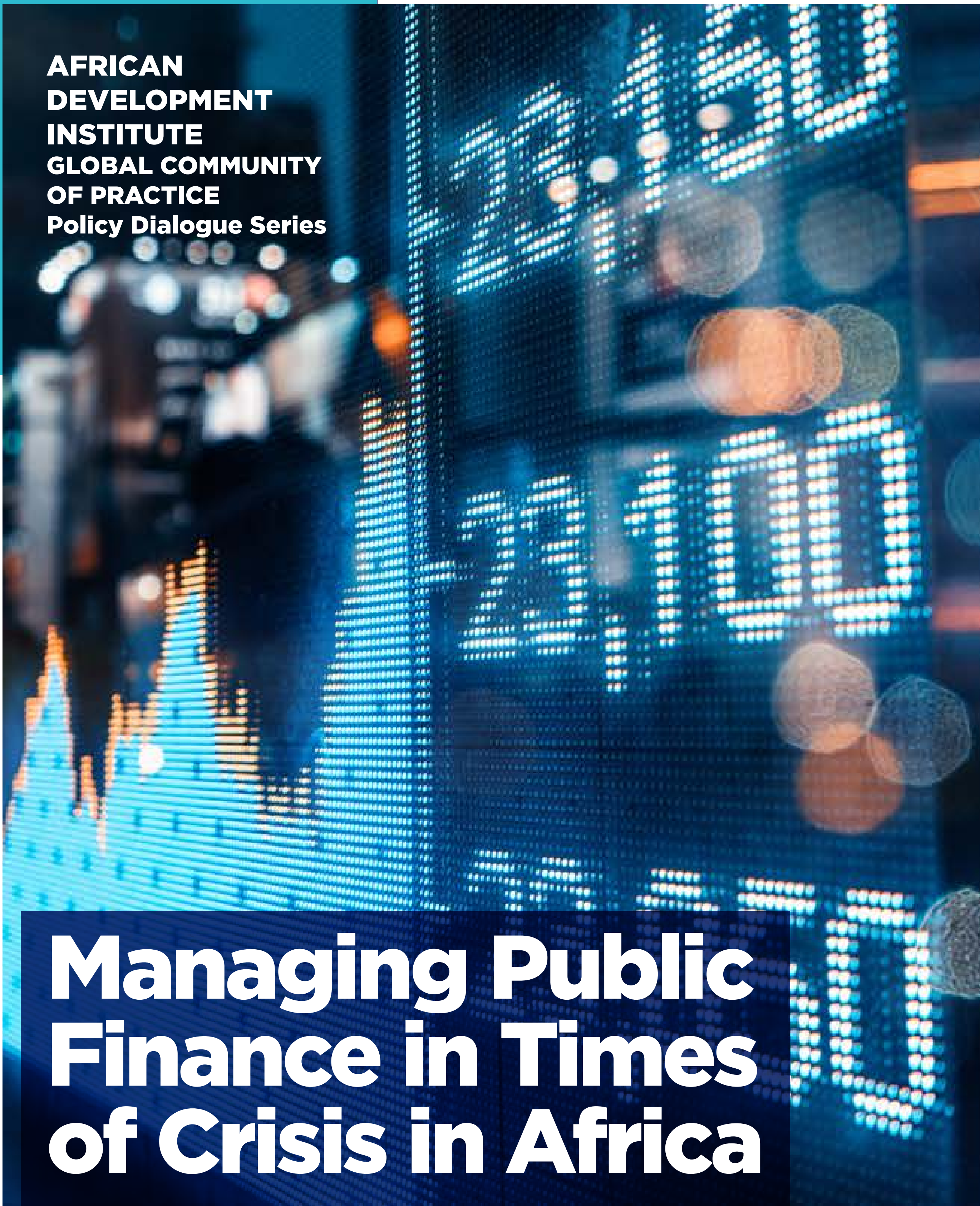

AFRICAN DEVELOPMENT INSTITUTE
GLOBAL COMMUNITY OF PRACTICE
Policy Dialogue Series

Managing Public Finance in Times of Crisis in Africa

Notes for Policymakers

AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

AFRICAN DEVELOPMENT INSTITUTE
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1. African Development Institute

2. Governance and Economic Reforms

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1 Background

- The Covid-19 pandemic impacted Africa's macro-economic outlook, financial flows, public finance management, lives, and livelihoods in fundamental ways.

- The crisis has exacerbated Africa's fiscal challenges and worsened the financing development goals, reversing decades of progress on the continent (Figure 1).

- The need for enhanced mobilization and prudent management of scarce public finances to deliver desired development impacts has been deepened by the crisis.

- The ability to stimulate the economy in the short-term during downturns depends on the effectiveness of prior counter-cyclical measures (Figure 2).

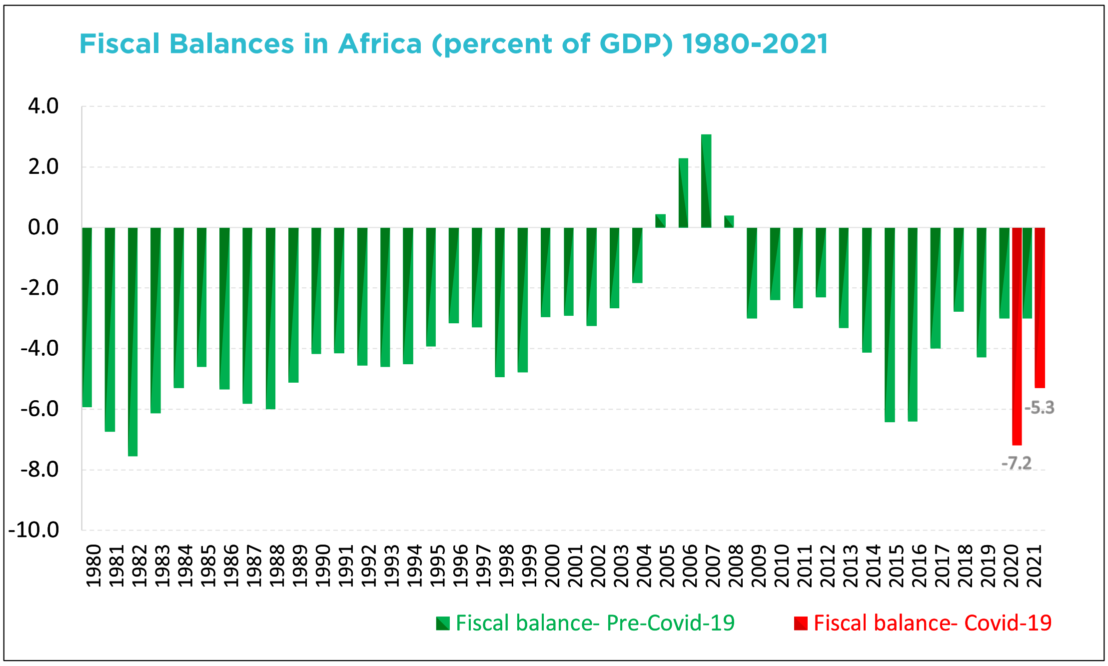
- Africa's long-term sustainable recovery from the fiscal impacts of Covid-19 will largely depend on the availability and efficient management of affordable financing for inclusive and sustainable development.

- The African Development Institute (ADI) of the African Development Bank Group (AfDB) convened a Global Community of Practice (G-CoP) Policy Dialogue and executive training on Managing Public Finance in Times of Crisis in Africa, from February 28 to March 01, 2022, and March 02-04, 2022, respectively.

- The Policy Dialogue explored practical policy options to strengthen public finance management capabilities to better respond to the crisis and help build resilience for the future. The executive training program provided practical tools and implementable policy options and shared experiences and practices to manage public finance in Africa.

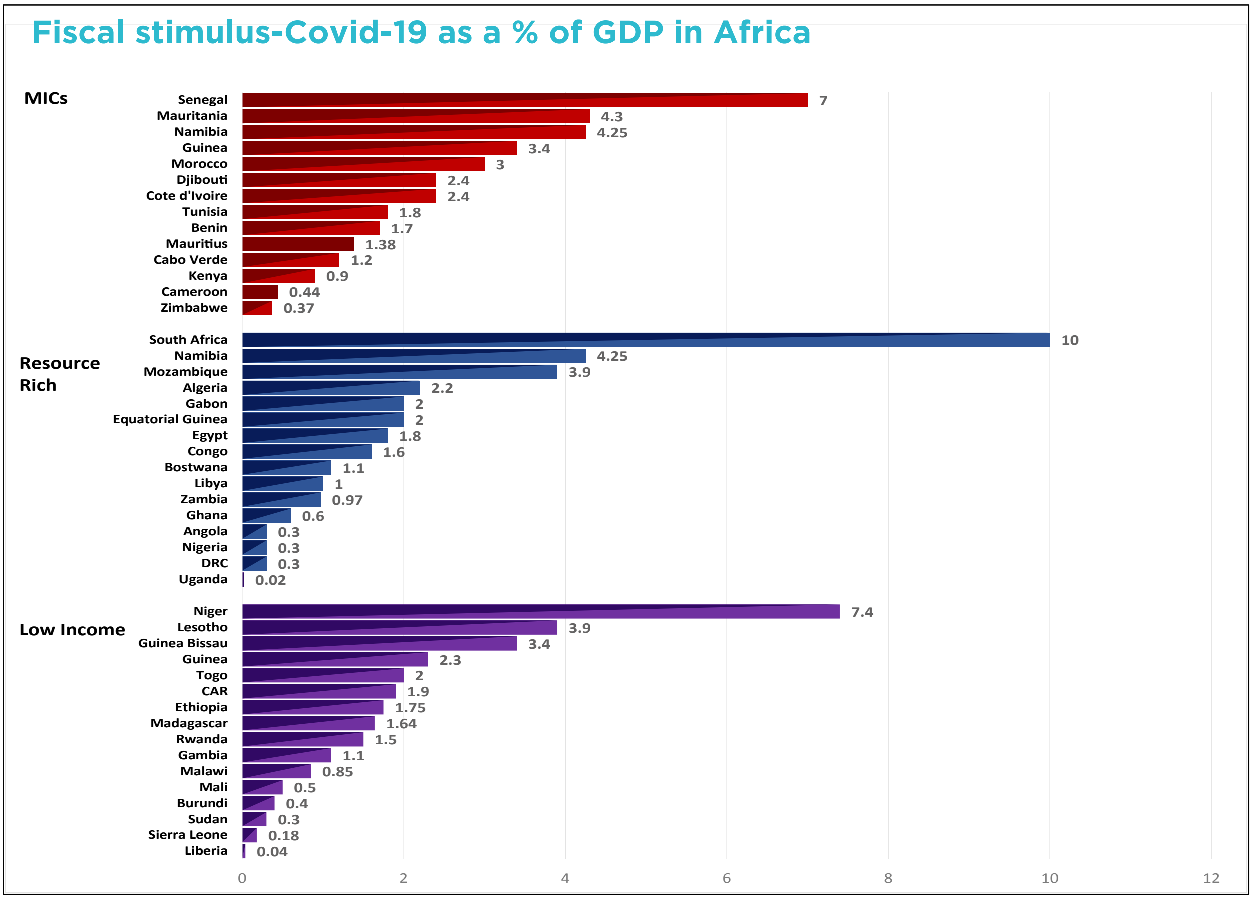
- The brief summarizes the key policy options that emerged from the discussions.

Figure 1: Covid-19 and fiscal performance in Africa



Source: AfDB Statistics

Figure 2: Fiscal Stimulus for Covid-19 in Africa



Source: IMF Data

2 Policy Options

- **Discussions of policy options were based on the following 5 thematic areas, suggested in time dimensions of short-term, medium-term, and long-term:**

    - Resource mobilization – with a focus on domestic and external sources
    - Resource allocation and utilization.
    - Public Finance Management and Accountability Capabilities.
    - Public Finance Management for Managing Global Commons.
    - Partnership and Coordination for Strengthening Public Finance Management.

2.1 Resource Mobilization – Domestic and External Resources

2.1.1 Short-term policies

- Digitalization to improve the collection and administration of tax revenue, for example by adopting comprehensive Integrated Tax Administration Systems (ITAS).

- Adopt comprehensive and robust tax compliance improvement plans that connect all aspects of the compliance process.

- Improve frameworks for reducing tax evasion and avoidance, including profit shifting, transfer pricing, as well as the exchange of information, and general improvement of tax compliance and enforcement.

- Strengthen capacity for effective formulation and implementation of debt policy and Medium-Term Debt Strategy to ensure more prudent debt mobilization and management.

- Leverage financing from the private sector, and advance innovative ways to raise funds for development including public-private partnerships (PPPs).

- Strengthen legal and institutional capabilities to mitigate illicit financial flows, especially those which are due to the operation of multinational corporations. Africa loses about $89 billion (about 3.7 percent of GDP) annually in illicit financial flows.

- Make effective use of policy-based operations (PBOs) to promote domestic revenue mobilization.

- Centralize mobilization and management of grants for efficiency use and more credibility with the donors

- Adopt and implement Tax Administration Diagnostic Assessment (TADAT) for better diagnosis of tax systems and challenges; to inform evidence-based tax policy and tax administration reforms.

2.1.2 Medium-Term Policies

- Adopt Medium-Term Revenue Strategy (MTRS) to bolster revenue collection and management—along with Medium-term Expenditure Framework (MTEF) to prioritize and control spending and fiscal overruns.

- Build fiscal buffers and counter-cyclical fiscal policy frameworks, and embed them in the PFM system to manage both reoccurring minor crises, and to help strengthen the systems' resilience to mitigate the effect of major crises.

- Propose to external lenders to index loans to resource-intense countries based on the changes in commodity prices to help free up the fiscal space of these countries, especially during periods of crisis.

- Digitize/automate domestic revenue mobilization and utilization procedures to enhance transparency, traceability, accountability, and consequence management.

- Accelerate Treasury Single Accounts (TSA) reforms to improve liquidity, visibility and management.

- DFIs could increase guarantees and liquidity facilities to banks with which they have lines of credit, within a comprehensive debt management strategy and program.

- Deepen organic development of domestic capital and financial markets, both primary and secondary for effective borrowing and liquidity management.

- Encourage fiscal decentralization and regionalization of revenue collection, utilization, and public accounting, especially for federal states and autonomous regions.

- Development Finance Institutions (DFIs) could re-profile and use their risk capital to support domestic revenue mobilization and private sector investments in natural resources beneficiation and value creation in Africa.

- Invest Pension Funds and Sovereign Wealth Funds in local markets.

2.1.3 Long-term Policies for Building Resilience

- Diversify the economy from commodity dependence to build fiscal resilience against shocks (especially in resource-rich countries).

- Implement the African Continental Free Trade Agreement (AfCFTA) and leverage its opportunities to support economic expansion and integrate the region's small-scale and fragmented economic and financial systems to enhance resource mobilization.

- Multilateral Development Institutions to scale up concessional loans and development assistance during a crisis.
- Encourage strategic franchising to facilitate the location of top brand industries and ivy league institutions' production factories in Africa.
- Build domestic value chains in key resource sectors and implement local content policies to encourage local industrial production and value addition and gradually reduce export quotas for low-value-added commodities.
- Strengthen institutional capacity for tax administration, smart contracting for natural resource-based projects, and trade agreements.
- Improve the business climate to accelerate foreign direct investments (FDI) and private sector capital inflows into African markets as a way of deepening the Domestic Stock Exchange Markets.
- Development finance institutions should consider increasing the issuance of bonds in domestic currencies.

2.2 Resource Allocation and Utilization

2.2.1 Short-term Policies

- Introduce fiscal stimulus packages that contain discretionary measures that are timely, targeted, and temporary, with clear exit options.
- Establish robust budget classification and codes and charts of accounts that allow the creation of new programme codes and line items in the budget to respond to specific needs during crises.
- Develop robust social transfer schemes (cash transfers, etc.) which could be more effective than subsidies to energy and other utilities.
- Establish crisis response mechanisms and procedures/protocols (e.g desk, unit, inter-ministerial committee comprising of central PFM agencies depending on country circumstances) that can quickly activate and coordinate PFM crisis response actions to crises, and specific PFM processes for ease of activation during a crisis.
- Promote results-based PFM and move from needs-based budgeting (also described as a shift from activity-based budgeting (ABB) to programme-based budgeting (PBB).
- DFIs and development partners to support the maintenance of critical public spending (e.g health, education, social protection), especially in low-income countries to improve counter-cyclicality (e.g., crisis response window).
- Shed unnecessary fiscal burden emanating from high overheads.

2.2.2 Medium-term policies

- Automate and digitize PFM processes and systems to enhance transparency, flexibility, and speed during the crisis, for example, implement the Integrated Financial Management Information System (IFMIS).

- Develop robust macro-fiscal forecasting capabilities, which are necessary to quickly establish scenarios for resource availability, sector needs, and resource re-allocation at the onset of a crisis.

- Implement PFM systems reforms that allow for better budget planning, execution, and control to make spending more efficient.

- Move towards a balanced budget.

- Promote prudential borrowing only for growth-enhancing infrastructure and during severe shocks.

2.2.3 Long-term policies for building resilience

- Undertake country public investment management reviews to assess the strength and performance of infrastructure governance in the areas of planning, allocating, and implementing investment in economic and social infrastructure, which are required for economic transformation and human development in the countries. Countries can use tools such as the Public Investment Management Assessment (PIMA) to achieve this goal.

- Improve regional coordination and cooperation in times of crisis (e.g., Covid-19 vaccine distribution).

- DFIs and development partners and countries could collaborate to provide continuous training and capacity building and institutional strengthening of public finance institutions in RMCs.

- Make a gradual shift from cash accounting to accrual accounting, perhaps starting with semi-accrual rules and principles—within the context of best practice and the generally-accepted accounting standards.

- Assess long-term sustainability of the public pension system and implement reforms to eliminate further fiscal risks.

2.3 Public Financial Management and Accountability Capabilities

2.3.1 Short-term policies

- Governments should develop standard operating procedures for policymaking and coordination during the crisis, with clear mandates and sunset clauses embedded in the law, regulations, and public service rules for temporary measures.

- Incorporate flexibility in the policy and budgeting process to ensure that there is responsive policy realignment and budgetary re-allocation during a crisis.

- Strengthen the procurement system through the implementation of beneficial ownership, open contracting standards, and e-procurement to expose those who hide under the veil of incorporation, especially politically exposed persons, to commit fraud through the public procurement systems.

- Undertake Africa-wide PEFA assessments to benchmark the PFM capabilities of RMCs as a basis for identifying common gaps, weaknesses, and needs; as well as individual strengths of countries that can be leveraged for peer-to-peer learning.

- Adopt targeted fiscal stimulus measures, preferably from fiscal buffers built over time, to provide social safety nets to protect lives, private investments, and firms during the Covid-19 pandemic and beyond.

- Devise smart contracts, including recovery of loans for commercial projects, and deepen public-private partnerships.

- Deepen fiscal transparency and accountability.

- Adopt a proactive rather than reactive approach to supreme audits to promote fiscal transparency.

- Strengthen the oversight role of the parliament on PFM.

2.3.2 Medium-term policies for rebuilding the economies

- Put in place business continuity plans including counter-cyclical policies for both revenue and expenditures before the crisis.

- Strengthen the sub-national PFM capacity of RMCs as sub-national level governments are very critical in governance and service delivery given their closeness to the grassroots, especially during a crisis.

- Realign Perverse Subsidies.

- Reduce and eliminate fiscal wastage resulting from overpricing of public infrastructure projects.

- Develop a legal and institutional framework for establishing supreme audit institutions where they are non-existent.

- Promote operational, functional, financial, and organizational independence of Supreme Audit Institutions (SAIs).

- Invest in capacity strengthening for the SAIs to ensure that they have the needed human, technological and financial resources to operate effectively. Similarly, the support should be extended to Parliament to fulfil its oversight roles and to Internal Audit agencies to ensure the efficacy of ex ante expenditure management.

2.3.3 Long-term policies for building resilience

- Professionalize and provide operational independence of the Supreme Audit Institutions (SAIs) to make sure that the SAIs are capable of delivering on their mandates without any interference by the executive branch of government.

- Develop Harmonized Strategy and Compliance Mechanism for fighting Corruption and Illicit Financial Flows.

- Development partners and capacity development institutions could collaborate on the research, review, and funding of a new PFM curriculum in Africa's tertiary level institutions – universities and colleges.

- Ensure clear, coherent, and continuous support for PFM reform within the Executive, and over time, broaden support across the political spectrum.

- Develop and support long-term human and institutional capacity development for SAIs.

- Invest in the development of fiscal infrastructure and promote data governance through digitization and continuous real-time access to data on-site and off-site.

2.4 Public Financial Management for Managing Global Commons

2.4.1 Short-term policies

- Mainstream gender, SNG, climate change, etc., into planning, budgeting, expenditure, and debt management processes.

- DFIs can direct their activities (and hence implicit subsidies) towards activities with positive externalities for the environment, and mitigation and adaptation against climate change.

- DFIs and development partners can collaborate to strengthen institutions and promote high global standards of governance, and transparency in managing global commons e.g., UNFCC on the Paris Climate Agreement, IETI on transparency in managing natural resources, etc.

2.4.2 Medium-term policies

- Abolish inefficient fossil fuel subsidies and promote focused investment in renewable energy that offers a more resilient and decentralized energy source.

- Adopt innovative approaches to mobilize finances for climate action, such as green bonds, sustainability bonds, green funds, credit enhancement, leasing, and guarantees.

- Strengthen government commitment to low carbon internationally and nationally.

2.4.3 Long-term policies for building resilience

- Make energy pricing coherent as part of post-crisis fiscal reorganization, including phasing out fossil-fuel subsidies, building carbon pricing that includes social protections, and emission trading systems. This will help to build fiscal resilience.

- Increase ambition of long-term environmental objectives (including net-zero GHG emissions) and ensure that policies and investments triggered through fiscal stimulus packages are aligned with low carbon development outcomes in the post-Covid-19 pathway.

- Build partnerships for external financiers to support green growth recovery and enable the economy to transition to a low-carbon development strategy.

2.5 Partnership and Coordination for Strengthening Public Financial Management

2.5.1 Short-term policies

- Align overseas development assistance to national development priorities, reform instruments for partnerships in engaging with DFIs to ensure flexibility in crisis and out of the crisis, and allow resources to be made readily available during a crisis.

- Revisit the use of Country Classifications and Risk Ratings during times of severe shock—within the context of comprehensive debt management initiatives.

- Development partners could develop partnerships to assist countries to build tools for data analysis and evidence-based decision-making.

- Building strong strategic partnerships including African-based PFM institutions.

2.5.2 Medium-term policies

- Increase the capacity to mobilize Development Aid and adopt mechanisms that make its use more flexible, particularly in the event of a crisis.

- Strengthen partnerships to promote green technology and cooperation, building capacity for domestic green innovation and adoption to build resilience post- covid crisis in the region.

- Build partnerships of DFIs in investing in sustainable private sector projects which can support long-term private sector-led growth.

- Build partnerships to strengthen the capacity of Ministries, Department and Agencies (MDAs) in developing prioritization and planning methodologies and tools adapted to crises.

2.5.3 Long-term policies for building resilience

- Strengthen long-term relationships between universities and policymakers and tailor curriculum to key policy issues.

- Develop partnerships in supporting the development of PFM institutions, legislation, processes, and systems, for example, capacity in taxation in specialized areas by directing technical assistance from DFIs to specialized areas, such as transfer pricing and illicit financial flows, use of artificial intelligence in PFM.

- Safeguard the stability of the global financial/economic and social systems by promoting global rules for example rules on financial markets; environment, and public health, to build resilience and respond better to the crisis.

3 Policy Timing, Design, and Implementation

- Irrespective of policy choices, achieving the desired policy outcomes would depend largely on policy timing, flexibility in implementation, and contexts.
- Policy reforms to strengthen public finance management frameworks need political support to implement and make them effective, so country-specific political dynamics are a critical factor to consider.
- Map out potential multiplier effects and co-benefits of policy strategies and reforms on other sectors of the economy at the design stage, for example, the implications of fiscal policy actions on private sector investment.
- Policy design should include clear indicators of accountability and strategies for monitoring progress to maximize impact.
- Policy design should also focus on the long-term perspectives. Fiscal policy should not only focus on responding to the crisis but on rebuilding better economies that are resilient, sustainable, inclusive, and reduce inequality.
- The PFM tools and policies to deploy in crises depend on existing fiscal conditions: government budget position relative to medium-term objectives government indebtedness, the extent of contingent liabilities, and other long-term risks, such as aging costs.
- Fiscal policies should be flexible and include certain contingencies to build policy credibility during a crisis.

4 Lessons Learned

- The combination of minor and major crises has become more frequent. Preparedness in normal times is key to a swift response to a crisis.
- Digitalization is critical in building an effective PFM system that responds effectively to a crisis.
- Fiscal buffers are crucial for an effective policy response to a crisis as they support the implementation of countercyclical policies.
- Flexibility in the budgeting and appropriations process and legal framework is essential to assure room for contingency appropriations, emergency spending provisions, and re-allocations.
- Balancing the speed of disbursement and accountability in budget execution is important in building credibility in the PFM systems, and effective response to a crisis (where speed is of the essence to the majority of disbursements).
- Crisis support is more successful if it is nested in a framework that incorporates post-crisis recovery and includes a focus on fiscal and public expenditure reforms.
- Macro-fiscal modelling and forecasting are important components in the budget process, as it impacts the effectiveness of achieving macro-fiscal objectives and longer-term fiscal sustainability.
- Global commons problems like Covid-19, require global action to address their economic impact. Hence the global or continental approach to managing global shocks is imperative.
- Partnerships and collaborations among development partners are key to building sustainable capacity building in public financial management in Africa.
- Institutionalizing innovative and effective practices from a crisis is crucial for building resilience and preparedness for future crises.

5 Conclusion

- The Covid-19 pandemic has worsened public finance management challenges in Africa and worsened the financing of development goals.

- The Covid-19 crisis presents opportunities to improve PFM systems in Africa and rebuild stronger, sustainable, and inclusive economies.

- Countries should: develop robust digital public finance management systems; build and sustain fiscal buffers; establish effective medium-term debt management strategies; develop crisis response protocols for PFM processes; enhance the operational and financial independence of Supreme Audit Institutions; strengthen partnerships and collaborations for building capacity in PFM, and coordination of policy responses to crises.

- The achievement of desired policy outcomes depends on policy timing, timeliness, flexibility of implementation of policies, and contexts.

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