

# Prospects for Transformation of Public Financial Management in Least Developed Countries An African Perspective

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Cristina Duarte, Former Minister of Finance and Planning, Cabo Verde Islands

# Two Dimensions ....

- This is the central question of development finance from an African standpoint ...
- What Public Finance Management (PFM) Reforms to unlock Domestic Resource Mobilization (DRM)?
- Two Dimensions ...
- Political Will dimension: mindset, leadership, ownership,
- Technical Skills dimension : PFM reengineering ...

# The Political Will Dimension ...

- The Political Will dimension is **the main requirement to build developmental institutions.**
- To implement the needed PFM reforms to unlock DRM, there is a crucial precondition, African policy makers mind set, what should African policy makers do in order to substantially increase domestic development financing over a sustained period of time?
- **1<sup>st</sup>:** African policy makers should be conscious of the fact that is not a technical problem. It is not a question of creating innovative financing mechanisms, actually the finance world has already proven to be highly innovative. The supply of expertise on this matter is vast and available.
- **2<sup>nd</sup>:** African policy makers should be conscious that it is essentially a question of ownership & leadership. There are dozens of PFM reengineering solutions, there is a need for political commitment and a strategic approach based on a strong shared vision.
- **3<sup>rd</sup>:** African policy makers, must understand that development cannot be outsourced and act accordingly. African leadership must effectively lead, and in order to lead, **African leadership must exercise ownership over the natural resources flows, financial flows and fiscal flows** to built the necessary and indispensable institutions for domestic resource mobilization.

## The Political Will Dimension ... (cont.)

- **4<sup>th</sup>**: African policy makers should understand that Africa's structural transformation calls for an intangible dimension: the institutional dimension ... The setting up developmental institutions and DRM is a challenge that require strong institutions, accountability, and transparency.
- **5<sup>th</sup>**: It is now time to end equating the business of managing poverty to development... Africa must now shift its focus to creating wealth, better managing its own resources and fostering inclusiveness. The result is that the focus on poverty management has not left the space for "public policy" to focus on growing and retaining Africa's wealth ..
- **6<sup>th</sup>**: in order to do that ... a core challenge therefore is rebooting development financing in Africa. A critical element in rebooting development financing in Africa is Domestic Resource Mobilization. ... so transforming PFM systems
- **9<sup>th</sup>**: Africa should set itself a bold target, over the next two decades, to move away from aid ... and the SDG 16 & SDG 17 is the Achilles' heel.

# The Technical Solutions Dimension ...

- **The technical solutions/skills dimension will be “activated” only if the political dimension is “on” ..**
- PFM systems are the major indicator to assess Governments’ serious commitment in terms of transparency and accountability .... Because without accountable and transparent PFM systems there is no accountable and transparent governance ...
- If we imagine Institutional Capacity Building as a pyramid, PFM systems are the basis, the foundation. They are much more than budgeting and they go beyond the Ministry of Finance borders. The all government and public administration actively participate in the functioning/management of the PFM systems. **They are PFM Agents at different levels.**
- PFM Mega-System comprises the following systems: planning- budgeting (PBS), accounting, monitoring & evaluation, asset management (treasury, debt financing, state land property rights, ... ), procurement, public investment, auditing, resources mobilization (domestically & internationally), tax policy, tax administration, ...
- **This holistic approach of the PFM systems is an important requirement:**
  - **for the vertical and horizontal integration between planning and budgeting exercises. Vertically between sectors and horizontally, between national and local levels.**
  - **as well as, for budget consolidation, which by its turn is an important requirement for transparency and accountability.**
- This holistic and integrated approach of the PFM Systems played a crucial role in the successful management process of CAPE VERDE’s graduation from LDC to MIC. Namely in terms of resources mobilization, internationally and domestically, allowing the Government of Cape Verde to mobilize on highly concessional terms a significant amount of financial resources, increase the public investment portfolio by 6 X , and infrastructure the country at a very low cost.
- Huge investments were made in **“physical infrastructures”** and **“institutional infrastructures”** in social sectors (education, health, social protection, social housing, ...) as well as in economic sectors (transportation, energy, agriculture, fishery, water & sanitation, ICT, ...) which accelerated the achievement of the MDGs.

# PFM Systems, Domestic Resource Mobilization and SDGs

- Domestic resource mobilization is determinant to achieving the Sustainable Development Goals, and it is the key to ensuring national ownership of public policies and of domestic physical, fiscal and financial flows. (Cristina Duarte's Official Speech, Ministers of Finance 3<sup>rd</sup> Conference on Financing for Development, Africa Union, 2015)
- DRM has four dimensions:
  - **Budget Revenues/Tax Revenues and Tax Administration**
  - **Domestic Savings**
  - **Capital Markets**
  - **Illicit Flows**
- PFM Systems are particularly important for **Budget/Tax Revenues, Tax Administration and Illicit Flows.**
- From a budget/tax revenue standpoint and to further increase their tax revenue, African countries do not need to rely on raising the tax rate. What is needed is the expansion of the tax base and an improvement in tax administration. African countries must also watch the excessive granting of tax exemptions. One area to revisit is the tax exemptions granted to multinational corporations in the extractive sector to increase available tax revenues and to improve perceptions that tax systems are not fair.
- To measure the efficiency and effectiveness of DRM from a development finance standpoint, we need to tackle not only the aspects related to the resources mobilization process (tax revenues, domestic savings, capital markets and IFFs) but also, and even more important, the quality of the expenditures undertaken with the financial resources mobilized. From a public financial management standpoint these are the two sides of the same coin or in other words, the two sides of the budget should be tackled at the same time. Otherwise, we might find ourselves pouring water in a basket full of holes. Effective fiscal policies and fiscal management institutions can ensure mobilization of the necessary tax revenues without negative impacts on private activities

# PFM Systems, Domestic Resource Mobilization and SDGs (cont.)

## The Example of Single Account Reform in Cape Verde Islands.

- Single Account Principle ... is crucial for budget and finance consolidation
- 60% of the accounts of public entities were in the banking system without control from the treasury
- We applied the single account principle ... we cancelled those accounts and consolidated the balances in the treasury account at the central bank ... boosting short term liquidity
- We applied some banking rules to the treasury management ...
- Reduce the need for short term debt ...
- Basically we were borrowing our own money from the banking system and consequently paying interests on our own money ...
- This is exactly what happen with most of the African countries .... Africa's liquidity is overseas ...feeding mostly international financial system ... and Africa borrows its own money and pay interests on our own money ... to infrastructure Africa.

# PFM Systems, Domestic Resource Mobilization and SDGs (cont.)

- From the illicit flows standpoint, they have become a serious issue worldwide and according to Global Financial Integrity 2015 study, in the period 2004-2013 the developing world as a whole lost US\$7.8 trillion, particularly for the 37 ADF African countries that requires substantial resources for development finance.

(Global Financial Integrity, "Illicit Flows from Developing Countries", Dev Kar and Joseph Spanjers, 2015)

- Various studies have estimated the amount of illicit flows that leave Africa on annual basis. Such estimates vary from USD 50 billion to USD 75 billion. Comparing with the approximately USD 90 billion financing need to infrastructure Africa and the fact that this financing need Africa mobilizes mainly in the international markets, we should at least question if Africa is not borrowing its own money and paying interest rates on its own financial resources. One more paradox among others.
- Illicit financial flows impact negatively on collection of tax revenues and so perpetuate Africa's economic dependence on external aid. As such, domestic resource mobilization cannot be discussed or resolved without taking into account IFFs.



# Bibliography

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