predictable and credible government economic policies 3. Promote sound finance management 4. Accelerate regional integration
Corporate Governance
1. Enabling environment and effective regulatory framework for economic activities 2. Ensure corporations act as good corporate citizens: human rights, social responsibility and environmental sustainability 3. Codes of good business ethics 4. Corporations treat all their stakeholders in a fair and just manner. 5. Accountability of corporations and directors
Socio-Economic Development
Includes: capacity for self-sustaining development, accelerate socio-economic development, social development areas, affordable access to water, energy, finance, markets and ICT, gender equality and broad participation.

Table 2: Bank's Country Policy and Institutional Assessment Criteria
Economic Management
1. Macroeconomic Management* 2. Fiscal Policy 3. Debt Policy
Structural Policies
4. Policies and Institutions for Economic Cooperation,
Regional Integration and Trade*
5. Financial Sector
6. Business Regulatory Environment
Policies for Social Inclusion
7. Gender Equality
8. Equity of Public Resource Use
9. Building Human Resources*
10. Social Protection and Labour*
11. Environmental Policies and Regulations*
Public Sector Management and Institutions (governance cluster)
12. Property Rights and Rule-Based Governance*
13. Quality of Budgetary and Financial Management
14. Efficiency of Revenue Mobilization*
15. Quality of Administration*
16. Transparency, Accountability and Corruption in the Public Sector

Table 3: Relevant Paris Declaration Performance Indicators (indicative)	
1	Partners have operational development strategies
2a	Reliable public financial management systems
2b	Reliable procurement systems
3	Aid flows are aligned on national priorities
4	Strengthen capacity by co-ordinated support
5a	Use of country public financial management systems
5b	Use of country procurement systems
6	Avoiding parallel project implementation systems
7	Aid is more predictable
8	Aid is untied
9	Use of common arrangements or procedures
10a	Missions to the field
10b	Joint country analytic work
11	Results-oriented frameworks
12	Mutual accountability reviews

Table 4: Relevant indicators of public finance accountability (indicative)

A. Public finance management out-turns
1. Aggregate fiscal deficit compared to the original approved budget.
2. Composition of budget expenditure out-turn compared to the original approved budget.
3. Aggregate revenue out-turn compared to the original approved budget.
4. Stock of expenditure arrears; accumulation of new arrears over past year.
B. Key cross-cutting features: Comprehensiveness and transparency
5. Comprehensiveness of aggregate fiscal risk oversight.
6. Extent to which budget reports include all significant expenditures on central government activities, including those funded by donors.
7. Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation
8. Administrative, economic, functional and programmatic classification of the budget.
9. Identification of poverty related expenditure in the budget.
10. Publication and public accessibility of key fiscal information, procurement information and audit reports.
C. Budget cycle
C(i) Medium term planning and budget formulation
11. Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting.
12. Orderliness and participation in the budget formulation process.
13. Coordination of the budgeting of recurrent and investment expenditures.
14. Legislative scrutiny of the annual budget law.
C(ii) Budget execution
15. Effectiveness of cash flow planning, management and monitoring.
16. Procedures in operation for the management and recording of debt and guarantees.
17. Extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with original/revised budgets.
18. Evidence available that budgeted resources reach spending units in a timely and transparent manner.
19. Effectiveness of internal controls.
20. Effectiveness of internal audit.
21. Effectiveness of payroll controls.
22. The existence of a transparent procurement system.
C(iii) Accounting and reporting
23. Timeliness and regularity of data reconciliation.
24. Timeliness, quality and dissemination of in-year budget execution reports.
25. Timeliness and quality of the audited financial statements submitted to the legislature.
C(iv) External accountability, audit and scrutiny
26. The scope and nature of external audit.
27. Follow up of audit reports by the executive or audited entity.
28. Legislative scrutiny of external audit reports.

Source: PEFA 2004.