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CABRI Virtual Peer Learning and Exchange Event

The risks to national budgets in Africa posed by contingent liabilities and public–private partnerships (pre- and post-COVID-19)

CABRI Policy Brief

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Acronyms and abbreviations

AfDB	African Development Bank
ECOWAS	Economic Community of West African States
GDP	gross domestic product
IPP	independent power producers
IMF	International Monetary Fund
PPP	private–public partnership
SOC	state-owned corporation
SOE	state-owned entity
WAEMU	West African Economic and Monetary Union

Acknowledgements

This policy brief reflects the key takeaways from the discussions held during CABRI virtual peer learning and exchange event on the risks to national budgets in Africa, posed by contingent liabilities and PPPs, during the Covid-19 pandemic. Specials thanks goes to the panel members, presenters, discussants, facilitators and participants for their valuable inputs and contributions during the event. Finally, our thanks go to CABRI management and team for their support.

1 Introduction

The management of contingent liabilities and the enormous risks they pose to the fiscus are concerns across all regions in Africa. Despite progress made with reform efforts to strengthen the capacity in the management and monitoring of contingent liabilities, the risks have increased, and the claims now threaten the financial stability of government budgets.

Further progress towards reform is hindered by (1) the lack of political will to effect these reforms and (2) the absence of a clear rationale when issuing guarantees. Policy uncertainty and challenges persist – such as outdated business models and weak institutional arrangements related to governance and oversight. The CABRI Virtual Peer Learning and Exchange Event (22–23 September 2020) applied a holistic and strategic approach to better understand the challenges and to mobilise the right capabilities for effective execution in addressing the potential risks that implicit and explicit contingent liabilities pose to financial stability in the region.

CABRI's online event convened government officials from 22 African countries working in public debt and budget offices in national ministries of finance, as well as representatives from selected state-owned entities (SOEs) and other relevant stakeholders such as Agence UMOA-Titres (AUT), AFRITAC-East, the African Development Bank (AfDB), Eskom and the Macroeconomic and Financial Management Institute.

This policy brief is based on the findings of three case studies conducted in West, East and Southern Africa with a special focus on Kenya, South Africa and the West African Economic and Monetary Union (WAEMU) region, as well as on inputs and key messages emanating from the online peer learning and exchange event.

The focus of this brief is to provide: (1) an overview of the role of SOEs and the main issues affecting their financial stability in Africa; (2) a description of the risks contingent liabilities pose to national budgets; (3) input on regulatory and institutional challenges and benefits; (4) important lessons learned; and (5) guidance on strengthening and building internal capacity to better manage contingent liabilities, as well as possible ways forward for analysing risks, policies, frameworks and implementation plans.

Despite progress made with reform efforts to strengthen the capacity in the management and monitoring of contingent liabilities, the risks have increased, and the claims now threaten the financial stability of government budgets

2 Overview

The role of SOEs in Africa

SOEs form one of the largest sectors of the economy in many African countries and are important contributors to national development. They provide citizens with access to vital services such as water, electricity, health, sanitation, telecommunications and transportation.

African economies have placed SOEs at the centre of their national development strategies. Concerns, however, have been expressed regarding the effectiveness of these approaches, including the managerial and technical capabilities of participating SOEs in delivering on these objectives. Many SOEs are struggling financially and have consequently placed a significant strain on national budgets, contributing in some cases to economic and fiscal crises.

Issues affecting SOEs' financial sustainability

When considering the issues affecting SOEs' financial sustainability and impact on the fiscus, they can be separated into two groups:

1. Entities with long-term structural issues that were already in financial distress prior to COVID-19 due to unfunded policy mandates, operational inefficiencies, lack of oversight and weak corporate governance; and
2. Entities that are performing well, but, due to the crisis, have short-term liquidity constraints.

For the second group, it is recommended that guarantees should not, if possible, be issued to these entities, and they should rather be encouraged to continue operating within sound financial principles that will enable them to borrow on the strength of their own balance sheets.

At the CABRI peer learning event, the following reasons were identified as to why SOEs in the first group are experiencing financial difficulties, with South Africa's Eskom being a case in point (see the South African case study):

- Interferences in business processes;
- Political rather than technical appointments to boards and chief executive officer positions;
- Tension between boards and executives;
- Regulatory frameworks (tariffs), operational issues and turn-around strategies that are not fully implemented; and
- Policy issues undermining the mandate for SOEs since 2009.

All these factors have had a severe impact on Eskom's ability to operate efficiently and access financial markets. Policy regulations have prevented Eskom from raising tariffs, and they were further hindered in the collection of payments for services delivered by municipalities contesting the debt owed. As a result, Eskom is continuously dependant on government support.

Mandates

To uphold governments' social responsibility and policy pledges, SOEs are often mandated to deliver services (e.g. water and electricity) to uplift the poor without proper compensation or on-budget funding. This leads to shortfalls in revenue and an underinvestment in the maintenance of assets, finally resulting in the continuous issuance of government guarantees that the fiscus does not in fact have sufficient capacity to absorb should these contingent liabilities materialise.

Key questions about the services SOEs deliver need to be considered. Should the service be provided by the public sector (SOEs)? Should service provision be privatised or should it be brought onto the government's balance sheet (budget)?

If the service constantly requires government support and/or injections of capital, SOEs should be funded from the budget. If the government is not expecting an economic return on investment from their support to SOEs, then the SOEs need to cater for the expense in their budgets. If the private sector has the capacity and could provide the service more efficiently, then the service in question could be privatised, for example by independent power producers (IPPs), or responsibilities could be shared between the government and the private sector through public–private partnerships (PPPs).

Prior to actually issuing state guarantees, there should be a clear understanding of the rationale for doing so. As part of that rationale, conditions must be set that are well researched, measurable and time bound, and that ensure the SOE's financial position will improve over time.

Since 2010, the approach South Africa has followed to issuing guarantees has been to support SOEs in developing public infrastructure by issuing guarantees that aim to lower the SOEs' borrowing costs. This model has proven to be ineffective given the current financial situation of many SOEs. A better option could perhaps have been to strengthen the institutions and enable them to borrow on the merits of their own balance sheets –and thereby lowering the cost of borrowing.

Another rationale for issuing guarantees in East and West Africa was for SOEs to have access to other sources of funding, to lower project costs, reduce direct financing from government and to support the long-term financial stability of SOE projects.

In the end, it does not matter if governments officially issue guarantees because the perception of implicit guarantor prevails in either case. Moral hazards can only be addressed if the political will is present and supportive. If not addressed, bailouts and capital injections will continue and be necessary every year.

It is, however, a common practice across the continent that the onus rests on the government to step in and provide the necessary support when SOEs (also known as state-owned corporations) experience liquidity challenges. This weakens public finances further, especially when these entities and corporations are unable to utilise government guarantees and other support to turn their financial prospects around.

Weak financial oversight

SOEs needs to rethink and review their business models to ensure their continued relevance and resilience and that they are deserving of their government's increasingly scarce resources. There is often a lack of strategic thinking on the mandates and business models of SOEs that limits the ability to effectively monitor them and provide direction.

Governments are the custodians of state resources and the key investors in SOEs. Improving government oversight is therefore key to optimising SOE functionality. This can be accomplished by introducing a centralised credit risk unit (or directorate) within the national public debt office of the Ministry of Finance with the required range of analytical skills.

Continuous risk assessments on the financial soundness of SOEs are critical. In West Africa, the capability and tools to assess the risks are often limited. The problem does not only lie with limited tools and capabilities, however, but also with the availability of data for assessing the financial risk. Data is often of a poor quality or simply unavailable. This is due to a lack of efficient structures to collect the required information, which then leads to coordination and information-sharing challenges between governments and other key stakeholders.

To develop public infrastructure, the Government of Kenya has put more emphasis on increased private capital flows through PPPs, and more than seventy PPP projects are under construction in that country. The problem, however, is the lack of skilled staff to quantify the potential risks to PPP projects. Currently, only four officials in the Debt Policy, Strategy and Risk Management Department assess the risks to the fiscus posed by these projects in Kenya.

Despite credit risk units, such as in South Africa, having strong analytical capabilities to assess the risks posed by contingent liabilities, their recommendations are sometimes not taken into consideration by decision-makers. The problem is, even with the best analytic tools, skills and sourcing of reliable data, decision-makers and politicians still need to take these recommendations seriously and act accordingly.

Corporate governance

It is important that corporate governance within SOEs is strong:

- SOE boards and management must have the requisite skills to deliver on their respective mandates;
- Incentives must be aligned with policy objectives; and
- There must be consequences for poor decision-making (e.g. not maintaining existing infrastructure).

Shareholder departments should provide the necessary strategic guidance and monitoring to SOEs, including financial performance monitoring. To perform these functions effectively, officials within government departments need specialised technical knowledge and experience to appreciate the strategic interplay of the respective stakeholders' mandates and functions. Risk mitigation strategies and initiatives, and other shareholder support measures, must be identified and the necessary remedial action taken speedily. Risk mitigation strategies and initiatives should include:

- Approval of corporate plans;
- Regular shareholder meetings and reporting;
- Quarterly financial statements; and
- Performance agreements (including delivery targets, etc.) between the ministers of shareholder departments and all SOE board members.

It is often the case that shareholder departments do not fulfil their mandates and operate merely as post offices, such that, when quarterly financial statements are received from SOEs, they are passed on to the Ministry of Finance without checking that the required risk mitigation strategies have been applied.

Officials within SOEs, as well as in the shareholder departments and the Ministries of Finance, must take cognisance of possible unfunded developmental mandates that will place strain on SOE balance sheets if left unattended. Proper corporate governance principles – such as the selection and performance of board members and senior management – must be complied with to prevent unwarranted political interference in the day-to-day running of the business.

A strong message emanating from the CABRI peer learning event was that responsible officials need less political interference and more political guidance. Implementing governance structures, adopting and applying a solid regulatory framework, and developing good practices and regulations will eventually counteract political inference and prevent the risks resulting from the lack of oversight. Decisions should be guided by sound financial statements, the capacity to manage projects and by sustainable borrowing practices. In summary, applying basic performance targets and financial oversight will significantly improve the performance of SOEs.

Coordination

Many countries in Africa identify the lack of information sharing and reliable data as significant problems that negatively impact the efficient monitoring of contingent liabilities. Before demanding compliance from SOEs, governments should first take a hard look at themselves and ensure their own house is in order. Capabilities, skills and proper coordination need to be in place within Ministries of Finance to enable effective management and oversight of SOEs. Governments cannot blame others if no proper coordination and information sharing mechanisms have been built within their own structures.

There are various divisions within Ministries of Finance which play an important role in monitoring and overseeing SOEs. In South Africa, there are shared responsibilities within public finance, economic policy, budget office and asset and liability management (public debt office) divisions. In many instances, sharing information is not a common practice. In other instances, there might even be a duplication of responsibilities. This makes it extremely difficult for senior management or Ministers of Finance to make decisions if messages or recommendations are not coordinated. Constructive engagement is therefore needed prior to the issuance of guarantees.

In South Africa, the problem of proper engagement has been addressed with the establishment of a Fiscal Liability Committee (FLC) within the National Treasury. One of its key responsibilities is to make recommendations to the Minister of Finance on the issuance or approval of guarantees. The FLC's terms of reference and roles, amongst others, include:

- Conducting risk assessments of counter-party credit quality and advising the Minister accordingly;
- Monitoring the concentration of risk within the SOE's debt portfolios;
- Adopting a limit for total contingent liabilities issued, setting conditions and monitoring adherence;
- Monitoring the utilisation of guarantees and adherence to conditions;
- Providing oversight on the implementation of the National Treasury's contingent liability policy;
- Ensuring adequate reporting systems are in place; and
- Making decisions on the introduction of a funded contingency reserve account.

Similar structures have been adopted by countries such as Liberia and Malawi, where final recommendations to provide state guarantees to loans issued by SOEs are made by the Debt Management Committee (Liberia) to the Minister of Finance or Parliament for their approval.

The challenge is to establish proper monitoring mechanisms to track the regular servicing of these loans. Liberia is planning to open an escrow account with the Central Bank, into which interest payments to service SOE debt will be deposited and from where they will be paid. This will make the monitoring of payments easier and reduce the risks posed by contingent liabilities.

Weak coordination amongst stakeholders is, however, common in Africa countries. Reporting on guaranteed loan information is a concern. Malawi has implemented policy measures to manage information flows, which include:

- A clearly defined understanding of the guarantee process and the role of different departments and role players such as the Central Bank;
- Quarterly reporting of information between SOEs and the different role players;
- Analysing the risks to ensure timely action if and when needed; and
- Building strong relationships and workflows between different role players in the guarantee approval process.

Many countries show greater awareness of the importance of information sharing and have adopted appropriate practices accordingly. The challenge is to strengthen such arrangements and for stakeholders to apply the practices consistently. Better information sharing and coordination will lead to better monitoring of the risks and more timely interventions.

3 Risks posed by contingent liabilities to national budgets

Contingent liabilities are becoming a significant source of fiscal risk on the African continent. Budgetary risks from contingent liabilities and direct fiscal transfers (equity injections) from the state to SOEs are on the rise. The issuance of state guarantees was initially used to reduce the costs of doing business and to lower borrowing costs. However, as a result of increasing SOE borrowing requirements, these fiscal instruments have been utilised over time to prevent guaranteed SOE debt from defaulting due to liquidity and solvency challenges.

To avoid SOEs defaulting on guaranteed debt because of their vulnerable financial situations (caused by higher operational costs and revenue constraints), governments should instead choose to make direct capital injections and to provide budget support to SOEs. In this way, the affected SOE's balance sheet is strengthened, enabling it to meet maturing guaranteed-debt repayment commitments.

Contingent liabilities, therefore, have impacted government debt levels, as capital injections (or budget support) have primarily been funded through government debt. Total debt has therefore increased sharply and is approaching unsustainable levels. This can be attributed to the impact of repeated bailouts and capital injections into struggling SOEs, PPP claims as well as the impact of COVID-19.

Several SOEs are in financial distress and are making a loss. Multilateral debt relief initiatives to assist heavily indebted poor countries in Africa have opened up the opportunity to embark on significant public sector infrastructure investment programmes (Africa needs US$95 billion of capital investments per annum). Certain sectors were identified as the major 'drivers' for the delivery of economic infrastructure, such as the transport and energy sectors.

Due to restricted pricing tariffs (i.e. administrative costs), social responsibilities imposed by governments and financial mismanagement, many SOEs are constantly making losses. Such losses have inadvertently contributed to governments then being required to support SOEs in financial difficulties by providing fiscal support, either in the form of guarantees or as direct monetary transfers.

SOEs in the energy sector are the poorest financial performers mainly as a result of low electricity tariffs (West and East Africa). Tariffs set by national regulators do not reflect depreciation charges or the cost of electricity from IPPs.

This state of affairs begs the question: How much are governments (through their budgets) prepared to support these financially unsustainable entities and with what ultimate cost to the fiscus? Better options could include compensating SOEs for fulfilling social responsibilities, privatising the services they provide and adapting their business models.

The future and continued existence of some of these entities in distress remains a political decision and may therefore not be informed by any financial sustainability analysis.

To avoid SOEs defaulting on guaranteed debt because of their vulnerable financial situations, governments should instead choose to make direct capital injections and to provide budget support to SOEs

4 Regulatory and institutional challenges and benefits

Significant challenges

Countries in East, West and Southern Africa have identified that the most significant barriers or challenges in managing contingent liabilities are:

- Bureaucracy (e.g. irrelevant or cumbersome rules, lengthy approval cycles, etc.);
- Lack of resources/capacity (e.g. insufficient budgets, people, tools, support);
- Poor information systems (e.g. inaccurate, outdated, missing, or confusing data) – considered as the most important barrier;
- Authority issues (e.g. lack of decision-making responsibilities);
- Moral hazard – given their strategic role, SOEs believe that whatever happens, the government will provide support;
- SOE mismanagement;
- Poor monitoring of public corporations; and
- Unclear regulatory frameworks concerning contingent liabilities and fiscal risks.

Regulatory and institutional frameworks

Given the risks posed to public finances, countries that have adopted regulatory frameworks (and made the necessary institutional arrangements and established good practices) are in a better position to analyse these risks, monitor exposure to contingent liabilities and to keep senior management and politicians informed.

The regulatory frameworks in West African countries are considered limited and do not adequately cover the management of contingent liabilities. Only a few countries have developed legal frameworks; however, in many instances, these are not adequately adhered to or implemented.

Legal frameworks for the management of public debt need to make specific provision for contingent liabilities, particularly for any guarantees provided for the debt of public and private entities. This ensures macro-fiscal sustainability through the promotion of fiscal transparency, accountability and discipline in the management of contingent liabilities and public debt. From a micro perspective, clear and flexible interactions between different stakeholders will strengthen their commitment to the execution of various guaranteed programmes and projects. This is further supported by adopting a risk-based approach to ensure a better assessment of the various initiatives undertaken.

In East and Southern Africa, the issuance of guarantees is legitimised through an Act of Parliament, and in some countries, it is supplemented by specific laws and directives. In most countries, the various Acts are supported by policy documents at various levels of interaction. These policies are well supported at government and management levels given their level of awareness and familiarity with the legal requirements pertaining to the management of contingent liabilities. Ministers of Finance authorise the issuance of government guarantees in most countries while, in some others, authorisation rests with Parliament or the Cabinet.

In most West African countries, the institutional frameworks have not yet included a liability management and coordination unit (or committee) which could monitor contingent liabilities or make recommendations to inform decision-making authorities on the various findings and issues affecting budget risks.

Existing institutions – such as debt and budget offices, offices of the accountants general, and even parliaments – do not fully perform their oversight role in managing contingent liabilities. These shortcomings persist despite clearly defined regulatory frameworks outlining the responsibilities of the respective divisions within the Ministries of Finance. This has led to poor coordination between the relevant divisions, weakening the monitoring of public enterprises and PPPs and contributing to the risks that contingent liabilities and PPPs pose to governments and the fiscus. In addition, essential technical capabilities and skills to measure and analyse risks are limited.

Key benefits of a legal framework

- Limits political interference, requires political commitment to punitive measures;
- Reduces conflict between technocrats and politicians on the issuances of guarantees, and leads to consistency in policymaking;
- Reduces the costs of guaranteed debt;
- Guarantees are issued cautiously (e.g. in Kenya – guarantees may only be issued for capital projects, not operational expenses); and
- Ensures the best possible terms are negotiated with beneficiaries to mitigate the risk of default.

Key benefits of institutional arrangements

- Clarification of the roles and responsibilities of various parties;
- Coordination mechanisms (such as high-level coordination committees, regular meetings) among related institutions;
- Centralised risk management and reporting; and
- Risk-based analysis through comprehensive datasets, appropriate tools and technical capacity (PPPs in particular often comprise a set of complex contracts such as hedging arrangements, which require special legal and financial expertise).

Countries that have adopted regulatory frameworks are in a better position to analyse risks, monitor exposure to contingent liabilities, and to keep senior management and politicians informed

5 Important lessons learned

Conditions attached to government (budget) decisions regarding the issuance of guarantees are unrelated to the reasons (causes) why guarantees are applied for. In South Africa, for example, the increase in guarantees over the period 2008/09 to 2018/19 can be attributed to several factors, including:

- Poor governance;
- Inappropriate business models;
- Policy uncertainty;
- Costly policy decisions (e.g. earlier rounds of contracts with IPPs); and
- Solvency and liquidity concerns.

These factors have required the government (Ministry of Finance) to provide fiscal support, either in the form of guarantees or direct budgetary transfers.

Failure to address the source of the problem in a targeted manner when financing decisions are made, results in 'misguided' government financing or guarantee support. As a result, the government faces successive guarantee applications and financing requests with limited benefits. Government guarantees then continue to rise and the SOE's financial performance continues to deteriorate, further increasing fiscal risk and leading to potentially worse sovereign and SOE credit rating outcomes in the future.

When entities are considered 'too large to fail', an immediate 'red flag' must be raised. In the case of Eskom (see the South African case study), as the quality of government's exposure deteriorated, the level of this exposure should have been reduced. To effectively implement prudent risk management practices, professional and 'healthy' relationships must exist between government and SOE management as well as between SOE management and their respective boards. A further important relationship is that between government and the private sector. The involvement of the private sector introduces an added level of oversight to technically complex operations.

Credit rating agencies play an important role. Excessive exposure to contingent liabilities can result in multiple adverse credit ratings, making countries less attractive as investment destinations.

SOE ratings are either entity-specific or the result of sovereign credit rating concerns. Credit rating agencies view public sector finances holistically. The sovereign rating serves as a country credit rating 'ceiling' that places a 'lid' on all corporate ratings in the country.

Administrative costs. Higher and increasing tariffs may improve an SOE's financial position, but will also raise the cost of doing business in the country. While this may suit the SOE's creditors, it is an undesirable situation for the private sector. For this reason, collaboration between SOEs and the private sector must be improved.

The more transparent the fiscus and SOE finances, the easier it will be for investors to take critical, swift and informed decisions. When all stakeholders have access to the same data, it is easier to detect unsuitable SOE business models and capital structures as well as any operational inefficiencies that bring unnecessary costs into their operations.

Professional and 'healthy' relationships must exist between government and SOE management as well as between SOE management and their respective boards

6 Ways forward

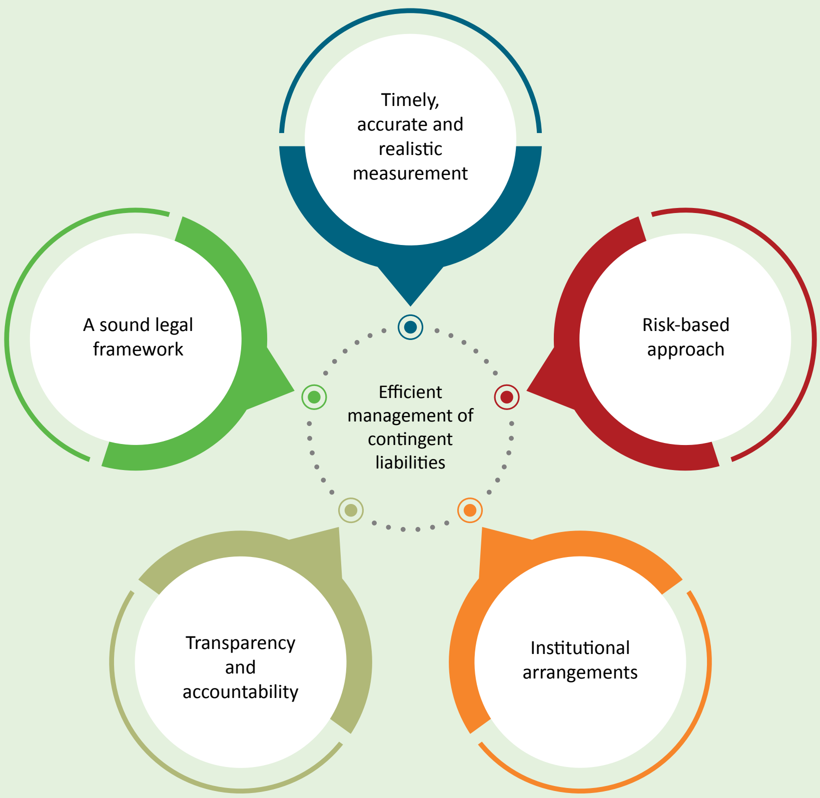
Strengthening and building internal capacity

As illustrated in Figure 1, when strengthening and building internal capacity to manage contingent liabilities, certain components need to be taken into account. These are described below.

Legal and institutional arrangements

- Develop a legal framework to make provision for contingent liabilities, in particular guarantees provided to public and private entities.
- Develop a regulatory framework that clearly stipulates assigned responsibilities, accountability frameworks, institutional arrangements and how the interaction between relevant stakeholders (debt office, accountant general office, budget office, shareholder department and SOEs) should be structured in terms of oversight, governance, reporting and the sharing of information.
- Establish a unit as part of the public debt office to manage and report on contingent liabilities with the responsibility to register all guarantees issued, make recommendations on new applications to fiscal risk committees, monitor fiscal risks and to develop analytic tools and risk-mitigating strategies.
- Establish an internal financial risk committee with the responsibility of developing practices on government guarantee application processes and the conditions under which new guarantee applications are approved. In this way, the terms of reference of the committee will be clear. Such committees will be able to review any new applications and make recommendations for approval to the Minister of Finance (or whichever appropriate Minister). The committee will also monitor any risks to the fiscus as well as the financial soundness of SOEs in terms of the conditions under which guarantees were issued.

Figure 1: The centralised approach for the efficient management of contingent liabilities



Process, procedures and practices

- Create a central database/register to capture data and keep records on any government guarantees that are issued and approved. These records should be reflected in the accountant general's annual financial statements to Parliament for auditing and reporting purposes.
- To strengthen accountability, SOEs should report on their financial performance and soundness of operations on a quarterly basis.
- Create a separate entity within the Ministry of Finance to manage PPPs with the responsibility of identifying future projects, negotiating contracts, coordinating arrangements and agreements with the private sector, and monitoring agreements and claims that may arise between government and the private sector.
- Develop criteria to account for and monitor public and publicly guaranteed debt as well as any explicit contingent liabilities.
- Conduct regular stress-testing on any possible materialisation of contingent liabilities. This will ensure the government (Ministry of Finance) is adequately prepared and can account for such risks timeously.
- Strengthen the internal controls over contingent liabilities between various role players with regularly shared information. Debt offices, accountant generals and budget offices should not work in silos, but rather with a clear separation of duties. The duplication of responsibilities and reporting structures should be avoided.
- Closely monitor compliance with the conditions under which the guarantees were issued.
- Conduct regular internal and external audits.
- Incorporate on-budget and off-budget liabilities (debt and contingent liabilities) as part of the total government debt, and publish a consolidated report on government's total exposure. This report becomes one of the budget documents prepared for the Minister's budget speech to Parliament.

Transparency and accountability

When reporting on contingent liabilities, unreliable data and the availability of information are contributing factors that make it difficult for West African countries to comply with accounting standards and IMF requirements.

While contingent liability monitoring systems exist in many countries in East and Southern Africa, they are often weak and ineffective, either due to data inadequacies or ineffective capturing of the range of contingent liability risk. The contingent liability analysis undertaken in most countries does not feed through into national budget resource allocation for annual budgeting purposes. As a result, national budgets, in the main, do not include statements on contingent liabilities.

Reporting and transparency of policies

- Establish a reporting framework for the monthly or quarterly publication of contingent liabilities, together with other public debt reporting practices.
- Improve the quality of information and the regularity of reporting in order to better understand, assess and monitor fiscal risks arising from contingent liabilities.
- Conduct transparent reporting on contingent liabilities, which are often left off balance sheets.
- Given the fiscal risks associated with contingent liabilities, establish clear legal and policy underpinnings for transparency and accountability.

Building monitoring capacity

In Kenya, capacity building in virtually all aspects of contingent liability management is critical. Lack of adequate staffing levels and limited expertise in matters concerning fiscal commitments and contingent liabilities are areas the Kenyan government is working to improve.

Strengthening capacity

- Strengthen staff capacities through training, peer learning and experience.
- Create and raise awareness of the importance of monitoring and managing contingent liabilities in a coordinated manner.
- Involve civil society and create citizen awareness and, if possible, have regular interactions with shareholder departments and SOEs to discuss matters of mutual concern.
- Through oversight, ensure SOEs are fulfilling their roles and responsibilities.

During the peer learning event discussions, it was mentioned that senior appointments at SOEs are sometimes political and not based on candidates having the skill-sets necessary for managing large corporations. The shortage of the skills required to analyse risks from contingent liabilities and PPPs poses a huge problem across the continent. When the right skills are sourced from the private sector, candidates often find it difficult to adapt to a government environment, where having a deep understanding of the broader context is sometimes more important than applying the tools, a quality that is developed and learnt over time. One option would be to train and mentor candidates from an early stage in their careers to prepare them for these positions.

Additional steps forward

Linking approval of guarantees to specific conditions

It is important that the conditions for guarantees are well researched, measurable and time bound, and that the financial analysis illustrates how, post-approval, project implementation and execution will benefit the future health of the SOE. For this to occur, a symmetry (full transparency) of financial and 'other' technical data at the project level (and sectoral level, where relevant) is required between those key stakeholders responsible for generating the data and those in the Ministry of Finance responsible for making the key decisions regarding the issuance of guarantees or 'fiscal bailouts'.

Reliable information

Annual reports (including audited financial statements), corporate (and borrowing) plans and annual auditor-general reports on SOEs must be accessible. However, the requirements are generally broad when SOEs apply for guarantees and the guarantee conditions are unlikely to remedy the underlying challenges at the SOE (high-/macro-level intervention). This then compromises the sustainability and viability of the critical infrastructure project (micro-level execution) under consideration. In most cases, continuous assessment – focusing specifically on how government-guaranteed project financing factors into an improved SOE financial performance – is not carried out on post-guarantee approvals.

Guarantee approval process

The process as currently pursued leaves room for SOEs and their executive authorities to apply for the issuance of government guarantees. At the same time, the Ministry of Finance is poorly placed and capacitated to effectively assess and analyse project-specific guarantee applications. Besides incorrect analysis of the data required to assess guarantee applications, the quality of risk analysis is also affected by the lack of credible and timeous project-specific data, resulting invariably in guarantee approvals (or non-approvals) being delayed until such time as the required data is eventually obtained. This delay may result in drastic changes to the entire financing landscape and the economic factors on which the financing decisions were initially made, thus severely reducing the effectiveness of the government's guarantee decisions and approvals.

Strengthening governance and performance monitoring

Without sound management of public corporations, all effort will be in vain. This requires the promotion of performance-based management within SOEs and the implementation of performance contracts with specified results and targets concerning all the guarantees and subsidies that the government provides. In this instance, countries should create an effective SOE office, sign a performance contract with the SOE and strengthen the monitoring system to better manage the risks after issuing the guarantee. Better risk management depends on how well the financial and technical components within SOEs coordinate their activities.

Conclusion

As shown in this policy brief, most countries in Africa are finding it extremely challenging to manage contingent liabilities and the adverse risks they pose to the national fiscus. The poor management of contingent liabilities in Africa is one of the main contributing factors to higher debt levels. COVID-19 has made it even more challenging since governments have to support SOEs in distress while having limited resources to do so effectively.

At the CABRI peer learning and exchange event in September 2020, various challenges and shortcomings have been identified and a solid platform established for training needs and targeted in-country engagements in the future. As such, this policy brief aims to provide African countries with guidance on strengthening oversight, better governance and management of SOEs, and on developing a more holistic and strategic approach to financing public sector infrastructure.

The poor management of contingent liabilities in Africa is one of the main contributing factors to higher debt levels

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