Programme Support and Public Finance Management

A New Role for Bilateral Donors in Poverty Strategy Work

BY ULRIKA BROBÄCK AND STEFAN SJÖLANDER

Effective public administration and efficient financial management systems are a necessity for any country seeking to reduce poverty and ensure welfare services reach the poor. This report discusses the roles of multilateral and bilateral donors in this context and the tools they have developed, stressing the importance of co-ordinated initiatives. The focus is on development assistance tied to policy reforms, known as programme support.

The authors provide donors and recipients with tools that incorporate principles and methods applicable to public finance management in partner countries. They describe a range of public finance management functions – including e.g. payment, budgeting and accounting – and highlight the need to strengthen the position of partner countries in talks with lenders and donors.

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Sida studies

Foreword

Along with other aid donors, Sida has in recent times taken a stronger programme focus in its development assistance work. The intention is for this to improve ownership and mechanisms for donor co-ordination, as well as create partnership-like relations with recipient countries.

However, it has become apparent during the process that few donors have succeeded in developing effective routines and procedures for analysing and supporting public finance management systems in partner countries. Donors generally feel uncertain about channelling their money through recipient countries' budget systems. Moreover, until now they have not had access to the tools needed to analyse attendant risks. This has resulted in rather few joint sector programmes being implemented.

As part of the ongoing development of poverty reduction strategies (PRS) linked to the HIPC debt relief initiative for the most indebted poor countries, the World Bank and IMF have now begun to highlight the programme support issue. Special tools for analysing financial management systems, such as CFAAs (Country Financial Accountability Assessments), have been developed. Yet it remains unclear how the different tools are linked and how their conclusions will be used. Neither is it entirely clear how the authorities in partner countries will participate in these investigations.

This report presents and analyses the key issues at the heart of programme support and public finance management, and discusses the problems and details connected with this form of support and the methods used. The opinions expressed in the report are those of the authors.

The report's aim is to contribute to Sida's growing interest in public finance management in partner countries and the need for knowledge in this area. Sida hopes it will prove useful for other donors as part of a co-ordinated effort to assist partner countries in developing and improving their public financial planning and management systems. The report may also serve to simplify the development of agreed procedures and processes aimed at making programme support practicable, reliable, safe and effective.

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November, 2001

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Executive Summary

Sida and many other bilateral donors and multilateral organisations are today moving more clearly towards a policy which involves supporting poverty alleviation, primarily in Africa, via different forms of programme support. Allied to this, the IMF and World Bank have launched the HIPC Initiative, a framework for debt relief and special support for the most indebted countries. The initiative demands broad participation from multilateral and bilateral lenders and donors.

A condition for obtaining debt relief is that partner countries develop and present a poverty reduction strategy, a so-called *Poverty Reduction Strategy Paper* (PRSP). The PRSP process is still being developed and many questions remain unanswered. Among the issues examined by the report is how responsibility will be shared between different actors, the details of which are not yet clear.

PRSPs are a comprehensive framework and include a country's entire economy (i.e. both the private and public sectors). Economic growth is seen as the key to being able to reduce poverty in a sustainable manner. Yet growth by itself is insufficient and does not automatically guarantee reduced poverty. Effective public administration systems are necessary so that increasing financial resources can be turned into concrete welfare services and measures that promote growth. The increasing importance of public administration has influenced the World Bank, which recently has begun addressing issues related to its development and content.

National public finance management systems are a particularly important component of this development. A range of diagnostic analysis tools has been devised for these systems, chiefly by the World Bank. There is great need to co-ordinate both these instruments and the different participants in the process.

The report makes recommendations about the requirements that must be met for financial management systems to be effective channels for programme support. Programme support includes funds not tied to individual projects but which are given, or lent, to finance expenditures contained in poverty reduction strategies. These include programmes that cover specific sectors, known as sector programmes.

Programme support to underpin poverty reduction strategies through government budgets can be supplied in a variety of forms: HIPC debt relief (which frees up resources), general budget support, or sector programme budget support. For programme support to help alleviate poverty through the creation of real welfare services, it is crucial that the different systems within public administration function properly and that the public administration apparatus has access to competent staff. Donors, moreover, must be prepared to review the conditionality of development assistance through programme support, for example by considering for what length of time assistance can be provided.

But good financial management systems alone cannot guarantee the delivery of welfare services financed by the government budget. Also essential is good governance, manifested in a transparent public decision-making process and a transparent public administration that can implement government decisions.

Bilateral donors, not least Sida, can play a major role in this new world of development assistance. The key to influence lies in an active and outward-looking attitude. Bilateral donors are needed as a third party in the dialogue between partner countries and the Bretton Woods Institutions. Bilateral donors also have unsurpassed expertise and experience in institutional development work and can therefore influence a country's development and, for instance, prevailing World Bank methodology.

There are good reasons why bilateral donors should collaborate and create broader platforms for their work. Small individual donors such as Sida should institutionalise their work with like-minded organisations and participate jointly with them in, for example, the World Bank's poverty missions.

Changes lead to demands for new structures and competencies in development agencies.

The next step is to bolster partner countries' institutional base, particularly at regional level.

A more extensive summary of the report and its recommendations can be found in Chapter 9.

The appendix describes a number of points and issues of relevance when evaluating public finance management systems that receive programme support. The appendix draws on and relates to the analysis contained in the main report. Despite this, the appendix is self-contained and can be read and used separately. It can, for example, be used when taking first-time decisions on programme support or when reviewing existing support.

It and the main report can also be used during dialogue between donors and recipients as both documents discuss demands that may be put forward by either side.

Introduction

In the past two years economic growth has come into focus as a means of reducing poverty, a trend that has increased the emphasis on performance. Efforts to attain stable macroeconomic conditions have received priority in the past, but a clear link to poverty has been conspicuously absent.

In order to strengthen the development of poverty reduction strategies and achieve higher economic growth a new comprehensive framework has been introduced. Closely allied to this, the IMF and World Bank have launched a new debt relief initiative for the poorest and most indebted countries. This initiative includes the provision of debt relief for existing IMF and World Bank loans. Donors and lenders are striving to attune their efforts to demand, i.e. demand from the poor countries themselves, in order to guarantee partner countries' "ownership" of poverty reduction programmes allied to debt relief measures. The success of this approach thus far is debatable, though.

The need to build public administration institutions in partner countries and develop competencies therein has been recognised as part of this process and become a core focus of development efforts. The status of public finance management functions has also attained a prominent position. This more integrated and comprehensive approach removes previous limits on the work of donors and recipients and their areas of responsibility in development assistance. New instruments have been created and existing ones modified to support this new and broader way of working. In consequence, it has become much clearer that multilateral and bilateral organisations work in a shared arena. Bilateral donors' long experience of institutional capacity-building work suggests they play – and will continue to play – an important role in this area.

Data and information contained in the report are based on published material and discussions conducted in Washington DC with staff of the International Monetary Fund and World Bank, and in New York with United Nations officials. We have also talked to staff at NORAD, Sida, the Swedish Ministry for Foreign Affairs and the Swedish Ministry of Finance. (See "Personal references".) Via email we have corresponded with and posed questions to officials at the European Union, OECD, and bilateral organisations in the UK, Netherlands, Denmark and Canada. The interpretation of discussions and information received is, of course, ours alone.

As stipulated in our Terms of Reference, the report concentrates on development of poverty-focused assistance to African countries and is consciously written from a donor's standpoint. When we write "these countries" or invoke similar terms we are referring to the partner countries of Sida and other bilateral donors, primarily in Africa.

Experiences from the World Bank's introduction of the new *Poverty Reduction Support Credit* (PRSC) in Uganda and the introduction of the new classification framework for public accounting systems in Mozambique are presented as field studies.

The report is principally written for staff at Sida, the Swedish Ministry for Foreign Affairs and embassies that work with programme support in the countries concerned and provide ancillary technical support. It is also aimed at donor organisations with policy frameworks similar to those of Sida, and at relevant development partners. Consultants and external organisations that work with these issues may also find the report useful.[1] Our hope is that the material will promote co-ordination of current donor activities and increased understanding of this field. This, we hope, will assist partner countries to develop and strengthen the financial planning required for communities to deliver welfare services to their inhabitants. As a next step, we believe it would be of great value to examine the institutional conditions present in a partner country to enable that country to develop its own debate and decision-making forums and determine how donors can best facilitate this process.

1. The report was originally intended as an update of our previous report, "Sector Programme Support and Macroeconomic Development: the need for an effective public administration and financial management and control systems – materials for guidelines", February 1999. As the title indicates, the report examined the then new Sector-wide Approach (SWAp) and sector programme support. The adoption of SWAp resulted in areas such as public finance management systems and macroeconomic development in partner countries suddenly being included and integrated in the same framework. Since our first report, however, poverty-focused development assistance has been transformed. The report therefore includes a body of new material to reflect current conditions. All the same, this new material contains many links to the previous report.

Outline of the report

The report has the following structure: the introductory chapters, 1–3, present the new framework for and background to poverty-focused development assistance. An account of the HIPC is provided, as well as an introduction to the PRSP poverty reduction strategy. Also discussed are the role of the World Bank and IMF in this development, risks associated with the new initiative, and the connection between poverty reduction strategies and the economies of partner countries. Finally, chapters 1–3 describe different forms for supporting poverty alleviation.

Chapter 4 gives an account of the different types of programme support provided to the countries in question and how these give rise to a need for public administration reforms.

The need for reforms in public administration is explored in Chapters 5 and 6. Here, special emphasis is laid on the World Bank's diagnosis instruments, weaknesses in the current approaches of donors and lenders, and the requirements implicit in the analysis of public finance management systems.

Chapter 7 discusses bilateral donors' important role as a third party in discussions about new poverty credits between partner countries and the Bretton Woods Institutions.

Chapter 8 gives an overview of the need for new methodologies and information flows inside bilateral development agencies stemming from the emergence of new forms of development assistance.

An extensive summary of the report is contained in Chapter 9, along with recommendations.

Chapter 10 highlights the need to support partner countries in their task of building regional institutions that can function as forums for dialogue and debate when formulating and implementing new forms of assistance.

The appendix discusses issues to consider when evaluating the state of public finance management systems in relevant countries and opportunities for using those systems. Such evaluations are applicable when, for instance, new programme support is to be introduced or old support agreements are renegotiated.

Those who work with these issues are invited to read the appendix and use it as a source of reference. Descriptions are primarily based on experiences from Portuguese-speaking and English-speaking countries in Africa. These are Sida's "chief" partner countries. At the same time, we would like to underline the general practicability of the appendix. The described functions, such as planning, budget process, accounting functions, payments systems, income policies and audit structures, are universally applicable – from French-speaking Africa to Sweden.

Unsourced views and opinions are our own, usually based on our own experience. This is also true for pictures, diagrams and tables not accompanied by a source reference.

A new framework for poverty-focused development assistance

CHAPTER 1

1.1 The role of multilateral and bilateral organisations in development work

Sida and many other bilateral donors and multilateral organisations are today moving more clearly towards a policy which involves supporting poverty alleviation in Africa via different forms of programme support.

Programme support is a modality aimed not at financing a specific project, but at supporting the implementation of a wide-ranging policy/expenditure programme (often for a sector) laid down by a partner country's government. The aim is for programme support funds to be transferred and accounted for through partner countries' public finance systems. This makes it easier for them to support and become part of the country's budget priorities. It also means that "an effective public administration and effective financial management systems" (see Sjölander and Brobäck, 1999) are not only necessary for sector programme support, but for all forms of programme support. Besides sector programme support, the term also includes general budget support and debt relief.[2] This new and more wide-ranging approach within the field of development assistance is now encouraging organisations to integrate their areas of support and responsibility with others. The situation requires new forms of co-operation and new roles and ways of working that are adapted to a joint framework.

The actions and working practices of the IMF and World Bank have tended to assume a central position in development assistance, both in a historical and modern context. The Bretton Woods Institutions' (BWIs)[3] efforts in this area have long been the target of hard and at times contra-

2. The different forms of programme support are examined in more detail in Chapter 4.

3. The Bretton Woods Institutions (BWI) is a joint name for the IMF and World Bank.

dictory criticism from the governments of developing countries, left-wing political interests, environmental groups in the industrialised world, European aid donors and BWI personnel (including Dollar and Pritchett (1998) and Stiglitz (2001)). Not even the most ardent defenders of the IMF and World Bank would claim these institutions are the best supporters of development strategies in all cases. Within the new framework currently being developed, it is vital that bilateral donors that provide programme support are active and can contribute their (in some cases significantly greater) expertise.

The ongoing development of so-called poverty reduction strategies that have accorded a more prominent role to institutional capacity-building includes many examples to indicate that bilateral donor involvement provides valuable input to the process. Discussions in international forums in which bilateral donors participate often give rise to an alternative or broader basis for continued efforts than is contained in the work of the IMF and World Bank. Bilateral donors can also help increase the leeway for local influence over the process, thus complementing the BWIs' analyses and development work. The working groups that collaborate on the mode and application of *Sector-wide Approaches* (Ch. 4) are a specific example of bilateral participation and co-operation. Knowledge gathered here can help focus attention on fundamental software issues concerning institution-building in connection with a launch of sector programme support in a different way compared, for instance, with the way the World Bank has focused on such issues.

Sida was early in perceiving the need for capacity in public administration. Sida developed its first policy for public administration aid in the 1980s. This policy is now being revised to include aspects of democratic governance and human rights. Sida and other bilateral donors have a good incentive to maintain and develop a high level of competency in this area. Such competency presents opportunities to influence and augment the work on methods and application being carried out primarily by the World Bank.

To clarify the new framework for development work, we begin by describing the background to the emergence of poverty alleviation strategies. Debt burdens and economic growth are key variables in this context.

1.2. The debt burden in poor and indebted countries

The debt burdens of the poorest and most indebted countries have for many years played a role in hampering economic growth. One of the reasons for this is that the money spent on maintaining the national debt could instead be used for domestic investment or the import of investment or input goods, all of which are necessary for higher growth. Debt servicing[4] also reduces the total resources available for public expenditure. This often has a major detrimental effect on sectors targeted by poverty-focused programmes. The debt burden can also lead to increased environmental degradation when short-term measures to provide financing for debt payments are accorded priority over the external environment. Furthermore, a heavy debt burden can lead to political instability. This, in turn, may have strongly negative consequences, not least on the poor.

The international campaign JUBILEE 2000 was launched to combat the negative effects of the debt burden in heavily indebted countries[5] in the early 1990s. The campaign aimed to secure a one-off debt write-off in 2000 for debts that the poorest countries could not afford to repay to international financial institutions (IFIs),[6] governments and commercial banks. The ambition was to implement the write-off process in concert with lenders, borrowers and representatives of civil society. The campaign aims to create awareness and a sense of shared responsibility among lenders and borrowers over high indebtedness levels in some poor countries. The prime aim of the JUBILEE debt relief is to underpin economic and social justice and basic human rights in heavily indebted countries.[7]

Multilateral organisations have long been preferential creditors for debts in the poorest countries. These debts have not been written off, in contrast with debts to other creditors. The *Heavily Indebted Poor Countries* (HIPC) Initiative was launched in the late 1990s to ease the debt burdens of the most indebted countries. The initiative is described in more detail below. Write-offs of multilateral debts are included for the first time in the HIPC framework. Yet debate still continues about the scale of debt relief necessary to bring about a long-term and sustainable improvement for the poorest and most indebted countries. Many critics question the "optimistic" forecasts of the IMF and World Bank, claiming the debt relief process is too closely controlled and the amounts involved are inadequate. Some studies suggest the debts of many HIPC countries will soon become unsustainable under current agreements (Pettifor 2001, Fjellman 2001).

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4. The total sum a country spends on its debt by way of interest payments and amortization.

5. See www.jubilee2000uk.org.

6. The term international financial institutions (IFIs) includes the IMF and World Bank along with other financial institutions such as regional development banks.

7. The fact that JUBILEE 2000 stops short of criticising governments that have pursued unsustainable and inequitable economic policies means that its efforts – in certain contexts – can be counter-productive.

1.3. The HIPC Initiative

In order to reduce the debt burdens of poor indebted countries to a so-called "sustainable level",[8] the IMF and World Bank in 1996 launched the HIPC Initiative.[9] The HIPC process, which has since been expanded, can today be divided into two steps: the *decision point* (the point where debt relief is approved and transitionary debt relief begins) and the *completion point* (the point at which remaining debt relief is granted). By the start of 1999 only two countries – Bolivia and Uganda – had reached the completion point and a further five (Burkina Faso, Ivory Coast, Guyana, Mali and Mozambique) had reached the decision point. That so few of the 41 classified HIPC countries had got this far resulted in the HIPC Initiative being expanded (enhanced HIPC/HIPC II), primarily at the behest of the G7 nations.[10] In an effort to accelerate the process, the threshold values were lowered for the definition of "sustainable debt".[11] By November 2001, 24 countries had reached the decision point and three had reached the completion point under the expanded debt initiative (IMF and the World Bank 2001c).

The HIPC Initiative has helped forge an important link between debt relief and poverty alleviation. The idea is that domestic resources freed up by HIPC debt relief will fund programmes started by the target country to tackle poverty. The country's strategy for using these resources must be evident at the decision point. Specific measures should be in place in HIPC countries that have reached the decision point to facilitate monitoring/control of the use of the "extra" budget resources made available through debt relief. Great store has thus been set by measures to improve the way disbursed public resources are accounted for. But regardless of how much accounting systems improve, it will remain logically impossible to state precisely the quantity of budget resources freed up by debt relief.

A number of donors have been sceptical of supporting the HIPC and expressed doubts over the ability to track funds as intended (discussions with IMF staff in 2001). Under pressure from bilateral donors, the IMF and World Bank conducted a joint study to assess the status of public finance management systems in HIPC countries, based on pre-existing written ma-

8. Threshold values, present value of debt/export 200–250%, debt servicing/export 20–25% and the fiscal criterion present value of debt/budget revenues 280%, with the sub-conditions of exports/GDP and budget revenues/GDP 40% and 20%.

9. See www.worldbank.org/hipc

10. Includes the world's leading industrialised nations. The G7 does not take binding decisions but its views carry much weight for organisations like the IMF and World Bank.

11. Threshold values: present value of debt/export 150%, and the fiscal criterion present value of debt/budget revenue 250%. Sub-conditions are export/GDP 30% and budget revenues/GDP 15%.

terial (IMF and the World Bank 2000a). The results of the study were not very encouraging. Of the 25 countries studied, only two were regarded as capable of accounting for and tracking public expenditures acceptably. This finding confirms the enormous need for capacity-raising efforts in the public finance management arena in the countries concerned.

As mentioned previously, the HIPC Initiative is closely allied to poverty alleviation. It is a condition for reaching the completion point that a HIPC partner country draws up a poverty reduction strategy and publishes it in a *Poverty Reduction Strategy Paper* (PRSP). The purpose of this document is to present an account of the country's policies and strategies for alleviating poverty. It is a condition for reaching the decision point that the HIPC partner country has drawn up an *interim PRSP* – an I-PRSP.[12] With regard to the launch of a PRSP, a mechanism has been developed that has led to closer collaboration between the IMF and the World Bank. PRSPs are discussed in more detail below.

1.4. Poverty reduction strategy as the basis of development assistance and soft loans – Poverty Reduction Strategy Paper (PRSP)

At the end of 1999 the World Bank and the IMF decided jointly that nationally owned poverty strategies should form the basis not only for HIPC debt relief, but for all World Bank and IMF soft loans and credits. Existing loans were transferred to the I-PRSP – the preparatory process for a PRSP – to accelerate the transition from the previous and strongly macroeconomic-focused policy documents known as *Policy Framework Papers* (PFP).

The overall aim is to arrive at policies that focus clearly on economic growth and poverty reduction. This approach involves formulating macroeconomic policy on the basis of poverty reduction strategies. It represents a major change in the IMF's stance, which prior to PRSPs needed to take no heed of such considerations and could deal more in isolation with the macroeconomic area.

Although the partner country has to produce its "own" poverty reduction strategy, the IMF and World Bank are both involved in preparing a PRSP (too much so, many would say). The documents must describe the country's macroeconomic, structural and social policies as well as programmes that contribute to reaching the stated goals of economic growth and reduced poverty. Clear targets, performance indicators, sources of fi-

12. An I-PRSP summarises what is already known about a country's poverty situation and government policy in this area. It includes a description of the plans and process behind creating a complete PRSP.

nancing, and the need for external financing allied to the programmes must also be detailed. A PRSP must also be preceded by a broad consultation process in which different sectors of civil society provide input.

The content of a PRSP varies from country till country depending on individual circumstances. However, four main elements should always be included: (I) a description of the participatory process in the country; (II) a poverty diagnosis; (III) aims, indicators and monitoring systems; and (IV) prioritised public measures. A complete PRSP should also include a summary of prioritised government actions over a three-year period, with tables presenting the country's macroeconomic framework and explaining its public expenditure programmes and allocations to key areas. A matrix containing principal policy measures, institutional reforms and implementation dates should also be included.

The ultimate aim of a PRSP is to help the partner country attain the International Development Goals (IDG)[13] set out below:

International Development Goals (IDG):

1. Reduce the portion of people living in extreme poverty by half between 1990 and 2015.
2. Enrol all children in primary school by 2015.
3. Make progress towards gender equality and empowering women by eliminating gender disparities in primary and secondary education by 2005.
4. Reduce infant and child mortality rates by two-thirds between 1990 and 2015.
5. Reduce infant and child mortality rates by two-thirds between 1990 and 2015.
6. Provide access for all who need reproductive health service by 2015.
7. Implement national strategies for sustainable development by 2005 so as to reverse the loss of environmental resources by 2015.

Source: A Better World for All – Setting the goals, www.paris21.org

1.4.1. PRSP process still under development

The PRSP process is still in its infancy. It is developing as partner countries and all involved development partners draw lessons from their experiences. As yet it is unclear how this new orientation will work and what the "final" framework will look like. What is clear, however, is the need for *the active participation of organisations that want to be part of the development process*. The IMF and World Bank have high ambitions and, as expected, have assumed a leading role in the process. As noted previously, it is important that bilateral donors that provide programme support become in-

13. The international development goals have been accepted by, among others, the UN, OECD/DAC, IMF and the World Bank. See A Better World for All, OECD, UN, IMF and the World Bank. In addition, www.paris21.org/betterworld

volved and act as a "counterweight" to the BWIs in this process.

The importance of partner countries having a sense of ownership for their poverty strategies is often referred to in material published by the BWIs. Indeed, the officials of these institutions view it as a precondition for success. It is anticipated that the replacement of the former *Policy Framework Papers* (PFP) with the PRSP will strengthen ownership of the programmes. The goal is that poverty reduction strategies will be drawn up via a democratic process, with wide-ranging participation of different players in the country concerned.

The World Bank, together with staff from the IMF, has compiled a *PRS Sourcebook* to guide countries in formulating their individual poverty strategies. The book is highly comprehensive, covering areas ranging from poverty-related outcomes to macroeconomic policy. It consists of three main parts. Part 1 focuses on critical elements in the development process of a PRSP, part 2 deals with macro and sectoral issues, while part 3 discusses cross-cutting issues like good governance, gender and environment. The PRS Sourcebook is updated as the process develops.[14]

We believe more active support for partner countries is needed so they can participate in the process on a genuinely equal basis. The true ownership of the PRSP can be discussed in this context. The roots of democracy in the partner country are also limited, which often precludes a PRSP from being considered by parliament. The PRSP sometimes acquires the role of a parallel planning instrument that, in reality, has no influence over actual budget allocations or spending policy. Moreover, partner countries do not collaborate when assessing the policies or technical rules and regulations that best serve their individual development.

The overall aim of a PRSP – to reduce poverty through more effective strategies – is rooted in six key principles within the framework of the World Bank's *Comprehensive Development Framework*[15] (CDF). The aim is for a poverty strategy to be:

- **country-driven,** involving broad-based participation by civil society and the private sector in all operational steps;
- **results-oriented,** and focused on outcomes that would benefit the poor;

14. Available in book form or on compact disc. Updates available at: www.worldbank.org/prsp or www.imf.org/external/np/prsp/prsp.asp

15. The Comprehensive Development Framework (CDF), originally a World Bank initiative, represents a new way of working with development support. It is based on the following principles: the country's ownership; partnership with all donors and stakeholders; a long-term and comprehensive attack plan for development focused on development outcomes, primarily poverty reduction. PRSPs are based on these principles.

- **comprehensive** in recognising the multidimensional nature of poverty but also
- **prioritised** so that implementation feasible, in both fiscal and institutional terms;
- **partnership-oriented,** involving co-ordinated participation of development partners (bilateral, multilateral and non-governmental); and
- **based on a long-term perspective** for poverty reduction.

Source: PRS Sourcebook, World Bank (2000b), www.worldsbank.org/poverty/strategies/overview.htm

The objective is for these fundamental principles to provide a platform for adopting a new attitude among all involved parties, including those inside and outside the country. The comprehensive framework that extends from poverty-oriented results to macroeconomic policy enables efforts on different levels to be linked together. The aim is that all efforts should combine to contribute to a permanent reduction of poverty and sustainable economic development. One notion is that PRSPs can support this process by providing a mechanism to increase co-ordination between different donors' contributions.

In our opinion, the complexity of this effort again indicates the need to support partner countries in building up their own institutional frameworks that can take part in this work. This also means getting existing public institutions to function properly if the CDF goals are to be realised in practice.

1.5. Equal need for effective public institutions in the past

The need for effective public institutions and finance management systems in African countries is nothing new. It has been felt for a long time – by donors and partner countries alike. Public administration is another area that has not received priority. During the debt crisis in the 1980s it became necessary to try and restore the macroeconomic balance in the African economies that were affected. This resulted in a focus on the macroeconomy. A number of adjustment initiatives and stabilisation programmes, spearheaded by the IMF and World Bank, were launched to correct imbalances. The reforms carried out during this adjustment process were focused chiefly on economic stabilisation, privatisation of state-owned companies, and trade and price liberalisation.

These first-generation reforms did not include development of public institutions, though the measures taken to achieve macroeconomic balance did impact on domestic institutions. The introduction of economic reforms and demands for more restrictive budgets resulted in public sector spending cuts and reduced salaries for civil servants. The salary cuts – which particularly affected well-paid officials – prompted many with high skills and knowledge to leave the public sector. This resulted in diminished capacity within the public sector. Capacity was also affected by the colonial policies pursued in many of the countries.

The situation was also influenced by the provision of development assistance, which was in the form of isolated projects and often reflected donors' preferences. This resulted in project employees often earning higher salaries than their counterparts in core areas of the public sector. The fact that donor resources were kept outside government budgets impeded the ability of governments to make rational and strategic choices with regard to public expenditure. The institutional crisis in the public sector has hit the inhabitants of IDA countries in other ways,[16] mainly in Africa. Among its causes are the inability of governments to increase tax revenues, a lack of good governance, and deficient delivery of public services.

Governments' already weak institutional capacity and governance left donors dependent on their own institutional financial control functions within different donor-financed projects. This further undermined institution-building and the accountability of recipient governments to their own citizens.

Public administration assistance has been provided as part of this form of development co-operation, though on a small scale. Bilateral donors such as Sida have operated in the area of institutions for more than ten years. In spite of this, administrative assistance has until now not received the international attention it merits. The IMF and particularly the World Bank now place great emphasis on reforms and capacity-building within public institutions. There may be several reasons for this.

One explanation could be that ignoring this area is impossible because effective public institutions are necessary for long-term development goals to be reached in a sustainable way and lead to improved conditions for citizens. A second possible explanation is that macroeconomic improvements in the countries concerned, most of which have undergone stabilisation programmes, have the World Bank and IMF to carve out new areas of responsibility. The launch of the HIPC Initiative may also have played a part. All donors are keen to ensure that the support they provide to the initiative is actually applied for poverty-reducing purposes. Pressure from other donors within the HIPC framework may also explain why the World Bank and IMF have highlighted the need for institutional development.

16. The International Development Association (IDA) is the World Bank's arm for providing support to its poverty reduction mission. IDA support focuses on the world's poorest countries and extends credits with highly favourable lending conditions.

There is now a clear realisation within the development assistance field that public institutions in IDA-countries must be included as an area for reform within a strategy for long-term poverty alleviation. This has pushed lenders and donor organisations to adapt their instruments and alter the focus of their support. Existing instruments have been modified or replaced in order to conform with PRSPs.

The next chapter describes the development by the IMF and the World Bank of the various credit instruments with which the two institutions work.

The approach of the IMF and World Bank

CHAPTER 2

2.1. Collaboration between the IMF and the World Bank

The new PRSP approach has led to closer collaboration between the IMF and World Bank. Whenever a government presents an I-PRSP or PRSP, these are assessed by a Joint Staff Assessment (JSA).[17] A JSA is conducted jointly by IMF and World Bank officials and provides a framework for the institutions' respective boards to assess whether a proposed I-PRSP or PRSP constitutes a sound basis for the specific country to receive World Bank/IMF loans or HIPC debt relief. The JSA also determines both the size of the envisaged support and the format for the programmes supporting the country's poverty reduction strategy. By November 2001, some 35 countries had prepared an I-PRSP and five had presented full PRSPs. The majority were from Africa (IMF, World Bank 2001b).

Although co-operation between the BWIs is ever more apparent, their respective areas of responsibility remain divided along traditional lines. The IMF focuses chiefly on planning macroeconomic strategy; the World Bank has the main responsibility for developing poverty reduction strategies. Responsibilities are shared where areas overlap. Examples include promoting a beneficial climate for private sector growth, trade liberalisation, financial sector development, and implementation and transparency of the state budget. That the two institutions have different responsibilities and remits heightens the need for close co-operation. An important consideration is the need to avoid duplication. The IMF, moreover, needs to know about the World Bank's planned efforts in a particular country so it can formulate correct macroeconomic strategies. (The IMF

17. JSA guidelines for I-PRSPs, see www.imf.org/external/np/prsp/2000/prsp.htm#annexVI and for PRSPs, www.worldbank.org/prsp.

also needs to receive corresponding information from other external actors, particularly bilateral donors.)

When a country reaches the decision point for HIPC debt relief, the rules actually dictate the implementation of immediate measures, chiefly in the realm of financial management, so the way the extra funds generated by the debt relief are used can be followed up. The need for capacity-building in financial management is great, though this has not been tackled by the IMF to any great extent in the past. In practice, the IMF's staffing and financial resources are insufficient to enable it to contribute to the necessary overhaul of public finance management systems in a timeframe its officials deem adequate or desirable (conversations with IMF personnel, 2001). This increases reliance on bilateral donors vis à vis their work with development of institutions in partner countries and their expertise in this field.

The development of comprehensive poverty reduction strategies requires new forms of appropriate support. From their relative positions, the IMF and World Bank have both produced new, ambitious instruments. These are described below.

2.2. The IMF's instruments and approach

2.2.1. The Poverty Reduction and Growth Facility (PRGF)

The IMF decided in September 1999 to replace its *Enhanced Structural Adjustment Facility* (ESAF) with a new *Poverty Reduction and Growth Facility* (PRGF). The PRGF is now the IMF's main tool for supporting countries that implement PRSPs. The biggest difference between the PRGF and ESAF is that the aims and policies of the former are directly linked to partner countries' poverty reduction strategies as detailed in a PRSP. By contrast, the ESAF was tied to structural adjustment programmes and had a purer macroeconomic focus. According to current PRGF regulations, measures and programmes undertaken under PRSPs with the aim of reducing poverty (e.g. social and sectoral policies, infrastructure projects and institutional reforms) must be costed, put in order of priority and integrated into the macroeconomic framework. This is highly significant. It means that these aspects of poverty reduction programmes are put on a par with macroeconomic policy and intended to influence it.

The basic idea is that rapid, sustainable growth should be the core of all strategies for effecting a lasting reduction of poverty. Poverty reduction programmes are financed by state budgets, which means it is important that measures are sustainable so as not to jeopardise macroeconomic stability. The fact that PRGFs are tied to a country's PRSP means the state budget should improve the financial situation of the poor and also generate economic growth. This requires a clear statement in government policy that state expenditure will be targeted at areas which have a direct or indirect impact on the poor. Moreover, ancillary fiscal reforms should be designed to foster greater economic efficiency and improved distribution of incomes.

In contrast with the studies and recommendations presented in previous external and internal ESAF macroeconomic surveys, the studies conducted for PRGFs must be deeper and more extensive. The macroeconomy can no longer be treated in isolation. Under a PRGF, the macroeconomy is treated on a par with social, structural and institutional issues. Studies must therefore be adapted to explain how macro and structural reforms affect social development. PRGFs also place a greater emphasis on creating understanding of the effects of macroeconomic policy on the poor. What, then, are the links between poverty reduction and finance, monetary and exchange rate policies?

Through a PRGF, the IMF strives to concentrate on a selection of structural conditionalities. The prime focus is on taxation and exchange rate regimes, fiscal policy and transparency, and good budget, tax and customs administration. Great importance is attached to improving opportunities for holding individuals responsible for the administration of public money. This conditionality is restricted to the IMF's obligations under PRSPs and not (as with ESAFs) on the multiple conditionality advanced by the World Bank.

That the IMF is working hard to rationalise and focus its conditionality is essential for preserving the ownership of partner countries. The aim should be for conditionality to be formulated in such a way that it gives partner countries maximum leeway to pursue their own policies within agreed macroeconomic targets. The new system gives greater flexibility to finance budget deficits with loans, provided these funds are used for productive public expenditure and the country is regarded as having a stable external debt and macroeconomic conditions.

In this way, the IMF's credit instruments are aimed at guaranteeing the partner country's ability to exert influence and create its own balance between different policies. However, this has proved difficult to achieve in practice. One example is the insistence of the IMF (and to a lesser extent of the World Bank) that partner countries liberalise their trade policies. Increased trade is good for these countries' development, but lowering tariffs also has consequences for domestic resource mobilisation. The structure of the IMF's proposed trade-enhancing taxation policy often results in the taxes and tariffs that are easiest to collect – and which often are the dominant source of fiscal income in the countries concerned – being lowered or abolished (conversations with UN staff, 2001).

2.3. The World Bank's instruments and approach

The World Bank has clearly observed the importance of effective public institutions to a country's development and its ability to reduce poverty. As a result, the bank has shifted the focus of its work to good governance, capacity-building and anti-corruption measures. This change conforms with the bank's *Comprehensive Development Framework* (CDF), mentioned earlier. The inclusion of institution-building is now virtually *de rigueur* for World Bank loans or credits, though the lack of a systemic approach and a failure to handle institution-related issues in an integrated manner has often led to fragmentation in its efforts. The bank's evaluations of its own projects in *Public Sector Management* (PSM) and institution-building draw no long-term positive conclusions (World Bank 2000a).

2.3.1. The Poverty Reduction Support Credit (PRSC)

Notwithstanding attempts to adapt existing instruments, the launch of the PRSP revealed that the World Bank lacks an instrument that systematically covers all the structural and social areas that need to be addressed in relevant IDA countries.[18] In the absence of an instrument akin to the IMF's PRGF, the bank developed a *Poverty Reduction Support Credit* (PRSC). A PRSC includes a series of yearly credits tied to a framework adjusted to meet needs over time. Each PRSC in the series is based on prioritised measures that feature benchmarks enabling the assessment of progress in social and public structural reforms. The World Bank has expended much energy on the first PRSC, which was recently introduced in Uganda.[19] But because the PRSC is a completely new instrument, the bank continues often to rely on its traditional lending instruments when supporting IDA countries in their implementation of PRSPs.

2.3.2. Traditional World Bank lending instruments

It takes time to execute effective public sector reforms and strengthen public institutions in a sustainable way. The World Bank's traditional lending

18. Includes the world's poorest countries by GDP per capita. In 1999 the threshold was GDP per capita of less than US$ 885. Eighty one countries were eligible for IDA support during the fiscal year 2000.

19. See description in Chapter 5.

instruments are based on Quick Disbursing Assistance (QDA). These are tied to policy conditionality, technical assistance (TA) loans and investment loans, and typically have short maturity terms and irregular repayment conditions. The World Bank has striven to adapt these instruments to current conditions and to support long-term reforms focused on improved systems. In this, the bank employs a "programming approach", which includes a multiyear matrix covering policy and institutional reforms, complete with indicators and follow-up measures for each loan. See "Glossary of abbreviations and concepts" for a more detailed description of these instruments.[20]

2.4. The PRSC and traditional lending instruments

In contrast with the World Bank's traditional instruments, the PRSC provides direct support to the state budget and combines the different goals of the bank's traditional lending instruments. A PRSC is initially focused on the public sector. The support, which can be equated with budget support, is for use in improving public resource management. Included here are accounting and budgeting, public procurement, capacity within public administration, reform of the public salary system, and implementation of sector programmes (Sjölander and Aarnes 2001). Irrespective of whether a country is to be granted a PRSC or not, the bank's traditional lending instruments will continue to be used in parallel with the PRSC as and when necessary (conversation with World Bank staff, 2001). An example might be when measures over and above the structural reforms allied to a PRSC become necessary in a specific sector. Achieving a satisfactory balance in the institutional arena may, for instance, require an additional investment loan.

Alongside institutional efforts and sector strategies, the World Bank's role in formulating poverty reduction strategies includes conducting diagnostic work to evaluate poverty and monitor developments. Studies and surveys are carried out in various areas to assess the situation of households, the private sector and certain companies. The World Bank is devoting more attention to corruption surveys and whether services are actually delivered. A lack of data and statistics in partner countries, togeth-

20. The heading "Traditional World Bank lending instruments" covers: Structural Adjustment Loan/Credit (SAL/C), Sector Adjustment Loan (SECAL), investment loans and the Sector Investment Programme (SIP), Sector Investment and Maintenance Loan/Credit (SIMs), Technical Assistance Loan (TA), and Adaptable Programme Loan/Credit (APL/C).

er with a need for continuous monitoring, means much remains to be done in this area.[21]

The introduction of the PRSC provides the World Bank with an instrument that is sufficiently broad and flexible to cover its field of responsibility, i.e. structural and social policies. Integration between macroeconomic, social and structural aspects enables the World Bank to support the implementation of a PRSP through a PRSC in co-operation with the IMF (and its PRGF). Though both institutions make their own lending decisions, the granting of a PRGF effectively is regarded by the World Bank as evidence of a satisfactory macroeconomic framework. The IMF, meanwhile, regards the granting of a PRSC as an approval of social and structural programmes (IMF, World Bank 2001b). Such reciprocity underlines the importance of the roles the two institution play in the PRSP process. On the other hand, it also spotlights the limitations of the studies each conducts.

2.5. Risks

2.5.1. Dependency

The IMF and World Bank have shouldered great responsibilities in reorienting their lending. However, there is a risk that in doing so they will come to monopolise the PRSP process. The Bretton Woods Institutions (BWIs) naturally have great power. Their operating context is the world's poorest countries, which are in desperate need of resources and generally lack other sources of finance than IMF and World Bank loans. Moreover, bilateral donors often stipulate that a country must be entitled to IDA support – and that it should preferably have an agreement with the IMF – before they will provide financial assistance.[22] An agreement with the IMF is frequently regarded as a guarantee by bilateral donors when providing financial support. This situation makes it hard to avoid recipient countries becoming dependent on the BWIs. For this reason, the IMF and World Bank have a duty to meet the demands made on them. Their doing so is vital if PRSPs are to produce desired results. But do the institutions possess the ability to achieve their own ambitions under the *Comprehensive Development Framework* (CDF), i.e. promote ownership, partnership and a long-term and comprehensive framework focused on poverty alleviation? Certainly, part-

21. The World Bank's various diagnostic instruments are looked at in Chapter 5.

22. One example is Uganda, where the IMF judged the macroeconomic situation sufficiently stable to obviate the need for a new PRGF in 2001. The Ugandan government nevertheless has a PRGF agreement because it makes dialogue with other donors easier.

ner countries appear to need support when addressing the dialogue stemming from this question.

2.5.2. Imbalances and areas not addressed

In spite of the BWIs' high ambitions, their joint strategy has several weaknesses. On one hand, the clear division between their respective areas of responsibility helps avoid overlap. On the other hand, there is a risk that certain areas fall between the two institutions and thereby outside their sphere of responsibility. Moreover, IMF interventions remain based on a shorter-term perspective, while those of the World Bank take a longer-term view. This can lead to imbalances in their respective involvement. Their different spheres of responsibility within state budgets exemplify this: the IMF is in charge of the revenue side while the World Bank focuses on expenditure. Each institution's operations in its respective budget area appear to take no account of events on the "other side", despite a shared notional ambition to co-operate. This was evident during the development of Uganda's PRSC, which was initiated without reference to IMF work on tax and revenue issues.[23] Such demarcation makes it all but impossible to conduct any comprehensive, long-term budget analysis or planning.

2.5.3. Demand management and ownership

Breaking with old systems, traditions, ways of working and attitudes is a precondition for successful implementation of poverty reduction strategies in line with PRS. This applies as much to the BWIs as to other development partners. IMF and World Bank staff refer to how their current approach is demand-driven – a complete departure from their previous supply-side approach (conversations with IMF and World Bank staff, 2001). One of the major reasons for this change is the acceptance of the importance of not jeopardising the partner country's ownership.

Sadly, however, there are in fact many instances in which the BWIs have had difficulty abandoning entrenched work routines and thus guaranteeing genuine ownership and partnership for specific countries. Mozambique, where the World Bank recently conducted a string of studies to assess the status of financial management systems, is one example. In this instance, the bank published a number of recommendations for improving these systems. However, the measures were so complex that they risked jeopardising Mozambique's ownership. The IMF has also been criticised, among others by non-governmental organisations (NGOs) for not

23. Confirmed by personal experiences in Uganda.

making its PRGF more distinct from the old ESAF (IMF, World Bank 2000d). The criticism centres on the fact that poverty reduction measures are not integrated in the macroeconomic framework and that conditionality remains too strict. This suffocates the country's own policies, and with it its ownership.

The demand management model pursued by the BWIs appears in practice to concentrate on addressing the need for technical assistance because neither the IMF nor the World Bank can provide technical assistance without a prior request from the recipient government (conversations with IMF and World Bank staff, 2001). This stance creates a paradox in that it is the BWIs that decide which macroeconomic and institutional measures are to be made conditional on the granting of loans, while the country has to ask the BWIs for assistance in implementing such measures. This form of "demand management" can be justifiably characterised as managed and imposed from the outside.

2.5.4. Influence of bilateral donors, NGOs and other stakeholders and development partners

The above criticism prompts the following question: will the BWIs accept governments turning to other established partners, e.g. bilateral donors or the United Nations Development Programme (UNDP), for technical assistance in resolving the weaknesses that the BWIs have helped to identify? Turning to bilateral donors would be natural for many partner country governments. Bilateral donors have extensive knowledge and long experience in institutional capacity-building; approaching them would also be cheaper. Why borrow money for technical assistance when you can finance it through high quality development assistance?

We can see a clear need for future partnership between the BWIs and, especially, bilateral donors. The question is rather the extent to which the BWIs will allow bilateral, NGOs and other stakeholders and development partners to exert influence. Will the BWIs be interested in bilateral donors primarily as a source of finance? Or will bilateral donors and other organisations be given the chance to exploit their expertise in poverty reduction programmes and the PRSC? The World Bank's paper *"Reforming Public Institutions and Strengthening Governance"* gives no clear indication. The document stresses the importance of partnership between donors but entrusts only a few areas of public sector reform[24] fully to partners like the UNDP, bilateral donors and NGOs. Its reasoning for assigning responsibili-

24. Reform of the police force, penal system, general parliamentary processes, and good governance.

ty in these few areas is that the organisations in question possess greater expertise and experience than the World Bank – in those specific areas.

Although the IMF and World Bank have a leading role in poverty reduction strategies, they are not necessarily the best parties to implement all components of such strategies. Other actors have greater capabilities in certain areas, particularly in implementation. Notwithstanding the reasoning advanced in the World Bank paper, our impression from personal contacts is that both the IMF and the World Bank are keen to forge closer partnerships with bilateral donors and NGOs. Part of the rationale for this is a determination to make the PRSP process as effective as possible. Officials at both institutions also admit they lack adequate financial and personnel resources in these areas (conversations with IMF and World Bank staff, 2001). In addition, we can see that the presence of bilateral donors is important for striking a balance in the dialogue with partner countries around poverty reduction credits. This topic is discussed in more detail in Chapter 7.

2.5.5. Internal co-ordination at the IMF and World Bank

A lack of internal co-ordination is evident at the BWIs, especially the World Bank. One example is the existence of different policies and instrument for the same area. Also, the World Bank still behaves like a bank in a number of respects. Such factors give the BWIs' agenda a technical outlook that is not always in step with the real world, and in which loans and repayment of loans take precedence over actual results. Bilateral donors have another starting point, and a useful one in this context.

Our description of the World Bank and IMF's instruments and ways of working do not by themselves provide a comprehensive picture of the PRSP framework. To be able to understand how various efforts combine and contribute to the development of poverty reduction strategies and economic growth, it is important to be aware of – and to chart – the whole economy in which a PRSP is to be implemented. This is discussed in the following chapter.

A PRSP covers the entire economy

CHAPTER 3

3.1. Growth as the first conditionality for poverty alleviation

The starting point for PRSPs is that rapid, sustainable economic growth should be the core of every poverty reduction strategy. The expectation is that this will produce a lasting decline in poverty. Consequently, macroeconomic developments and macroeconomic stability in a partner country are included as key elements of poverty reduction strategies. Our remit is confined to how donors can support a partner country's PRSP through financial programme support and institutional efforts. For this reason, this report looks mainly at the state budget and public sector. One should be aware, however, that the public sector constitutes only part of a country's economy; the private sector also plays a prominent role in the stabilisation process and PRSPs. The report will look at both the private and public sectors in order to explain how different parts of the entire economy – and factors within it – can contribute to lasting development, growth and poverty reduction in the context of PRSPs.

Because the private sector is the primary source of economic growth, it is natural that this sector should have a central position in poverty reduction strategies. As described in the previous chapter (2.1), private sector growth comes within the remit of the IMF and World Bank. Economic growth itself does not automatically guarantee reduced poverty. Growth must be supplemented by managed resource distribution if it is to lead to welfare enhancements that will significantly improve poor people's lives. This requires that governments pursue an economic policy that allows the private sector to develop, while also improving the distribution of assets and incomes throughout society. This necessitates an effective public sector and effective public finance management systems.

The importance of growth for the poor also hinges on the structure of growth between different sectors. In countries where most poor people inhabit rural areas, growth in the agricultural sector can help reduce poverty by creating incomes for poor farmers. This can, in turn, stimulate demand for goods and services that can be produced by the poor. But growth in the agricultural sector can also weaken the economy if its rate is much faster than growth in other areas like the industrial (manufacturing) sector. An economy that depends heavily on a single sector is vulnerable, which has consequences both for growth and for the poor. A more diversified economy is necessary for establishing higher living standards over a longer period of time.

Poverty itself affects growth too. People living in extreme poverty often have limited opportunities to contribute to economic development. This influences economic productivity and efficiency. Thus, a weak economy striving for long-term, sustainable development cannot "afford" widespread poverty. Efforts to improve educational and health standards among poor people provide an opportunity to increase the workforce's productivity (in the public and private sectors) and thereby intensify growth. This example indicates the need for collaboration between private and public sector initiatives. Another example is public investments that improve the lives of the poor and also benefit private companies. These can stimulate private investments and have an effect on growth.

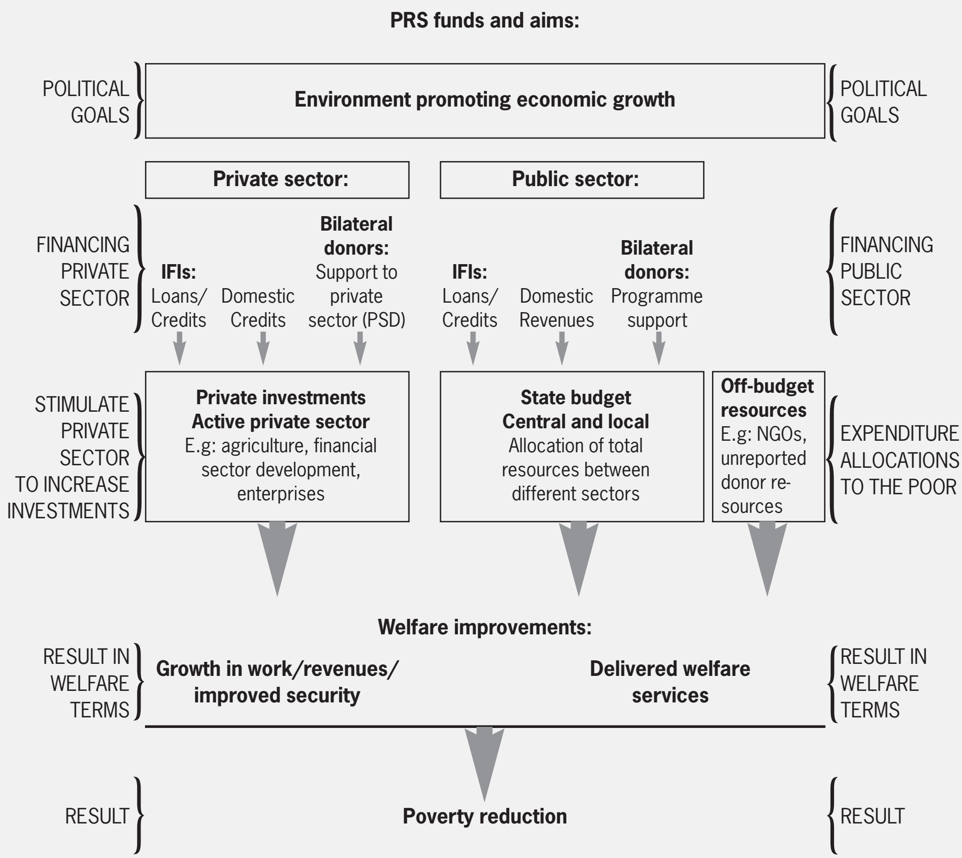
Other measures are also needed to reduce the vulnerability of the poor, such as expanding their access to financial markets – i.e. making it possible for poor people to borrow and manage money. Social safety nets are also needed so as to guarantee the poor some level of consumption and access to basic welfare services, even in situations of economic crisis. These areas are also covered by PRSPs.

In order to achieve a lasting reduction of poverty, the various strategies must be seen in a wider context, in which macroeconomic development and structural measures[25] can contribute directly and indirectly to the welfare of the poor.

The highly simplified model of a country's economy, below, aims to illustrate the relationship between the private and public sectors and their ability to generate poverty-reducing effects when they work together. It should be noted that the model, for the sake of simplicity, excludes certain sections of the economy, for example the informal sector, which is often very large in developing countries and which also generates growth

25. This reference concerns growth-promoting measures, effective resource use, improved welfare services, reforms in government administration, good governance and effective financial management systems. These are discussed elsewhere in the report.

and has poverty-reducing effects. The remaining text in this chapter is based on this diagram and will discuss a number of its aspects.



Here we detail some of the fundamentals behind the model:

3.1.1. Starting point: macroeconomic stabilisation

Macroeconomic development has long been a key element of structural adjustment programmes. During the 1980s and 1990s the focus here has been on macroeconomic stabilisation. Most countries that have undergone some form of structural adjustment have achieved a certain level of macro stability. One of a PRSP's aims is to underpin a macroeconomic policy targeted at growth on the one hand and at poverty alleviation on the other. Macroeconomic stability is a crucial component of poverty reduction strategies. Any attempt to introduce a PRSP that is outcome-focused and sustainable in the long run will have clear limitations unless attention is paid to this area. No exact values exist for macroeconomic variables that might denote whether a country's macroeconomic situation is stable or unstable. Rather, a comprehensive assessment of different key macroeconomic variables is what indicates a country's macroeconomic status. Key variables are growth, inflation, financial (budget) deficit, balance of payments deficit, and size of international reserves. *These also apply in a poverty context.*

Inflation is an important variable, and should be low and stable. High inflation is often detrimental to poor people, who tend to keep their financial assets in cash. This makes it difficult for them to protect the real value of their income. Hence, the value of their assets declines as inflation rises. Inflation can also cause great instability in relative prices, making investments riskier. This hampers growth, which is dependent on investment.

Exchange rate policy is of central importance to the balance of payments. Most African countries were once characterised by heavily overvalued currencies. Today, the bulk of them operate more liberalised exchange rate policies. An overvalued exchange rate results in goods becoming "cheaper" for domestic importers, while export goods become "more expensive" for foreign buyers. Together, this has a negative impact on the trade balance and can have negative repercussions for the composition of growth. The poor may also be affected because their consumption consists chiefly of non-mercantile goods (food, drink and school fees, for example) while revenues from those areas of the economy that produce tradeables are often relatively higher than from the production of non-mercantile goods. An overvalued exchange rate, which negatively affects the export sector, can therefore reduce poor people's relative incomes and purchasing power.

The *debt situation* also has consequences for the poor and for growth. Having a sustainable debt creates conditions for steady and continued growth and poverty alleviation because it removes the risk of default. This means keeping domestic and foreign debt at a level that is sustainable, without marginalising other government expenditure. Such an approach guarantees the financing of meaningful social programmes targeted at the poor. It also creates possibilities for extra investment that may be beneficial for growth.

International reserves can be viewed as a buffer that can neutralise the negative impact on an economy of unforeseen events. Temporary shocks that hit the economy, such as drought, can have a devastating impact on the economy and, therefore, on poor people. An economy needs sufficient foreign reserves to minimise this impact. External shocks can have very serious consequences for the poor, depending on the extent to which they affect their relative incomes, employment and private transfers. Such shocks also increase the likelihood of cuts in government spending on poverty-related programmes.

It is clear, then, that macroeconomic conditions have an influence on growth as well as on the poor. In other words, there are good reasons why macroeconomic policy is included in a PRSP. Another important component of the stabilisation process is the creation of an environment that stimulates the private sector.

3.1.2. Private sector: increase activity and investments

The development of the private sector is of key importance within this framework, not least from a growth perspective. For the private sector to contribute to growth the government should pursue policies that create incentives for private investment. The government can control conditions for the private sector by providing it with capital and implementing favourable regulations. Also, multilateral organisations and bilateral donors can contribute to developing the private sector by providing loans or development assistance. This involves supporting private investments and providing enterprises with technical assistance. To stimulate activity and investments it is vital that the private sector has confidence in the political process and its business environment. For this reason, macroeconomic stability is often a prerequisite for the development of the private sector. As well as being an engine of growth, an active private sector also creates new job opportunities, which provide an income for employees. In a society that lacks a well-developed social safety net, an income can mean a lot for the individual, providing security and fuelling private consumption. Alongside an effective taxation policy, private consumption can underpin the financing of public expenditure within the state budget.

3.1.3. Public sector: allocating expenditure to the poor

The state budget is an important political mechanism for influencing the prevalence of poverty. In theory, the state budget describes revenues and expenditure in the public sector. Under a PRSP, the state budget is also the mechanism for financing poverty-focused programmes. Domestic government revenues are generated by different forms of taxes, for example VAT, income tax, corporate taxes and customs duties. The lion's share of domestic government revenues is therefore derived from the private sector. The link between the public and private sectors is significant, not least when assessing the financial sustainability of domestic poverty-reducing programmes. As a rule, African countries are characterised by very low resource mobilisation in relation to public finance needs. However, an active private sector and an equitable and effective taxation policy give an opportunity to influence revenues.

The stipulation that poverty programmes must be financed via the state budget makes it necessary for the budget to be linked to policy decisions and planning within the poverty reduction strategy (PRSP). The amount of money that can be allocated among various areas of expenditure and sectors within the state budget depends on domestic resource mobilisation capacity, concessional lending from multilateral organisations, and the size of financial assistance (programme support) provided by bilateral donors. All resources are thus interlinked and supposed to be rooted in a common strategy under the umbrella of a PRSP. The mechanism for this is the state budget. Its core role means the shape of the budget process and budget systems are critical for success in implementing poverty reduction strategies.

Donors and lenders poured money into developing systems for the expenditure side of state budgets. But they have devoted far less attention to the revenue side. The skewed distribution of incomes that occurs in most African countries contributes to entrenched poverty. The more uneven is the distribution of incomes, the greater the beneficial effect on poverty of a given rate of economic growth. For growth to result in welfare enhancements that substantially benefit the poor, the government needs to pursue a fiscal policy (expenditure and taxation policy) that addresses income distribution and also accords with the stabilisation process.

It should be noted that not all financial resources earmarked for areas of expenditure included in the state budget are accounted for there. Support to non-governmental organisations (NGOs) and part of the government's donor resources are not disclosed in state budget accounts in the countries concerned. These off-budget resources are paid directly to the intended recipients without being registered in the budget. Neither are they available to any government ministry without the prior knowledge of the ministry of finance. This means they often are not included in the basic documentation available to partner country governments when they set policies and decide expenditure priorities for the national budget. Off-budget resources often account for a very large proportion of public expenditures. An example is Mozambique, where off-budget resources can constitute as much as 75% of total expenditure within the government's areas of responsibility (Joint Donor Review Mozambique 2001). Although these resources are not included in the state budget, they contribute to poverty-reducing effects. However, they also make it difficult to implement and follow up poverty programmes because their effects often are unknown.

3.2. Results and follow-up of poverty programmes

A key indicator of whether government policy is benefiting the poor is the proportion of actual budget allocations spent on social sectors and other areas such as roads and water supply. Assessing the effectiveness of resource use, requires an analysis of cost structures in the various sectors. In the education sector, for example, an imbalance between expenditure on teachers' salaries, textbooks/school equipment and debt servicing of school buildings can have a bearing on pupils' education.

Alongside the additional financial support to state budgets that is now part of poverty reduction strategies, donor countries are demanding more effective delivery of public services and the provision of accounts to show these services are actually reaching the poor. Merely allocating a certain amount of money to the health or education sectors does not automatically guarantee an improved situation for poor people. Quality is often more important than price in these contexts, and quality of public services is of crucial importance to the poor. Service delivery indicators are a prerequisite for being able to assess an administration's ability to deliver public services and for measuring their quality. Such indicators also reveal whether delivered public services correspond with a government's political priorities as expressed in the state budget.

3.3. Long-term domestic financing of poverty-reducing programmes

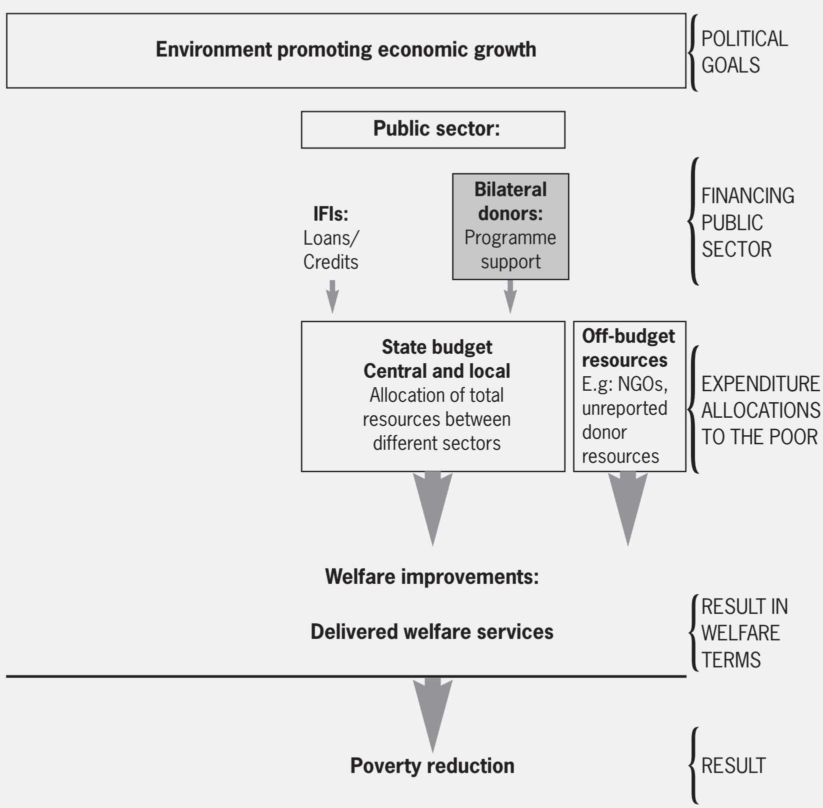
The extent to which poverty-reducing programmes and state budgets are financed domestically hinges on several factors intimately associated with the stabilisation process. There are several reasons why this is an important area within PRSPs. These include the fact that the domestic proportion of total resources must gradually increase over time[26] and to avoid a detrimental effect on the poor (see section 3.1.1). If state budget expenditures exceed total government revenues, the government can be forced to seek financing from other sources. This often leads to higher inflation, with negative consequences for poor people and growth.

26. If it is assumed that a country does not want to be aid-dependent forever.

Governments in IDA countries are often forced to allocate limited credits between the private and public sectors. Where a large borrowing requirement exists in the public sector, i.e. an oversized budget deficit, that starves the private sector of sufficient capital, the entire economy can be affected. The repercussions will affect long-term development of poverty reduction strategies and the distribution of credits to investments considered the most productive.

PRSPs must therefore be seen in relation to a country's total economy – and to the private sector, which accounts for the major part of economic growth. Our remit is restricted to the connection between programme support and institutional reforms, so the prime focus of this report is the public sector. We will henceforth concentrate our analysis on the public sector, the state budget and poverty alleviation (see model in Ch. 3.1).

The next chapter describes how lenders/donors can support government policy via programme support, including poverty reduction strategies. The diagram below illustrates this area of analysis and focuses particularly on the box entitled "Bilateral donors: Programme support".



Integrated approach to programme support

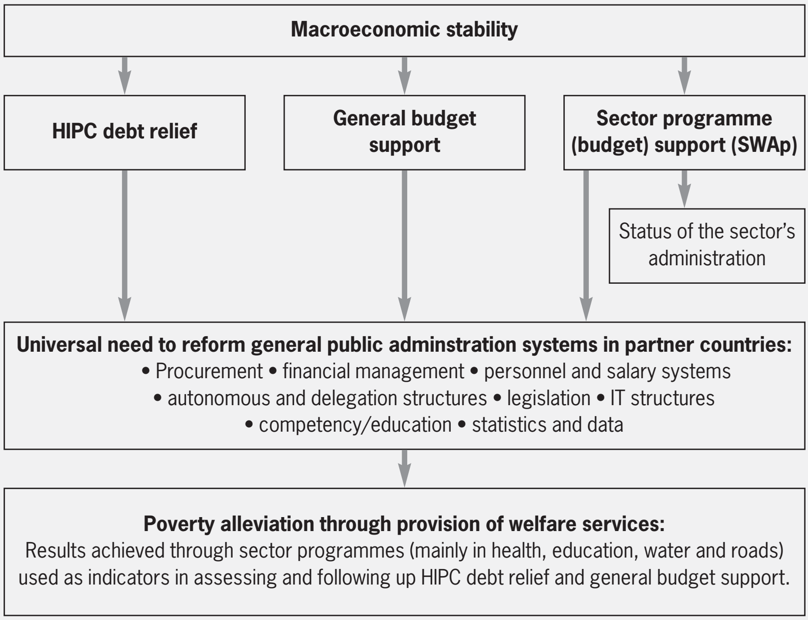
CHAPTER 4

4.1. Different forms of programme support

Programmes supporting poverty reduction strategies (PRSPs) can be conducted in different ways in the public sector and from a lender and donor perspective. We will use the diagram below as a basis for this chapter and to illustrate how these different approaches and models coexist. Against the background of the previous chapter's discussion about the need for macroeconomic stability and growth as a basis for poverty-alleviating measures, this chapter describes the three forms of financial programme support measures that can be used to support PRSPs. It then discusses the need for administrative reforms in connection with programme support measures. Financial management systems are described in detail. These reforms are an important component of efforts to secure more effective delivery of welfare services to the poor. Finally, the chapter describes the ways bilateral and multilateral organisations work with programme support today.

In a situation of macroeconomic stability (see previous chapter), donors can provide financial support to government poverty reduction strategies and the state budget through programme support, which is intended to finance improved welfare services. Programme support can be described as a modality aimed at supporting implementation of a general policy or expenditure programme developed by a partner country. All forms of programme support are linked to policy reforms in the partner country, wherein poverty issues are today deemed of key importance.

Because of the rather liberalised currency policies pursued in most African countries today, balance of payments support aimed at "closing an external gap" is, in practice, no longer provided. Balance of payments support by way of import support has been phased out, while "general balance of payments support" effectively functions as budget support.



From this, three forms of financial programme support can be identified as applicable for supporting government poverty reduction strategies and the state budget: debt relief through the HIPC Initiative; general budget support; and sector programme (budget) support.

4.1.1. HIPC debt relief

Debt relief via the HIPC Initiative can be seen as an indirect way of supporting the budget. This is because expenditure which otherwise would have been used for debt servicing is instead used for poverty-focused purposes.

For this to be viable, it is necessary that the government would have repaid the debt had it not been granted debt relief. Lack of funding and other reasons mean it is not unusual for some debts to be left unpaid by debtor countries. The size of what is defined as extra budget resources can thus be said to depend on the extent to which the government had planned to meet its debt servicing commitments and on the extent to which it is possible to verify that the extra resources disbursed are really used for alternative and agreed purposes.

Multilateral organisations and bilateral donors alike can contribute to the HIPC Initiative. The idea is that funds "saved" by HIPC debt relief should be seen as a part of the state budget (which must prioritise poverty reduction measures). The funds should be monitored using the country's own public finance management systems.[27] While the countries concerned are expected to take responsibility for supervision and reporting, the BWIs have assumed the role (within the PRSP framework) of evaluating the nations' capacity and guiding governments by use of mechanisms to report on and follow up poverty-related public consumption.

4.1.2. General budget support

General budget support works in a more direct manner. Money is usually transferred directly to the countries' bank accounts, without being earmarked. In order to make it straightforward enough to verify that funds provided via general budget support are actually used to help the poor, the budget must make clear that social sectors and other poverty-oriented programmes (such as water supply in rural areas) are accorded priority. The state budget has been attracting more attention as general budget support has attained higher prominence. Analysis of the support naturally highlights the budget process, allocations and transparency. The close link between the budget and other financial management systems has necessitated improvements in payment, accounting and audit systems and their inclusion in the analysis so it is possible to ascertain how the money has been used. Alongside bilateral budget support, the World Bank can use the PRSC credit to lend funds that are transferred directly to the state budget, like a general budget support. These funds are also tied to institutional reforms and improvements.

4.1.3. Sector programme budget support

Sector programme support consists of resources targeted at supporting specially designed programmes in certain sectors. The most common are health, teaching, roads and water. Donors support a specific sector to implement a sector strategy agreed with the government under the auspices of a *Sector-wide Approach* (SWAp). Sector programme budget support concerns the financial resources that underpin this sector strategy and which are registered in the state budget and paid directly to the government's bank account. It should be noted that not all sector programme support is paid as budget support. Many donors still finance projects designated under a government's fixed sector programmes.

The partner country government also finances a proportion – and

27. It is worth stressing that the HIPC Initiative's concessions in many cases constitute only a marginal contribution to the state budget.

often the major part – of the total expenditure within a sector programme. One possible source of such financing is general budget support or debt relief received by the government. Thus, general budget support and HIPC debt relief both provide resources for sector programmes. This increases the reliance of sector programmes on these two forms of programme support.

Sector programme measures play an important welfare-enhancing role in a number of ways. They are concentrated on sectors that directly benefit the poor, for example improved water supply, infrastructure, education and health. Efforts directed at social sectors – education and health – also serve as important investments in human capital and can help sustain economic growth. Investing and developing human capacity through welfare services can play a significant role in promoting lasting economic development. Moreover, sector programmes provides the vehicle for measuring the results of all forms programme support. The development and results of the welfare services provided via sector programmes serve as natural indicators for assessing the results of HIPC debt relief and general budget support.

All three of the above programme support forms are tied to the state budget, which should reflect the government's economic and social policies. The government's ability to use these resources to deliver welfare services ultimately determines how programme support will affect the poor. Ensuring the resources reach their intended target in an effective way, and can play their intended role, requires good functionality in the recipient government's administration general systems.

4.2. The need for institutional reforms

A state budget may indicate that the government is pursuing poverty-oriented policies that prioritise allocations to poverty-related sectors. But this is no guarantee that it is helping improve the lives of poor people. Efficiency in administration systems is also necessary to enable programme support resources channelled through a government to filter down through the economy and reach citizens in the form of welfare services. Regardless of the form of programme support that donors/lenders choose, institutional measures are important – for donors, lenders and recipients alike.

The need to build institutions is a wide-ranging area. Measures include financial management, personnel and salary systems, legislation, IT structures, competency enhancement/training, and improved statistics/data. The capacity of the sector administration is also important, not least for improving the efficiency of sector programme support and influencing its results.

4.3. The importance of effective public finance management systems

When donors channel financial support through partner countries' systems to support a government's policy (including its poverty-reducing strategy), it is essential that these systems work. If they do not it jeopardises the development of both the economy and the poverty programme. Because macroeconomic policy in IDA countries largely depends and is based on credits and donations from donors, these funds must be accessible within the government's systems if it is to implement its policy. It is therefore important that a government's payment system is capable of distributing support funds in an effective way so they can finance the spending programmes specified in the state budget.

A payments system with inadequate capacity impedes the government's ability to pursue an effective fiscal policy in accordance with the stabilisation process.[28] In cases where a government has to fund certain budget posts by resorting to domestic lending, and where only a limited number of credits are available, the private sector may be deprived of capital. This results in the domestic debt burden – and thereby debt servicing – increasing , with negative consequences for economic growth.

Substandard payments systems also hinder the development of sector programmes and other poverty-related programmes covered by government policy – unless resources can be assigned to their intended destination in an effective and expeditious manner. Irregular and insecure payments risk complicating planning and restrict development in sectors that provide welfare services to the poor, both at central and local level.

An accounting system that can provide information about actual payments is a necessity for monitoring the fate of budgeted resources. A weak accounting system closely linked to the payments system can result in it taking a long time to conduct a comprehensive follow-up of payments made. Without access to information on how budget funds are actually applied, it can be difficult to draw up a realistic budget. A palpable risk exists of the budget becoming an empty "planning instrument" unless different parts of the financial management system are integrated. Such an outcome would make it impossible to assess whether the budget was a

28. Cf with the stabilisation process as described in Chapter 3.

true reflection of the government's economic and social policies. Building up and strengthening financial management systems therefore promotes more effective handling of resources. This, in turn, makes it easier to implement government economic policy and poverty reduction strategies.

4.4. Programme support: co-operation between multilateral and bilateral donors

The moves by the IMF and, in particular, the World Bank into the institutional arena have resulted in some bilateral donors seeking close co-operation with them, chiefly in public finance management. The UK's DFID is an example of one of the most progressive bilateral donors. It has invested great energy in promoting good governance and public finance management, often in close collaboration with the World Bank. The Netherlands has also articulated a clear ambition to work closely with the World Bank.

The aim of programme support is to create improvements by reforms. But programmes seldom include the technical assistance (TA) and capacity-building required to implement such reforms. Institutional reforms do not appear especially well integrated in many bilateral donors' programme support policies. There is a major need for a more integrated working relationship between programme support and TA/capacity-building efforts in the current environment, in which various initiatives inter-react within a joint framework. Regular follow-up of developments in this area is also required. At present, there appears to be no regular follow-up of disbursed programme support by way of comprehensive reporting of outcomes.

4.4.1. Long-term financial undertakings required of donors

The need for long-term undertakings is increasing in this form of development co-operation. Most programme support agreements today cover a one-year period. It is important for recipient governments to be able to plan appropriate budget processes. This requires continuity and predictability in the provision of programme support because the processes constitute a large proportion of total budget resources, as a rule. In terms of the time frames for programme support, we note that a number of bilateral donors are keen to work over longer periods than one year. Sida in 2001 decided to provide two-year programme support to four countries, while the Netherlands is attempting to move towards three-year budget support programmes. DFID has gone even further with a ten-year budget agreement with Rwanda covering general budget support and sector budget support to the education sector.

The IMF's PRGF document[29] states that IMF and World Bank staff must take a more active role in mobilising external resources in accordance with PRSPs. The aim is to attract additional donor resources to countries with the greatest need, where they can be used effectively (according to IMF and World Bank assessments). The importance of bilateral financial help – and the need for it – is noted. The document also urges bilateral donors to participate in the PRSP process and to commit to supporting it over the medium term.

4.5. Weaknesses in PRSPs

By providing programme support, bilateral donors assist governments' poverty reduction strategies. In this regard, it is important that bilateral donors analyse what PRSPs actually include before they make decisions about support. What are they actually supporting? In our opinion the PRSPs that we have seen display a number of shortcomings. While detailed information is provided about goals and benchmarks to be achieved within certain periods, information about actual implementation is less extensive. Some strategies have a hollow ring, failing to provide a concrete link between stated indicators and prospects for carry through. In order to develop more comprehensive and actually achievable implementation strategies, we see a need for wide-ranging analysis in different areas that can underpin evaluations of programme prospects and possibilities.

The aspiration that governments should draw up PRSPs in a "democratic process" is a positive development. But it also makes high demands of governments' ability to make this happen in reality. It should be said that the IMF and World Bank are involved in this process, though this creates a risk that the areas spotlighted are those that are most closely aligned with their interests. One should not forget that most budgets in the target countries are devised by the BWIs, imposing restrictions on budget deficit size, and stipulations about the composition of sectoral expenditure and state budget financing. These conditions are the basis for the programme support provided by bilateral donors. The primary purpose of a state budget – that of a fiscal management tool – can be easily confused with an instrument that facilitates World Bank and IMF macroeconomic reforms. As this report points out in numerous places, it is important to strengthen the often weak role played by parliament in the PRSP process.

Poverty reduction strategies place great weight on budget allocations to social sectors and poverty programmes. On top of the efforts taken to follow the flow of resources through different sectors, budget analyses are needed to evaluate the effects on matters like environment and gender. Following the work carried out by NGOs is one way of obtaining this information. Co-operation in certain areas can also influence these matters.

As stated in the previous chapter, the state budget is a mechanism that bundles together all resources (domestic resources, multilateral debt loans/credits, bilateral programme support) aimed at supporting PRSPs. One condition for effective poverty alleviation is that the budget process and budget systems (together with other financial management systems) work in practice. Unless they fulfil minimum requirements there is a risk that everything will collapse, in which case the PRSP cannot be put into practice and ends up merely as a traditional declaration of intent.

For financial programme support to be translated into satisfactory outcomes in the form of good quality, well-delivered welfare services that benefit the poor, it is vital that programme support is provided in concert with institutional measures that stress administrative capacity. This area is addressed in the next chapter.

Need for institutional reforms and institutional capacity-building in public administration

CHAPTER 5

5.1. The World Bank's changed approach

Earlier, we indicated how the development of programme support in its different guises implies a need for public administration reforms in partner countries. Donors, lenders and partner countries themselves all share a common interest in ensuring such reforms are carried out. For donors, this is important for tracking programme funds after their transfer to partner countries' financial management systems. More generally, welfare services cannot be provided in the absence of an effective civil service.

In the past the World Bank has adopted a macro perspective on the development and substance of public administration. Its opinions, relayed through various *Civil Service Reform* initiatives, have often concerned the size of public administrations and civil servants' salaries as a proportion of total public spending, etc. The bank has seldom implemented its own long-term capacity-building projects in core areas of public administration. Because the bank has lacked information about actual conditions, its insistence on public administration adjustment processes has often created problems elsewhere. Civil service cutbacks demanded by the bank may trigger unemployment or additional costs for healthcare or social insurance (further burdening a social insurance system that is probably already weak).

Similarly, both the World Bank and the IMF have included areas of public administration considered to be in need of reform in the *Policy Framework Papers* (PFP) agreed with partner countries. Requests for new government accounting systems provide an example of this. However, the task of implementation has been left to the partner country government, which has often needed assistance from a bilateral donor to implement required reforms. In addition, the IMF has carried out different types of short-term project in many of the countries concerned to address fiscal issues.

The World Bank, meanwhile, has transformed its attitude to institutional reforms in public administration. This shift has taken place alongside – and possibly because of – changes in programme support and the way it is disbursed and performance-assessed. It is most clearly and comprehensively expressed in the policy paper *"Reforming Public Institutions and Strengthening Governance"* (World Bank, 2000a). This paper, published in November 2000 by the *Public Sector Group* within the World Bank's *Poverty Reduction and Economic Management* (PREM) network, is described by the bank as a strategy. Its thrust was confirmed during a visit to the World Bank in Washington D.C. in March–April 2001, and the subsections 5.2 to 5.5.3 are based chiefly on information and opinions contained in it.

5.2. Essence of the World Bank's new policy and goals

The World Bank's chooses several themes to connote its new policy. The overriding one is the bank's (new) realisation that poverty reduction in partner countries requires effective public administration. The bank states three reasons for this. First, publicly provided welfare services are an important aspect of poverty alleviation and cannot be delivered without an effective civil service. Second, effective public administration facilitates economic growth. Third, effective public administration increases citizens' awareness, which can stimulate calls for participation and transparency.

These themes underpin the long-term aim of the new policy:[30] greater democracy and participation for poor people in the societal process, improved human rights, and a decent material living standard for all.

The policy is founded on four "strategic" requirements:

i) Political will and commitment in the partner country.
ii) Work with clients and other partners to strengthen the World Bank's tools for institutional analysis and ascertaining conditions in specific countries, including whether there is a will to carry out reforms.
iii) Changed lending approaches: adoption of a longer-term view.
iv) Strengthening the bank's internal capacity to assist countries in public sector reform through continued improvements in staff skills, organisation, incentives and relations with partners.

30. Includes poverty reduction and further improvements expected to stem from this.

The World Bank is aware it lacks sufficient staff and financial resources to implement its preferred programmes in all target countries. This is one reason why the bank wants to work with other providers of funds, including bilateral donors. It is unclear, though, whether this will to co-operate reflects a realisation that external donors/lenders may have greater expertise in the field.

The World Bank monitors efforts to improve the efficiency of public administration in a programme context and frequently cites the CAS and CDF as relevant structures for intended reform programmes in this area. Put in a PRSP and PRSC context, the World Bank wants to work with the "core areas" of public administration[31] as well as the administrations of sector ministries and related sector programmes. In an African context, the bank is aware of risks attached to programmes and therefore stresses the need for all to have a clear time schedule and list of priorities. In reform programmes, another important aspect for the bank is promoting private alternatives, including the sphere of welfare service provision.

The World Bank clearly articulates a readiness to take the lead in this area, perhaps indicating it is not fully aware of the expertise in public sector and reform issues that exists elsewhere.

The bank also supports delegation and decentralisation in the public sector, seeing this as the best way of being able to create processes capable of being performance-assessed.

Our experiences hitherto in sector programmes and the dialogue about poverty reduction strategies suggest an entirely different conclusion. The new forms of programme support have contributed to strong centralisation in preparatory work and decision-making processes. At a central level, these have been more or less concentrated to government ministries and agencies. Here, the influence of parliamentary institutions is either extremely limited or non-existent. Also, public administrations and political officials at a lower provincial, regional or district level have lost influence over policy. When it comes to poverty reduction strategies and associated credit instruments, they have become mere executors of centrally ordained policies.

In an African environment, the World Bank notes the importance of working in different ways, depending on the country's status. Thus a certain level of stability and efficiency must pertain before a government can address reforms of public administration and management structures. According to the World Bank, if such stability is absent then demands on public services must be increased only gradually, particularly at local level.

31. Ministries of finance, public administration, justice and ethics, as appropriate. Independent audit body.

5.2.1. The World Bank's introduction of toolkits/diagnostic instruments

In its work with public institutional reform the World Bank intends to develop toolkits to provide access to standardised information about conditions in relevant areas in specific countries.

The toolkits mentioned in World Bank 2000a, some of which already exist, are:

- **Governance and Policy Toolkit,** which is linked to poverty reduction strategy work.
- **Public Expenditure Institutional Assessment,** which assesses a government's capacity to formulate budgetary and sector policies.
- **Civil Service Institutional Assessment,** which analyses issues related to personnel, salaries and administration, and conditions in the civil service.
- **Assessment of Revenue Mobilisation Capacity,** which analyses the government's ability and will to increase domestic revenues in the budget.
- **Legal and Judicial Institutional Review,** which includes analysis of corruption or abuse of powers by public officials.
- **Intergovernmental Relations Institutional Review,** which is intended to evaluate possibilities for decentralising financial management.
- **Assessing Constraints on Service Delivery,** which is intended to attempt to ascertain why intended welfare services are not delivered.
- **Commitment to Reform,** which aims to identify any political will to participate in reforms.
- **Media Situation Analysis,** which is intended to analyse the media's ability to help combat corruption in a specific country.

The World Bank's policy papers also provide examples of measurable indicators in areas that impinge on the public sector. The World Bank intends to increase substantially its presence in these areas. They include:

- Public expenditure analysis and management.
- Revenue policy and administration.
- Civil service.
- Decentralisation.
- Dispute resolution services.
- Other institutions.

This list covers contentious areas. For instance, the World Bank has previously agreed with the IMF that analyses of state budget revenues, in other contexts, fall within the IMF's remit.

Other analysis instruments are described on the bank's website.[32] Those areas listed on the website as of June 2001 were:

- Civil service reform.
- Anti-corruption.
- Decentralisation.
- E-government.[33]
- Legal institutions of the market economy.
- Public expenditure.
- Tax policy & administration.
- State-owned enterprise reform.

The bank's website also lists "common problems" found in the public sector in the countries concerned. As of now, these are:

- Employment and salaries for civil servants.
- Corruption among, and mistrust of, public officials.
- Resistance to changes in public administration.
- Issues related to delegation, decentralisation and capacity in weak member countries.

5.3. Implementation of the World Bank's new policy in Uganda and Mozambique

In a number of member countries, the World Bank has already started implementing its considerably more hands-on public administration development policy. Two of these are Uganda and Mozambique, both of which have quickly stabilised their economies and attained a high rate of economic growth. It is as yet unclear if this growth has translated into better living standards for the poor, however.

32. See www.worldbank.org/hipc
33. Electronic government.

Case study: Uganda and the PRSC

After several years of preparations, the World Bank decided at the beginning of June 2001 to approve a yearly PRSC credit of US$ 150 million to Uganda. The formal agreement was for three years, though in reality it will continue for as long as the conditionality for the credit is met.

Under the agreement, the credits are paid unconditionally and directly to the government's account at the Bank of Uganda. In practice, however, they are tied to a list of benchmarks, which in essence represent public administration reforms. The benchmarks, which correspond to areas specified in the list, should be met during the course of the first three-year period following the initial disbursement in spring 2001. The programme and list are revised annually and extended for a further year. The benchmarks stretch to 13 pages in the credit document (World Bank 2001). The different components mimic the structure of Uganda's poverty reduction strategy – the *Poverty Eradication Action Plan* (PEAP) – and cover reforms, core ministries (finance, public administration, justice and ethics), and sectors such as health, education and water. The benchmarks clearly exemplify the World Bank's realisation that different areas and issues relating to public administration are integrated and mutually interdependent. This interdependency is just as valid for financial management reform as for other kinds of general public administration reform.

The Ugandan PRSC credit and its link to a co-ordinated public administration programme represents an excellent attempt to bring together reform measures and the donors responsible for different aspects of the programme, such as sector support. For perhaps the first time in public administration assistance, one can see the outline of a cohesive effort that reflects an understanding of the need to pool resources and in which the partner country is involved. Nevertheless, certain risks are attached to this approach. One is the centralising effect described earlier. Moreover, in breaking new ground for the World Bank, it raises many unanswered questions.

For instance, it is unclear how the annual follow-up process would be affected if only some of the agreed reforms had been implemented. What effect would this have on the next credit's size and disbursement? In addition, the credit programme is very wide-ranging, and experiences from working with reform programmes of this sort have not always been wholly positive. On top of this, the financial management benchmarks were strongly supervisory and centralised in character, taking little account of Uganda's highly decentralised civil service. These impressions possibly reflect the fact that this credit form and other World Bank diagnostic instruments are still in development.

5.3.1. Effects on – and opportunities for – bilateral donors in Uganda

Regardless of how it develops in Uganda, the PRSC will have a major effect on bilateral donors. All donors involved in financing projects that touch on any part of public administration encompassed by the credit-related programme will be affected and, in practice, subject to the scrutiny of the formulation and implementation of next year's credit programme. Bilateral donors will also be impacted by the fact that dialogue with the government will be concentrated on the PRSC programme and its implementation. Meanwhile, the PRSC programme and the World Bank's actions during its drafting make clear that bilateral donors (not least Sida) currently have greater knowledge and experience about public administration development – and its importance – than the World Bank. For this reason, bilateral donors may end up playing an important role in formulating future PRSC programmes – probably on-site in the countries concerned. Another important question is the need felt by partner countries for an alternative partner in dialogue to the World Bank. Here, bilateral donors could also play an important role by providing alternative assessments and analysis of developments within the specific public administration.[34]

Case study: Mozambique and the new classification structure

The PRSC is the World Bank's principal instrument for implementing a PRSP. But, even in countries where the PRSC has not yet been launched, the attitude of the bank and the IMF to public administration issues – particularly those connected with financial management – has clearly changed.

An example is the "wish" the two institutions expressed to the Mozambique government in the first half of 2001 concerning a new classification structure for the state accounting system, to be modelled on the lines of the UN's COFOG systems.[35] Though the purpose behind this wish was never expressly stated, it was clearly motivated by a desire to obtain a "functional classification" showing how state budget funds had been spent. The probable aim of was to use this material to produce standardised poverty reduction data for different countries and to measure the performance of Mozambique's poverty reduction programme – PARPA.

The new classification system's final format was reasonable and, from Mozambique's perspective, probably realistic. (Approximately 55 of 127 possible classification categories will be incorporated into the government's accounting.) The new structure constitutes a big step forward for sector programmes, which can now differentiate between different expenditure headers in a particular area (e.g. primary and secondary education under the education heading). However, the main problem – that the state budget includes only a quarter to a third of total expenditure – still applies. This of course limits the value of information derived from the new classification.

34. These questions are discussed in more detail in Chapter 7.
35. Classifiers of Functions of Government.

5.3.2. Role of bilateral donors in Mozambique

For bilateral donors, the most important consequence of the new classification system is that their future agendas will hinge far more on the desire of the World Bank and IMF to influence central public administration development. This will also affect other involved parties. Sweden is funding a major project to introduce a new state accounting model in Mozambique, and this was immediately identified as the ideal channel to implement the new classification structure.

The BWIs are likely to remain very interested in this centralised project, with the result that its destiny will no longer be decided solely by discussions between the Mozambique government and Sweden. This highlights the need for bilateral donors to understand and accept the new situation. The best approach is probably to collaborate with the BWIs and attempt to influence their suggested reforms.

5.4. Sida's policy in this area

Our 1999 report addressed the need for reforms in public administration.[36] It also raised issues relevant when assessing the quality and status of evaluation parameters. These remain as applicable today as they were then. They originate predominantly from Sida's involvement in institutional capacity-building in public sector institutions during the 1980s. Many of these parameters can also be found in the World Bank's policy paper *"Reforming Public Institutions…"* (2000a). As listed in our report, they are:

- Organisation/structure.
- Decision-making/autonomy.
- Personnel administration/systems.
- Competency and human resource development.
- IT structures and maintenance.

Sjölander and Brobäck (1999)

As long ago as ten years ago Sida devised a policy for its public administration development work in larger partner countries – and at that time was probably unique among donors in this regard.[37] The policy is currently being revised to reflect better Sida's current strategic objectives of democratic governance, human rights and poverty alleviation. It was tested via

36. See *Sjölander and Brobäck* (1999), Ch. 5, Development and the Status of Public Administration.

37. *"Making Government work, Guidelines and Framework for SIDA Support to the Development of Public Administration",* SIDA Education Division, Public Administration Section, 1991.

practical implementation in a large number of public administration development projects in southern Africa during the 1990s, particularly in core institutions.[38]

In the course of this work, Sida and its consultants have acquired much experience of the parameters that need to be evaluated and included in this type of capacity-building project in order to achieve good results. Public authorities such as Sweden's National Tax Board and the Swedish National Financial Management Authority have, in a consultancy role, developed policies based on these experiences. Bilateral donors other than Sida have also implemented a policy for financing capacity-building projects in public administration.[39] However, Sida was probably the first and still has the broadest expertise in this field.

5.5. Consequences for all parties

The World Bank has several motives for systematically addressing public administration reform in IDA-countries. These include a desire to maintain financial control over its loans as well as basic development aspects. The World Bank acknowledges that fundamentally changing institutional structures is an altogether more demanding and time-consuming task than manipulating macroeconomic policy. But its powerful motives mean it will definitely make a big effort in this regard (conversations with World Bank staff, 2001).

As explained earlier, the bank is developing or has developed a wide range of toolkits for this work. The World Bank's resources far exceed those of any single bilateral donor when it comes to such projects and the countries concerned are heavily dependent on continued World Bank credits. Because of this, the relative lack of success so far in implementing the bank's instruments is of no great consequence, though the experience may persuade the IMF to adapt the instruments it is currently developing. Neither does it really matter whether some of the bank's instruments never actually see the light of day, or that others are added at a later date. Come what may, the methods and diagnostic instruments the bank decides on will have a major impact on public administration development in the countries concerned: for the countries themselves and for the rest of the donor community.

No actor in this field will be unaffected by the World Bank's new pol-

38. Ministries of finance, independent audit bodies, inland revenue offices and in ministries of public administration or suchlike.

39. The Netherlands and UK, among others.

icy. For individual donors like Sida, the effects may prove very substantial. The activities of the World Bank (and the IMF) in Mozambique underscore this point. Just as all donors and partner countries rely on the BWIs' macroeconomic assessments, so the public administration reform programmes spearheaded by the World Bank (and to a lesser extent the IMF) will have an effect on all actors involved in public administration or sector programmes in partner countries.

5.5.1. Role of bilateral donors in developing methodologies

As described earlier, the World Bank is a relative newcomer to public administration issues – issues in which organisations like Sida and its external consultants possess great competence and knowledge. The best policy route for Sida and other bilateral donors is thus probably one of active engagement with the World Bank in an attempt to influence its policies and the diagnostic instruments it is developing. The World Bank would, for several reasons, be likely to respond positively to any such approach. The bank nurtures a genuine will to work in unison with other donors and it also needs external financing sources to carry out its anticipated methodology reforms (conversations with World Bank staff, 2001). This creates major opportunities for bilateral donors that wish to be involved. For Sida, there is a strong financial motive too.

Bilateral donors such as Sida have much to gain from working with the World Bank in these matters. The countries concerned would also gain from a bilateral involvement. The World Bank tends often to use blueprint-based models, as experiences from the PRSC in Uganda have shown. This creates a risk that newly developed instruments may be applied in the same way in different cases, without always taking individual circumstances into account. For this reason, Uganda and other nations have much to gain from having progressive bilateral donors as a third party in dialogue. Such donors are at least as proficient in public administration development as the BWIs; they also have different priorities. Bilateral donors (ideally by working together) can help create a multidimensional approach to relevant issues, both as technical partners (at present primarily for the World Bank) and as a reference point for partner country governments. Nor should this prevent bilateral donors from participating in the World Bank's PRSC missions and studies: on the contrary. The introduction of the new classification structure for Mozambique's state accounting system highlights the need for a third-party partner. It remains unclear whose interests are best served by the new system in the short term. When the IMF/World Bank discuss such issues with partner country governments bilateral donors can play an important intermediary role by proposing alternative approaches or ideas. We will look at these in Chapter 7.

5.5.2. Nordic co-operation

In our view, it is natural that Sweden and Norway should co-operate in these questions. NORAD and Sida both have great competence and interest in this area. They share a similar approach and could easily represent each other in public administration-related issues. By working together they would gain economies of scale and access to a larger pool of competencies. Putting greater emphasis on an integrated approach to public administration development would also help promote the creation of international partnerships in the field. At the moment, such partnerships are confined to financial management.[40] It is logical that Sweden and Norway co-operate in this respect.

Sida has other motives for expanding its links with Norway in public administration development. Sida's Norwegian counterpart, NORAD, is increasingly regarded as the leading bilateral voice – alongside DFID. This is in part a result of Norway's chairmanship of the SPA Task Team for financial management issues. Sweden, meanwhile, has more extensive experience and broader-based skills when it comes to public administration development projects.

Other bilateral actors play different roles and have different standpoints in these issues. DFID (and to some extent the Netherlands) follows a line that is closer to the World Bank's way of thinking and implementing new credit programmes.[41] Against this background, it is important that donors which do not share the World Bank's approach also participate in the process and show willing to tackle the issues based on their knowledge of actual conditions acquired through experience. This is a further argument for deeper co-operation between Sida and NORAD.

5.5.3. Integrated approach to financial management and public administration development

Our Terms of Reference require us to raise issues of relevance when assessing the quality, status and usability of the partner country's public finance management systems.[42] In our opinion, these yardsticks cannot be restricted to financial management systems alone. The usability of these systems depends on the nature of the institutions discussed in this Chap-

40. See Chapter 6.

41. Cf the shape and content of DFID's ten-year poverty credit to Rwanda.

42. See Chapter 6 and the appendix to the report.

ter. Therefore, we have opted to give an integrated account of what is important when assessing financial management systems and the institutional aspects that should be observed. This account is provided in Chapter 6 and the appendix. The technical systems and basic public administration structures must both work effectively – in terms of competency levels and access to relevant information – for changes to be successful.

The World Bank has realised this, which is why its new public administration policy (World Bank 2000a) identifies public expenditure management as one of the integrated management parameters for public administration reform programmes. This view, held by World Bank officials working with public administration issues, is at odds with the prevailing view among their colleagues working with financial management questions. The latter have instead developed diagnostic instruments that are confined strictly to the structure and content of financial management. These take no account of other conditions for capacity development.

Analysis of financial management systems

CHAPTER 6

6.1. Instruments

In a programme management model whose aim is to transfer funds to recipient countries' public finance management systems, an important question facing donors is the quality of these systems – with regard both to financial control and as a development tool. There is, therefore, a need to analyse these systems in the countries concerned. Numerous individual and joint studies have been conducted. In addition, both the IMF and the World Bank and, recently, a number of bilateral donors have developed diagnosis and analysis instruments for this purpose. Most of these have already been described in various reports[43] and need not be revisited in full. Here, though, is a brief overview:

- **IMF Code of Good Practices on Fiscal Transparency** analyses the availability of information required for assessing the systems in question. The code is based on four basic concepts: a clear division of roles and responsibilities between partners; public access to information; an open budget process and ability to follow up how funds are spent; and the need for independent auditing and monitoring.

- The Code on Fiscal Transparency is part of the IMF's **Reports on Observance of Standard and Codes (ROSC),** which cover institutional questions as well as macroeconomic variables and exchange rate policy. ROSC reports correspond in large measure with the **Code on Fiscal Transparency.**

43. See, inter alia, Stefan Falk's easy-to-read *"Overview of Budget Issues"*, Sida, 2000 and *"Public Financial Management in SPA countries, Key Challenges, Assessment Mechanisms and Role of SPA"*, NORAD/SPA Task Team on Public Financial Management and Accountability, 2001.

- **Public Expenditure Reviews (PER)** are an old World Bank instrument currently undergoing revision. PERs can in theory cover all issues related to the macroeconomy and public finance management, as well as other aspects of public administration. Recently they have been tied more closely to poverty reduction and their analyses often address opportunities for allocating government funds as intended and follow-up thereof. PERs are becoming increasingly connected with the implementation of the PEAS (see below). The World Bank sets great store by PERs being piloted by partner countries.

- PER analyses have also been linked to the HIPC Initiative and the need of the World Bank and IMF to track the effects of debt relief. So strong is this need that special analysis tools have been developed especially for it. In their joint HIPC Tracking Study (IMF and the World Bank 2000a), the World Bank and the IMF selected 15 **Key Public Expenditure Management Issues** from a clutch of more than 30. The two institutions aim to follow these issues up in all 25 HIPC countries.

- The World Bank's **Country Financial Accountability Assessment (CFAA)** is relatively new and has been used e.g. in Uganda and Mozambique. The CFAA basically covers all aspects of public finance management apart from revenue issues. It also covers the private sector and NGO development. The CFAA has so far been used mainly as a supervisory and risk assessment instrument, primarily for central government system and audit functions. The World Bank has also developed a "twin instrument" for the CFAA in the field of procurement – the **Country Procurement Assessment Review (CPAR).**

- The World Bank is continuously developing and experimenting with new instruments. Among them are the **Framework for Assessing Fiscal Vulnerability** and the **Framework for Public Expenditure Analysis & Support (PEAS).** The PEAS is an interesting instrument as it is designed to cover a number of different areas within the World Bank, including assessment of non-financial variables like **Government Capacity and Willingness.** It is also the instrument the bank is likely to use to develop a comprehensive programme for public expenditure. The programme includes identifying active participants in this area in each country. The PEAS is poised to become one of the acronyms that bilateral donors encounter most often.

  Other instruments that can be mentioned here are the **Country Policy Institutional Assessment (CPIA),** which attempts to assess the quality of financial management and **Institutional Governance Reviews (IGR),** which examine policy processes and actual service delivery.

- An initiative which bridges the divide between diagnostic instrument and standalone analysis is the **Joint Donor Reviews (JDR),** carried out by a group of bilateral providers of programme support. JDR is a joint study of mechanisms for the transfer of programme support to partner countries and pertinent financial management issues. JDRs have been carried out in a number of countries in the area covered by this report, i.e. primarily large partner countries in Africa. However, it has probably come furthest in Mozambique, where it has developed into an annual follow-up instrument tied to continued programme support (general budget support and debt relief).

- Analyses of the quality and effectiveness of financial management systems are also carried out separately from diagnostic studies. One example among many is the collaboration between the World Bank or independent donors and partner countries on the introduction of multiyear budgets – **Medium Term Expenditure Frameworks (MTEFs)** or **Medium Term Fiscal Frameworks (MTFFs)** – and their role in macroeconomic assessments and end-allocation of funds.

- A long-established group of international standards exist in accounting and auditing. These also serve as analysis tools. **The International Accounting Standards Board (IASB)** has developed **International Accounting Standards** based on the **Generally Accepted Accounting/Audit Principles (GAAP).** Likewise, **The International Federation of Accountants (IFAC)** has developed international standards for audit and other areas, including accounting. It is striking that there are still no fully independent international accounting or audit standards for the public sector – an important omission that the **IFAC Public Sector Committee,** is currently seeking to redress. Unfortunately, however, it is basing its efforts on pre-existing private sector standards rather than developing a special public sector blueprint.

  Attempts to develop government accounting practices in partner countries are often based only on the GAAP and IASB/IFAC. Neither is particularly suited to the purpose. The GAAP is more a vehicle for existing general practices rather than what ought to be general practices, while IASB/IFAC models are based on private sector accounting. One should consider what constitutes "good accounting practice" rather than approach this issue through the GAAP.

- In addition to the World Bank and IMF, a number of bilateral donors are developing their own guidelines for carrying out own assessments in **Public Expenditure Management (PEM).** Of these, the most advanced – though not as multidimensional and comprehensive as the World Bank's **"Public Expenditure Management Handbook"** from 1998 – is probably DFID's new **"Understanding and Reforming Public Expenditure Management"** (2001). This formulates staff guidelines and is instructive in a hands-on way not found in other documents. The DFID book explains fundamental terms and processes within PEM. It could be a good learning tool for staff at other donor organisations, though it would need to be supplemented with other subjects and linked more closely to poverty reduction programmes. It would also have to analyse the way PEM is coupled to service delivery and welfare service development, and devote space to the classic software questions encountered in public administration development. Our view is that the DFID material is not as easy to use operationally as the World Bank's PEM handbook.

- Other examples of guidelines include the UN's **"Guidelines for Effective Finan-**

cial Management" (1999), developed by its *Public Finance and Private Sector Development Branch.* These guidelines are interesting because they give an exhaustive treatment to good governance and corruption-related issues and provide a controversial slant on the direction of current policies, e.g. the IMF's tax policy in partner countries.

- Work carried out by individual bilateral donors may also be used as analysis material. The ODI's **"Aid and Public Expenditure"**[44] are similar to DFID's PEM guidelines but have a clear poverty perspective. This document, like the UNDP's material, is designed more as an account of different issues and is thus less serviceable for educational and training purposes. Sida, CIDA and other organisations have financed the production of other publications in this field.

6.2. Monitoring and co-ordination: development of a diagnostic tool

The second half of the 1990s saw a rapid development of diagnostic tools to assess the status and quality of public finance management systems in partner countries. This area now attracts the same attention as the macro area did in the past from the World Bank/IMF and bilateral donors alike. The reason is obvious: all donors and lenders are very keen to know whether the money they pump into recipient countries' financial management systems can be reasonably guaranteed to be secure and to be used for its intended purposes.

Improving these systems has major repercussions for development. Notwithstanding this, the approach taken by donors and lenders has focused largely on risk analysis and control aspects. This is particularly the case with the IMF and its debt relief initiatives. There is a palpable risk that the IMF will introduce artificial accounting functions to be able show its board what happens to "its money",[45] even though this is impossible once the money reaches the government bank account that services a partner country's state budget.

The importance that donors put on control functions and financial management system analyses can be compared with their interest in public institutions that contribute to long-term financial independence and sustainability. Donors have, until now, made little effort to demand analyses of the basic supportive systems in public administration, other than fi-

44. See www.odi.org.uk/pppg/cape/papers/dfidmanual.pdf
45. Cf the *Poverty Action Fund* (PAF) in Uganda.

nancial management systems. Only now has the World Bank begun addressing the need for such complementary studies in earnest. We reiterate our opinion that the diagnostic tools of the future must address system, process and capacity under the same roof. Our impression is that the development of analysis tools has until now been driven by donors' self-interest and taken far less account of the partner country's specific development needs.

A closer look at Fig. 6.1 reveals that the principal tools listed there cut across each other to a large degree. As an example, a ROSC, a CFAA, a PER and a JDR were conducted in Mozambique in the first half of 2001! At least 75% of these studies looked at the same areas and issues (with the possible exception of the ROSC), even if this was not the original intention. In fact, certain passages in the written reports that addressed problems and possible solutions bore a very close resemblance to each other.

Obviously, this is untenable in the long run. Having finally been able to reduce the amount of time and resources they must devote to discussing individual donor projects, partner countries must now allocate equivalent sums to discussing studies and analyses that in some cases cover more or less the same topic. In some cases the same lending institution is behind several different studies being conducted simultaneously – a situation that adversely affects lenders and donors as different opinions on what should be done, and how, are articulated. The fact that donor and lenders commission their own analyses increases the likelihood that they will use these, and nothing else, as the basis for their work.

World Bank officials have realised the disadvantages of this situation (conversations with World Bank staff 2001). But a glance at the number of analysis tools makes it clear that effective dialogue will not be possible. There is also a realisation that proprietary instruments in financial management are not comprehensive, making it difficult to set the right priorities and arrive at correct results when conducting them. The World Bank has for this reason begun to restructure its organisation to enable it better to meet the need for homogenous and complete tools for financial management analysis. Under the aegis of its *Poverty Reduction and Economic Management* (PREM), the World Bank recently allocated resources specifically for this purpose. *Public Expenditure Analysis and Support* (PEAS) will play a major part in this effort (conversations with World Bank staff, 2001).

Bilateral donors should also benefit from the development of a single, comprehensive tool – provided, of course, the World Bank's new instruments in this area are formulated in accordance with bilateral donors' wishes and demands. Whether this actually happens is very much up to bilateral donors. Good opportunities exist for those that play an active and inventive role to participate in the methodology development process and thus influence the outcome.

Another point to make in connection with the proliferation of analysis instruments is that most are not used to conduct follow-up work.[46] This lack of follow-up, combined with the sheer number of instruments, puts partner countries in an impossible situation that must be addressed as soon as possible. Sida has a contribution to make here.

Furthermore, bilateral donors have good reason to make demands on the BWIs, primarily the World Bank. The panoply of diagnostic tools developed almost concurrently by the bank in recent times reflects a lack of focus and internal co-ordination. This may be due to a lack of political co-ordination. However, if the bank wants to "take the lead" in public administration issues this must be reflected in a more cohesive and focused approach. This involves the bank publishing plans that detail priorities and sequencing of reforms. Should the bank prove unable to lead, it will be incumbent on bilateral donors to spearhead the development of a comprehensive instrument for public administration reform.

6.3. Points to note in developing financial management systems

6.3.1. Over-ambitious demands

Aside from the fact that they fail to address all necessary financial management issues in an integrated fashion, diagnostic instruments – particularly those of the World Bank – can be called into question for another reason. One can question the reasonableness of the requirements imposed by lenders and donors in response to diagnostic analyses – and against which partner countries' development is measured – given the conditions that apply in these nations. Studies like *Reports on Observance of Standards and Codes* (ROSC) are conducted in all IMF member countries, including Sweden. One might well wonder whether such instruments are in any way adapted to assessing conditions in countries like Tanzania and Mozambique. Some argue that their "blindness" is precisely what makes them interesting and reliable. This might have been true had it not been for the BWIs' status in these countries: their words and actions are extremely important and affect all relevant parties. The "blind" assessments made in a ROSC have resonance but are unreasonable given the conditions that apply in the specific country. This is the case regardless of whether the analysis is for internal use only.

46. The JDR in Mozambique is an exception, having been partly used for follow-up purposes.

The same charge could be levelled at the *Country Financial Accountability Assessment* (CFAA), the *Public Expenditure Review* (PER) and, to some extent, at the *Joint Donor Review* (JDR). Clearly, the countries concerned can gain in the long run from adopting accounting principles that comply with the *General Accepted Accounting Principles* (GAAP), which apply in Sweden, for instance. But the road is long and many more fundamental problems remain to be solved first.

To clarify the point, before starting work on budgeting that measures performance and effects it is important to be sure of what resources are actually available and can be used. This does not apply in most of the countries concerned. In many cases, their state budgets do not even show half of the resources used to fund public expenditure. Before demanding a classification of accounts that enables expenditure to be presented within structures of e.g. programmes or activities, it is imperative that one has at least reached the point when annual accounts can be compiled technically and in a controlled process. Demands from donors and lenders for rapid introduction of modern budget processes and follow-up systems pressures countries to produce finely tuned information very quickly. In many cases it is impossible to produce such information in the time stipulated, rendering the whole exercise counterproductive. Blind insistence that systems conform to European and American standards creates more frustration about inadequate information than it contributes to genuine systemic improvements.

6.3.2. Conditions in the countries concerned

In our 1999 report (Sjölander and Brobäck, 1999), we briefly described conditions in public finance management in the countries concerned.[47] In this follow-up exercise, it could be worth repeating some of what the 1999 report said:

> "**The budget** often reflects (random) parts of the public resources in a fixed cost-item based structure in which it is difficult to make new priorities between different expenditure purposes. It is most often under-budgeted which has the effect that funds allocated for investments are used for operating costs (mainly salaries and wages). It is also often unclear whether the investment objects listed in the budget actually exist. Legislation may exist but the definition of on/off budget is often unclear and the different approaches of different donors have created a situation in which there is often considerable uncertainty about the resources which are really avail-

47. Another report that takes up these conditions is the NORAD report to the SPA, mentioned earlier.

able. During the 1990s the budget process has improved but it is still difficult to ascertain the extent to which the budget is a reflection of the government's economic policies and the internal priorities between these policies. The administration of revenues is often weak and the actual tax base much greater than the amount of taxes collected. Budgets which extend over several years are being constructed but the budgets are still mainly a mechanical repetition of the budget for year 1.

The accounting system is a reflection of the budget structure and mainly functions as a budget follow-up of local resources (excluding expenditures like interest on the national debt etc). The supply of data into the system is uneven, particularly from provincial level. Technically the system has been based on single-entry bookkeeping without any rules for depreciation. The inclusion of donor resources is very irregular and the closing of the books on a monthly and yearly basis gives an extremely unclear picture of the actual use of resources both in respect of volume and purpose. Information from the system is "the same for everyone" and seldom gives consideration to individual needs or development potential besides the cost-item based structure.

The payments system is not reconciled and the picture of the bank account structure is unclear. The prospects of making liquidity forecasts are very limited and the link between the simultaneous registration of payments in the accounting system is weak or non-existent. The bank account structure for donors is based on individual initiatives made by each donor and follows no given rules on the periodicity of payments etc. The principles for authorisation of payments in the system are often unclear to the donors."

The general situation has improved slightly since the report was published in February 1999. But fundamental weaknesses remain. The links between multiyear projects and annual budgets are still weak; budgets disclose no information about their content; resource priorities cannot be changed; budgets include only a proportion of total available resources – which means accounting systems follow suit; accounting systems are founded on one-dimensional accounting principles; central payment system functions are not revised; audit bodies are weak; and governments have limited interest in domestic resource mobilisation as long as donors continue to pump resources unconditionally into sector programme support and other development programmes.

Of course, not all partner country systems suffer from all these weaknesses. But nearly all suffer from a number of them.

Even where structures are in place, the actual use of resources in conditions of scarcity can still be called into question.[48] Experience shows that real change can only be achieved by addressing all or almost all issues simultaneously and in an integrated fashion.

In an African context, it is a moot point whether essential basic structures actually exist or if it is possible to create them. In fact, is success possible at all given that individuals have so much to gain from not strengthening control systems and given the lack of incentive for civil servants in these countries to do their jobs properly? Is it even possible to help citizens in these countries to assert their rights vis à vis the government and civil servants? There is an obvious risk that donors have already decided that such conditions *can* be changed, even though this would not appear to be so from the outside. This stance may have something do to with donors' own objectives and requirements, for instance their obligation – often to parliament – to disburse a predetermined amount of money in the course of a given year, and the lack of alternatives to the programme support model.

In our opinion, financial management measures should be primarily geared to *establishing the basic principles that facilitate financial management in reality*. This requires that:

- The budget must comprise all relevant resources, or at least these must be known. The annual budget must be the result of multiyear projections and reflect the government's poverty reduction strategy.
- The accounts must encompass all resources and be capable of describing the information in different structures (functional, economic, geographic and institutional).
- Accounting and payment transfers must be part of an automatic and computerised reconciliation system (cross-checking of book-keeping and payment registration).
- The central payments system must be audited regularly.
- Payment systems must be computerised to enable daily liquidity assessments.
- Utilisation of the domestic resource base must increase and be tied to the financing of donors and lenders of sector programme support and other programme support associated with institutional development.

48. See, for example, "The cash rationing systems in Zamiba", Southern Africa Region, the World Bank, 2000.

Such improvements are limited in comparison to "modern" systems and omit e.g. any requirement for an introduction of modern accounting models. Nevertheless, they are difficult to achieve in many of the countries concerned and will remain so for some time to come. The existence of many entrenched structures in these countries makes it hard, for instance, to include all available resources in the budget. Donors themselves are to a large extent responsible for creating these difficulties. One contributory factor is their long-established practice of making funds available to sector ministries by transferring money to individual bank accounts owned by the sector ministries. These resources are in many cases difficult to trace for the ministry of finance, even though this is imperative in a programme support model.

6.3.3. Demands for change in donors' systems

A prerequisite for attaining the basic level described above is that donors help ensure that funds transferred to a partner country comply with all rules and structures that donors themselves want the partner country to follow for their domestic resources. This involves not just saying so on paper, but doing so in reality. It requires that donors are prepared to provide hard cash for a minimum of three years when considering programme support. This also requires them to accept resources being accounted for under the country's state budget framework (which can be limited to simple economic classification). In turn, this requires a readiness to submit to reporting routines that bring every new transfer of funds to the ministry of finance's attention. Moreover, donors must also map and then close any bank accounts containing live funds held over from previous projects. And so on.

6.3.4. Joint rules for donors

Another issue to be considered is the need for donors and lenders to agree on common rules by adopting a code of conduct. This is not a new idea and has previously been examined by members of the bilateral sector programme support group referred to earlier in the report.[49] Reforms in public administration will usually be spearheaded by the World Bank, but all donors that provide programme support also have a role to play. These donors have a strong incentive to develop common rules for what issues they should address and what they can – and cannot – achieve together. Practical experience in Mozambique indicates that such co-operation is

49. See "Harmonisation for general and sector budget support", contracted by DFID, 2001.

of value not just for sector programme support but for programme support in its three forms.

6.3.5. Sole focus on budget and planning processes creates imbalances

In many partner countries, the influence of the World Bank and other donors has led to government budget and planning instruments being refined to a degree that goes beyond the countries' own development needs. This is yet another example of how some initiatives are designed primarily to suit donors' needs. A large amount of work that has gone in to improving these instruments, not always with successful results.[50] The one-dimensional focus on the budget and planning process has created major imbalances in relation to the development of accounting systems and of payment and audit functions inside ministries of finance and with independent bodies. Because the different aspects of financial management are inter-dependent, one can ask whether the sole focus on budgets has been sensible given the overriding goal of creating systems that enable provision of welfare services. This concentration on budgets and planning has resulted in virtually all finance ministry staff with academic qualifications being assigned to macroeconomic and budget departments, starving the competency flow to other departments.

6.4. Grounds for assessing the usability of financial management systems

In our opinion, an integrated assessment of the usability of financial management systems in partner countries should be based on the following variables:

- The status and quality of financial management systems in monitoring financial flows and their ability to develop to the basic level outlined earlier.
- The status of other public administration systems – primarily competency levels within the government.
- Political will to implement reforms/good governance in issues relating to the management of public administration and its way of working.

Below we raise a number of issues we consider to be important in relation to the status of financial management systems and good governance

50. See JDR, Mozambique, 2001.

in public administration. A far more extensive description of the basis for assessing the status of financial management systems is contained in the appendix. We urge all who are involved in these issues to read this in full.

6.4.1. Status of financial management systems: points to note

Public finance management covers the following areas: *planning/budget, accounting, payment, audit and revenue*. Accounting, payment and audit are chiefly monitoring functions (which track where money is and how it is spent), but all five groups are important in a development context. All must be improved in order for governments to implement the development policies to which they have committed themselves.

When providing programme support, donors can select which of the systems relevant to these areas they wish to use. Sometimes, particular systems should be avoided, e.g. if they cannot show how money is spent or if they cannot guarantee that assistance or loans are actually spent on their intended target. Donors' choice in whether to use the systems does not hinge solely on their technical standard because it is not unusual for partner countries to have special legislation relating to accounting of donor funds as opposed to accounting of domestic funds. Nonetheless, all donors should strive to ensure their contributions are accounted for in the state budget, irrespective of whether they choose to transfer them via special payment routines and/or choose their own audit processes.

A number of technical matters should be borne in mind when deciding whether to use a partner country's systems:

Payment. Is transferred programme support registered as being present in the bank accounts that service state budget expenditure? Is there a chart explaining the government's different bank accounts and which confirms that transferred programme support can only be used to fund expenditure specified in the state budget? Are the payment system and the bank accounts that finance state budget expenditure audited? Is the government in a position to produce liquidity forecasts or to show that programme support has reached its right destination within the civil service and government agencies? Are payments reconciled with the accounting system? What bank accounts are known? Are there any bank accounts that contain government funds and are not accounted for in the budget? How do donors report fresh disbursements to partner countries?

Accounting. What accounting system is used? What information can be obtained from it? Are any efforts being made to develop the accounting system e.g. measures connected to information needs articulated by poverty reduction strategies? Are any funds not included in the government accounting system? What are these? What information is lacking from the ministry of finance? Is information available on the national debt and national debt repayments; about state-owned enterprises and privatisations of these; about government buildings and other fixed assets; and about payments and the government's revenue? Are there legal or other obstacles to including programme support in the accounting system? Can follow-up information be found in the following categories: performance indicators in sector programmes; operations data; information from specific projects; official statistics; diagnosis/studies carried out in this field; information from tracking studies; UN information about social development and living conditions or audit details?

Audit: What government audit bodies are there? What is the quality of their work? Are development efforts ongoing in these institutions? Do lenders/donors co-operate with them? Are there legal obstacles to auditing programme support lumped together with domestic tax and customs revenues? To what extent do the external audit organisations hired by donors co-operate with state audit bodies in auditing domestic resources and programme support? Is the payment system audited? How often is audit data produced and who has access to it?

Planning/Budget: What is the link between planning and budget instruments? How are poverty reduction strategies and multiyear budgeting reflected in the annual budget? What is the nature of the process of resource distribution in the single-year budget? To what extent are resources that are available to a sector programme subject to budget scrutiny? What funds are not included in the state budget? To what extent are known funds kept outside the government budget? What efforts are made to include these funds in the budget? What legislation governs government budget accounting? Is there a ban on including external resources in the budget?

Revenue: Is there any programme in the partner country aimed at increasing domestic resource mobilisation and state budget revenue? Are there any agreements with the partner country about increasing domestic public resources? How is the domestic financing component of a sector programme carried out over a period of years? Are there regular demands for the proportion of domestic financing to be gradually increased? Is there any institutional development in the country's customs administration and inland revenue?

These technical questions must be sifted and weighed against the priority of ensuring that basic functions within the system work effectively first. In summary, these are (taken from section 6.3.2.):

- The budget must include all relevant resources.
- All elements of the planning and budget process must be linked and consistent.
- The accounting system must include all resources and be presented in a reasonable time.
- The payments system must be transparent, checked daily and audited regularly.
- The proportion of domestic funding in the budget's expenditure programmes must always rise.
- All sources of state budget income must be audited and the audit made public.

6.4.2. Political will to conduct reforms and good governance in public administration: prerequisites for programme support[51]

Assessments of whether political will exists to implement reforms tied to programme support concern many parts of the economy and society. Because economic growth is of such long-term importance to poverty alleviation, the first criterion of good governance is that a government is demonstrably working to establish conditions for such growth. Included here are government efforts to construct a legal framework that allows private enterprise to operate and make reasonable profits. This market economy-based approach also defines the respective roles of the private sector (which generates the growth) and the state (which acts as a support and sets the rules).

Good governance is also important in areas for which the government is directly responsible. One example is good husbandry of natural resources as a precondition for good resource utilisation and the creation of an attractive environment for the country's citizens and foreign investors. In terms of general parameters when assessing good governance vis à vis citizens and their relation to the authorities, the following points should be observed:

- That the decision-making process and exercise of power by the authorities are conducted in a climate of democratic governance that enables citizens to participate and wield influence – and not only at elections.

51. This section is based largely on the paper *"Economic Governance. Guidelines for Effective Financial Management"*; UNDP, Public Finance and Private Sector Development Branch, 1999.

- That the political process and workings of the civil service are transparent. This should include possibilities for citizens to engage in dialogue with the civil service and appeal against decisions.
- That the government displays an aspiration to apportion resources equally and in a way beneficial to vulnerable groups.
- That the exercise of power is founded on set constitutional rules that allow citizens to hold accountable those responsible for drawing up and implementing government policy.
- That the government apparatus consists not only of supervisory bodies but also includes accounting bodies and ombudsmen. It is also important that state authorities demonstrate a will to implement any sanctions recommended or imposed by auditing bodies and aimed at individuals who have abused their position or powers.

This list might also include a visible desire on the part of state authorities to devolve power to decentralised and autonomous structures at a lower level of public administration.

An aspiration to improve financial control systems should be included among the criteria used to assess governance in public administration. As a rule, individuals in the countries concerned benefit from the poor state of government payment, accounting and audit systems – and have done so for a long time. A reluctance to improve these can reflect a lack of political will.

It is possible to define expressions of political will and good governance in conjunction with financial management as a facet of public administration. The fact that a government presents a budget strategy publicly is an example of this. So is the existence of an active supervisory fiscal policy body in parliament, or the fact that the independent auditor's position is protected by the constitution and that this protection extends to the auditor personally. There is good reason to tie future development efforts to this area. One aim of such a move could be to set a number of good governance variables for financial management within specific countries and which could be agreed upon internationally.

The ability of a public administration to implement government decisions – and its efficiency in so doing – also reflects a political will to improve citizens' prosperity. Thus the aspects of good governance in public administration presented here are intimately connected to the issues of financial management as explored in the appendix. Included here are issues related to which public administration functions and financial management systems must be in order for programme support to be converted into welfare services. Without good governance in the areas we have described, this is impossible. And in the absence of effective administrative functions and systems, the depth of political will is irrelevant: welfare cannot be provided anyway.

Assessing good governance in the countries concerned using the above criteria will in many cases give a limited or at times even depressing picture of ambitions and development levels. As with assessments of the public administration functions and systems, good governance should be viewed as a trend i.e. that it is possible to see continued progress towards a better situation. Ultimately, the best indicator of the ambition of state authorities to practise good governance in the longer term is the delivery of welfare services to (vulnerable) citizens.

In our opinion, therefore, political will to provide welfare services is a near-necessity for programme support and government-to-government co-operation. In the absence of such will, donors should consider alternative forms of co-operation. As explained in Chapter 5, the World Bank attaches great importance to these issues. There is thus every reason to follow (and, ideally, for Sida to participate in) the development of the World Bank toolkit *"Commitment to Reform"* (see section 5.2.1).

Good governance is of course a broader and less easily defined term than the public administration variables discussed in this section. We have outlined what we regard as the primary parameters for assessing government budgets and public administration as instruments for welfare development and poverty reduction. In addition to these, there are a large number of issues connected to good governance that we have not examined.

6.5. Work forums

Intensive efforts are taking place to develop methodologies and implement new diagnostic instruments for assessing public finance management in the countries concerned, predominantly in Africa.

The World Bank and IMF are heading this effort by developing their instruments and exchanging information. Bilateral donors, especially DFID, have also launched initiatives. Dialogue with partner countries over new or revised PRSPs is either beginning or already under way. The PRSC is still being developed and discussions are taking place about its introduction in other countries besides Uganda. The World Bank is working with DFID in a special working group to address financial management issues. The IMF's PRGF instrument adopts a more systematic approach than previously to fiscal system structures and accounting classification in partner countries. The measures directed at accounting classification are motivated by a desire to obtain standardised data on poverty for use in comparisons with the poverty reduction tools of both the IMF and specific countries.

Donors and lenders communicate continuously with partner countries in these issues and notably in the monitoring of PRSCs. A couple of international forums also exist in this area, mainly under the auspices of donors and lenders. The most prominent is the *"Strategic Partnership with Africa's (SPA) Task Team on Public Financial Management and Accountability"*. Originally launched to mobilise provision of financial assistance to countries in Africa, the task team has evolved into a respected discussion forum for methodology and implementation issues in this field. Backed by a mandate from practically all programme support donors, the SPA has launched various pilot studies in selected countries to determine prospects for co-ordinating analyses and analysis tools. Particular attention has been paid to the *Country Financial Accountability Assessment* (CFAA), reflecting a stated ambition to expand this diagnostic instrument beyond the technical and systems realm. An expanded CFAA would address the issues of ownership and input of local representatives.

Also of interest is the *Development Assistance Committee's* (DAC) new *Task Force on Donor Practices,* which may come to acquire a benchmarking role in financial management, in part due to its development of a code of conduct. However, the task force can only draw on very limited resources compared with those of the SPA. Multilateral organisations also run their own working forums, whose membership includes the World Bank, IMF and regional development banks.

We also advocate continued *collaboration between bilateral* donors, and the possible creation of special forums for this. We see a continued and closer partnership between Norway and Sweden in this area both as natural and offering many potential advantages. We believe Sida will need to allocate resources to monitor and participate in the development of the new management processes described in this report. All co-operation between Sweden and Norway, in which each country gives the other a mandate to represent it in different contexts, enables Sida to shift resources to these new, emerging areas. It ought to be possible to expand existing bilateral co-operation in sector programmes to a broader concept of programme support that embraces the three forms of support examined in this report.

Other bodies of interest in this context are *UN institutions outside the*

World Bank and IMF, chiefly the *United Nations Development Programme (UNDP),* and the *EU*. Both of these play an important role as counterweights to the World Bank and its policies and methodologies. The World Bank has called for a European counterpart to discuss these issues with (conversations with World Bank staff, 2001), but we note that neither of these two institutions is, as yet, in a position to shoulder this role. The UN/UNDP has no mandate for working with programme support. This immediately removes it from the frame – even though it has access to financial management competency. The EU, meanwhile, probably has fewer administrative resources in proportion to its size and status than any other provider of development assistance. It is for this reason, we believe, that the EU's role has been restricted to funding methodology development projects rather than working with the World Bank and IMF as a partner.

Non-governmental organisations (NGOs) are also major players, reflecting their role as highly knowledgeable representatives of people in the countries concerned. The involvement of NGOs in the budget process and as advocates of an alternative approach to the PRSP process (e.g. they have called for the HIPC initiative to be separated from PRSPs) makes them an important asset in discourse about poverty reduction and strategies to achieve it (IMF, World Bank 2000d). Bilateral donors such as Sida can work in different ways to ensure that NGOs and UN bodies are also able to participate in developing poverty reduction strategies.

The role and opportunities for Sida and other bilateral donors

CHAPTER 7

7.1. Participation motives of bilateral donors

The different forums in which bilateral donors participate often tackle issues from a broader basis then the World Bank. One such forum, the *SPA Task Team for Public Financial Management and Accountability,* has harnessed the Country Financial Accountability Assessment (CFAA) to include the ability to consider local influences. Another example of bilateral participation and co-operation are the working groups that collaborate on the mode and application of Sector wide Approaches and which were set up in the late 1990s. These forums highlight fundamental software issues related to institution-building in connection with introductions of sector programmes and do so differently from way the World Bank is currently applying its first PRSC in Uganda.

Among bilateral donors, Sida has paid special attention to the importance of institutional capacity-building. As already mentioned, Sida developed its first policy for public administration support as long ago as the 1980s. This policy, currently under revision, also includes aspects of democratic governance and human rights. Sida has an incentive to maintain high competency in this area and to ensure such knowledge develops and influences the World Bank's development of methodologies and implementation.

7.2. Proactive way of working

The ability to affect the content and shape of the diagnostic instruments and toolkits looked at earlier (and which are elaborated by the World Bank) does not depend solely on preserving a high level of competency.

Small bilateral donors like Sida must also be active and show initiative in order to be involved and able to exert influence (preferably in concert with other like-minded bilateral donors).

Sida can do this in different ways, including:

- Initiating contacts with the World Bank with a view to participating in development methodologies for public administration and financial management. The World Bank runs many methodology development programmes, in which Sida can participate in only one or two. Apart from the PRSP and PRSC, *Public Expenditure Analysis and Support* (PEAS) is a priority area. The PEAS may become the World Bank's leading public expenditure programme and will hopefully include state budget revenues as well as expenditures.

- Contacting DFID to take part in the financial management working group run by the World Bank and DFID.

- Approaching World Bank and IMF representatives in all relevant countries to ask how they view matters nationally and what type of credits or analyses may be applicable over a given time period. Sida should ask how such considerations affect bilateral donors and how they can best participate.

- Participating in SPA Task Team meetings. Participation in DAC's Task Force could also become relevant.

- Joining others in participating in processes aimed at developing PRSPs. As previous material in this report suggests, much work on methodologies remains to be done.

- Participating as often as possible in PRSC drafting missions, yearly follow-up work and pre-appraisals in different countries and obtaining early information from the World Bank when new a PRSC is to be developed.

- Promoting the common outlook among bilateral donors and bilateral co-ordination in this regard. This involves attempting to extend the current group's mandate beyond sector programme support to the other two forms of programme support: general budget support and HIPC debt relief. This (or other) bilateral consultative groups should also assess not just the methodologies developed by others (the World Bank) but should carry out their own development projects and analysis of how credit programmes and diagnostic instruments are implemented.

- Guaranteeing long-term collaboration with external resources, in the event that one's own resources are judged inadequate for keeping on top of these various issues. Subcontracting work to relevant consultants makes it possible to develop organisational forms of co-operation (e.g. division of tasks and responsibilities, deciding when to collaborate, etc.).

Inside Sida, this work requires a systematic approach and a shared effort or grouping to handle the issues. Success also necessitates some form of policy decision to implement the changes and take the required initiatives.

7.3. Role of bilateral donors in discussions with partner countries

The size of the World Bank and the credits it provides means that future discussions about public administration development programmes will be conducted largely between the bank and partner country governments in the countries concerned. The programmes are very broad and will incorporate the bulk of all development assistance-financed operations in a particular country. For example, Uganda's PRSC-financed programme already includes most reform projects in the public sector and will in future extend to private sector activities as well. Thus the programme will be financed almost exclusively from external sources. The following diagram shows the dialogue between the government and World Bank:

Government ⟷ **World Bank**

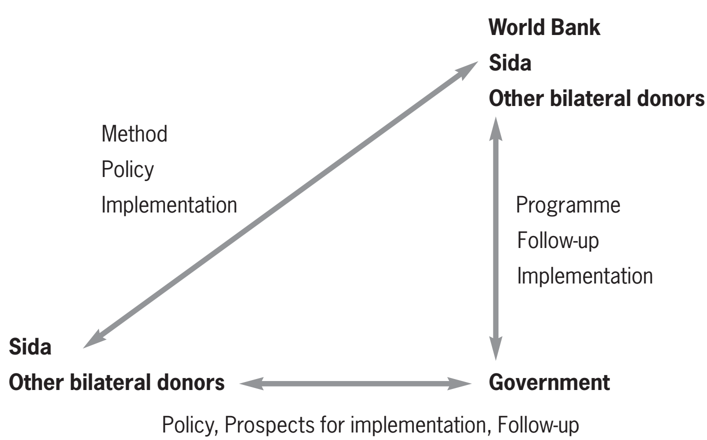
As a progressive bilateral donor, Sida should certainly take part in this dialogue – by participating in PRSC missions, for example. Sida's involvement can be illustrated as follows:

Government ⟷ **World Bank / Sida / Other bilateral donors**

Experiences from PRSC activities in Uganda, dialogue between bilateral donors and the Mozambique government, and weaknesses in PRSPs discussed earlier in this report all suggest a need for the governments of partner countries to be able to hold discussions with a third party other than the World Bank and IMF. There may be different reasons for this. Partner country governments may choose to keep some of these to themselves, but among those they commonly cite are: divergent approaches exhibited by the BWIs and the desire to obtain a second opinion. It is in bilateral donors' own interests to pursue an active dialogue with relevant governments. Doing so gives them an opportunity to assess whether the questions closest to their hearts are included in the programmes being discussed between the government and the BWIs. This connection can be illustrated as follows:

Government ⟷ **Sida/Bilateral donors**

By establishing a personal dialogue with a government, bilateral donors ensure that the process behind the new credit instruments and public administration development programmes is three-dimensional and dynamic. This can counteract a mechanical assessment of the degree to which loan credits comply with certain benchmarks when new credits are to approved. This can be shown as follows:



The significance of the participation by Sida and other bilateral donors in the new dialogue can be seen in the diagram. Sida has two roles. One is to co-operate with the World Bank and influence its methods and programmes. The other is to conduct a dialogue (individually or with other bilateral donors) with the governments of partner countries to acquire information about matters not disclosed in the official programmes or which are not highlighted in discussions with the World Bank. The task is then to include such considerations in discussions with the World Bank. Being a partner in dialogue for governments means being able to provide different forms of institutional capacity support, where considered desirable or necessary. Any process in which Sida participates should be fully transparent and should make freely available information to all parties involved.

In order to manage these partly new tasks and roles, bilateral donors need to make changes in their administrations. This issue is discussed further in Chapter 8.

Competency and structure in bilateral development administrations

CHAPTER 8

8.1. Need for change

Our assessment is that the current redrawing of the development map as described in this report will prove to be a more radical shift than the introduction of sector programme support two years ago. Bilateral donors that want to be active participants and not merely assigned an implementation role must review the way their development agencies work in terms of structure, information flows and employees' competencies.

8.2. Competency and structure: new forms of collaboration and information flows

Policy functions in bilateral development agencies have a key role to play in poverty reduction strategies. Policy is the natural channel for contacts with the BWIs about new PRSP, PRFG or PRSC concepts. Future tasks will be focused on methods as well as policy. The new development concept will thus have major implications for any separate *method functions* inside development agencies. *Those functions that co-ordinate country or regional operations* will assume a new and important role. They will be charged with piloting the dialogue surrounding a donor's participation in strategy or credit rounds in a specific country. Allied to this, they will also have the task of attempting to co-ordinate policy and methodology approaches between other bilateral donors, the BWIs and other external stakeholders. The new situation will also impinge heavily on those *functions that deal with issues of public administration and institutional development.* These functions will need to take part in the entire process underpinning the formulation of poverty reduction strategies so that such strategies are realistic in design and preserve the link with institutional development.

The new tasks that confront these sections within development agencies may precipitate a need for structural changes or new or enhanced competencies. Internal work patterns will also be affected, and it may be necessary to investigate which internal information flows should be formalised or guaranteed. Agencies may need to change the way they portray themselves externally and build new teams inside the organisation.

The need to adopt new work methods and information flows is applicable not only to development agencies centrally but also to embassies/field offices and, in certain cases, relevant ministry functions in donor countries. Embassies, in particular, need to modify the relationship between economist functions and programme officers responsible for sector programmes or civil service projects.

We believe that development staff need to be trained in the issues raised in this report. The content and extent of such training will vary between different groups, depending on how closely participants know and work with the issues. Our belief is that all staff will need some form of training. As noted previously, many donors and lenders are already aware of this need.

An individual bilateral donor like Sida may do well to address issues of structure and competency in more detail through an internal development project.

Summary and recommendations

CHAPTER 9

9.1. Programme support as a form of support

Sida and many other bilateral donors and multilateral organisations are today moving more clearly towards a policy which involves supporting poverty reduction, principally in Africa, via different forms of programme support. Programme support is provided in various ways, through budget support, sector programme support and also via debt relief under the HIPC debt relief initiative. The HIPC Initiative has helped create an important link between debt relief and poverty reduction through the *Poverty Reduction Strategy Papers* (PRSPs).

The rationale behind PRSPs is that rapid, sustainable economic growth should be the core of every poverty reduction strategy. The expectation is that this will result in lasting poverty alleviation. This involves both the private and public sectors playing a prominent role in the stabilisation process and PRSP. As the private sector is the primary source of economic growth, it is logical that it plays a central role in poverty reduction strategies. Prospects for developing the private sector are directly and indirectly affected by macroeconomic conditions and government policy. The key macroeconomic variables are inflation, exchange rate policy, domestic and foreign debt, and a country's international reserves. All have a bearing on the growth of the private sector – and therefore on the situation of the poor.

Economic growth itself does not automatically guarantee reduced poverty. Growth must be supplemented by managed resource distribution if it is to lead to welfare enhancements that will significantly improve the lives of the poor. This necessitates an effective public sector and effective public finance management systems. In turn, this is predicated on an increased commitment to domestic resource mobilisation and follow-up of the way public money is distributed.

When macroeconomic conditions are stable donors can support the government budget via programme support, whose purpose is to finance improved welfare services. Programme support can be described as a modality aimed at supporting implementation of a general policy or expenditure programme developed by a partner country (government), often in concert with donors. All forms of programme support are linked to policy reforms in the partner country, wherein poverty issues are today deemed of key importance. Three forms of financial programme support can be identified as applicable for supporting government poverty reduction strategies and the government budget: debt relief through the HIPC Initiative; general budget support; and sector programme (budget) support.

A state budget may indicate the government is pursuing poverty-oriented policies prioritising allocations to poverty-related sectors. But there is no guarantee this helps to improve the lives of poor people. Efficiency in administration systems is also necessary to enable programme support resources channelled through a specific government to filter down through the economy and reach citizens in the form of welfare services. Regardless of the form of programme support donors/lenders choose, there is a common need to develop systems and institutional capacity-building in public administration in partner countries.

The need for institution-building is a broad and multifaceted area. Measures to improve public finance management, personnel and salary systems, legislation, IT structures, competency, and improved statistics/data are equally important for sustainable development. The capacity of sector administrations is also important, not least for improving the efficiency of sector programmes and influencing their results.

9.2 Questions concerning the PRGF and PRSC – IMF and World Bank credit instruments to support PRSPs

The new approach of PRSPs has led to closer collaboration between the IMF and the World Bank. The institutions divide responsibility between them: the IMF focuses chiefly on macroeconomic strategy while the World Bank concentrates on developing poverty reduction strategies. The two have developed new credit instruments to support countries implementing PRSPs. The IMF's instruments are called the *Poverty Reduction and Growth Facility* (PRGF); the World Bank's are entitled the *Poverty Reduction Support Credit* (PRSC).

A PRGF is directly tied to a country's poverty reduction strategy. Under a PRGF, the macroeconomy is treated on a par with social, structural and institutional issues. This is a fundamental change. PRSCs include a series of yearly credits tied to a number of benchmarks designated on the basis of the country's PRSP. To date, Uganda is the sole country to have been granted a PRSC. Its benchmarks are chiefly tied to institutional reforms in public administration.

Both the PRGF and PRSC have been criticised. The PRGF has been targeted because it is based on the same premises as previous structural adjustment programmes. The criticisms levelled at the PRSC are that its benchmarks pay insufficient heed to the conditionality of institutional capacity-building and that participant governments lack adequate ownership. Neither of the instruments has been endorsed by the parliaments of partner countries.

The PRSC is still being developed and discussions are under way concerning its introduction in countries other than Uganda. The World Bank is working with DFID in a special working group to address financial management issues. The IMF's PRGF instrument adopts a more systematic approach than before to fiscal system structures and accounting classification in partner countries.

9.3 Need for reform of public administration

Coinciding with the introduction of PRSPs and the changing emphasis on different programme support forms, the World Bank has adopted a completely new approach to public administration reform. This change is more clearly and comprehensively expressed in the policy paper "Reforming Public Institutions and Strengthening Governance" (2000a), described by the bank as a strategy.

It is founded on four "strategic" requirements:

- I) Political will and engagement in the partner country.
- II) Investigations into actual conditions in specific countries, e.g. whether there is a will to implement reforms.
- III) New lending conditions: a longer-term view.
- IV) Changes at the World Bank: personnel, organisation and co-operation with others that have knowledge and proficiency in this area.

The bank's new policy also describes a broad range of issues within public administration and in which the bank aims to become more involved. These include decentralisation, anti-corruption measures, fiscal policy and administration, and public finance management.

The World Bank is currently developing a large number of diagnostic "toolkits" to ascertain the state of public administration in partner countries.

The bank has several motives for its new-found interest and engagement in public administration reforms in IDA-countries. These include a desire to maintain financial control over its loans as well as basic development aspects.

The World Bank's combined resources far exceed those of any single bilateral donor. For this reason, the methods and diagnostic instruments introduced by the bank will have a major impact on public administration development in the countries concerned. This has implications for the countries themselves as well as for the rest of the donor community.

No actor in this field will be unaffected by the World Bank's new policy. For individual donors like Sida, the effects may prove very substantial. Just as all donors and partner countries rely on the BWIs' macroeconomic assessments, so the public administration reform programmes spearheaded by the World Bank (and to a lesser extent the IMF) will impact on all parties involved in public administration or sector programmes in partner countries.

The World Bank is well aware it lacks sufficient staff and financial resources to implement its preferred programmes in all target countries. This is one reason why it wishes to work with other providers of funds, including bilateral donors. The process has much to gain from the participation of bilateral donors. In some areas, bilateral donors are more proficient than the World Bank and, in some cases, espouse an alternative approach.

9.4 Homogenous and comprehensive analysis tools needed in public finance management

In a programme management model whose aim is to transfer funds to recipient countries' public finance management systems, an important question facing donors is the quality of these systems – both with regard to financial control and as a development tool. Thus there is a need to study these systems. Numerous individual and joint studies have been conducted. The IMF, World Bank and a few bilateral donors have lately developed a range of diagnostic and analytical instruments. Among them are the *World Bank's Public Expenditure Review* (PER), *Country Financial Accountability Assessment* (CFAA) and *Framework for Public Expenditure Analysis and Support* (PEAS).

The multiplicity of such instruments means they overlap extensively, with repercussions for donors and partner countries alike. Such a situation is untenable in the long run, particularly for partner countries. The World Bank, especially, has realised the problems with the current state of affairs and has tried to restructure so it can better develop homogenous and complete tools for financial management analysis. Under the aegis of its *Poverty Reduction and Economic Management* (PREM), the bank recently assigned resources specifically for this purpose. *Public Expenditure Analysis and Support* (PEAS) will play a major part in this effort. The bank's various functions have traditionally operated autonomously, which raises a question mark over whether it will succeed in its drive to develop diagnostic instruments that really are complete and homogeneous.

Bilateral donors should support efforts to develop a single, comprehensive instrument which they can use in the way they utilise IMF and the World Bank macroeconomic analyses without having to conduct their own. Of course, this is predicated on the World Bank's new instrument being formulated and drawn up in a way that corresponds to bilateral donors' wishes and demands. Whether this actually happens is very much up to bilateral donors themselves. Good opportunities exist for those that play an active and inventive role to participate in the methodology development phase and thus influence the outcome. Those who believe the World Bank will not succeed in this mission have nothing to stop them from taking matters into their own hands.

Another point to make in connection with the proliferation of analysis instruments is that most are not used to conduct *follow-up* work. This omission, on top of the sheer number of instruments, puts partner countries in an impossible situation that must be addressed as soon as possible. Sida and other bilateral donors can play an active role here.

9.4.1 Are the demands reasonable?

The content of diagnostic instruments, particularly those of the World Bank, can be called into question not just on the basis that they fail to address all necessary financial management issues in an integrated fashion, but on the reasonableness of the requirements imposed by lenders and donors in response to the analyses. Given the conditions that generally apply in partner countries, demands from donors and lenders for rapid introduction of modern budget processes and follow-up systems puts pressure on countries in question to produce finely tuned information in double-quick time. In many cases it is impossible to produce such data in the time stipulated, rendering the whole exercise counterproductive. "Blind" insistence that systems conform to European and American standards creates more frustration about inadequate information than it contributes to genuine systemic improvements.

9.4.2 Core principles

In our opinion, measures taken within financial management should be primarily geared to *establishing the basic principles that facilitate financial management* in practice.

This requires that:

- The budget must comprise all relevant resources, or at least these must be known. The annual budget must be based on multiyear projections and reflect the government's poverty reduction policy.
- The accounts must encompass all resources and accurately portray different areas (functional, economic, geographic and institutional).
- Accounting and payment transfers must be part of an automatic and computerised reconciliation system (cross-checking of book-keeping and payment registration).
- The central payments system must be revised regularly.
- Payment systems must be computerised to enable daily liquidity assessments.
- Utilisation of the domestic resource base must increase and be tied to the financing by donors and lenders of sector programmes and other programme support associated with institutional development.

A prerequisite for attaining the first level described above is that donors themselves help ensure that funds transferred to a partner country are in practice subject to the same financial management rules applied to that country's own resources. This requires a readiness to submit to reporting routines that draw every new transfer of funds to the ministry of finance's attention.

Ahead of a decision on whether to provide new or continued programme support, any feasibility assessment of a country's financial management systems should, in our opinion, incorporate the following variables:

- The status and ability of the financial management system to control financial flows and its ability to develop to the level outlined earlier.
- The status of other public administration systems – primarily competency levels within the government.

- Political will to implement reforms/good governance in issues relating to the management of public administration and its way of working.

9.5 Variables for good governance need to be set

An ambition to *improve financial control systems* should be included among the criteria used to assess governance within public administration. As a rule, individuals in the countries concerned benefit from the poor state of government payment, accounting and audit systems – and have done so for a long time. It is possible to define expressions of political will and good governance in conjunction with financial management as a facet of public administration. The fact that a government publishes a budget strategy is an example of this. Other examples include the existence of an active parliamentary fiscal policy inspection body or the existence of laws enshrining the status of independent auditing and auditors. There is good cause to tie future development efforts to this area. The purpose could be to set a number of good governance variables within financial management within specific countries and which could be agreed upon internationally.

The ability of a public administration to implement government decisions – and its efficiency in so doing – also reflects a political will to improve citizens' prosperity. Included here are issues related to those administrative functions and financial management systems must work efficiently for programme support to be converted into welfare services. This is impossible without good governance in the areas we have described. And in the absence of effective administrative functions and systems, the depth of political will is irrelevant; welfare cannot be provided anyway.

Intensive efforts are currently under way to apply and develop methodologies and new diagnostic instruments to evaluate public finance management in partner countries, primarily in Africa. Both the World Bank and the IMF are driving this process by developing and co-ordinating their instruments. Bilateral donors, especially DFID, have also launched initiatives. Steps are also under way to promote continued dialogue with partner countries over new or revised PRSPs.

The PRSP process is continuing to evolve as partner countries and involved development partners draw conclusions from their experiences. As yet it is unclear how this new orientation will work and what the final framework will look like. What is clear, however, is the need for *active participation from organisations that want to be part of the development process*. The IMF and World Bank have a high level of ambition and, as expected, have assumed a leading role in the process. The report reflects our view that it is highly important for bilateral programme support donors to become involved and form a counterweight to the BWIs.

9.6 Ownership of PRSPs

The importance of partner countries having a sense of ownership over their poverty strategies is often referred to in material published by the BWIs. Indeed, officials at these institutions view it as a precondition for success. We believe more active support for partner countries is needed so they can participate in the process on a genuinely equal basis. The true ownership of a PRSP can be discussed in this context. The roots of democracy in the partner country are also limited, which often precludes a PRSP from being considered by parliament.

The PRSP sometimes acquires the role of a parallel planning instrument that has no influence over real budget allocations or spending policy. Moreover, partner countries do not collaborate when assessing the policies or technical rules and regulations that best serve their individual development.

9.7 Forums for debate and co-operation

Donors and lenders communicate continuously with partner countries on issues such as follow-up of a PRSC. A couple of international forums also exist in this area, mainly under the auspices of donors and lenders. The most prominent is the *Strategic Partnership with Africa's Task Team on Public Financial Management and Accountability.* Originally launched to mobilise provision of financial assistance to countries in Africa, the task team has evolved into a respected discussion forum for issues of methodology and implementation. Participants include the World Bank and IMF.

Also of interest is the *Development Assistance Committee's* (DAC) new *Task Force on Donor Practices,* which may come to acquire a benchmarking role in financial management, in part due to its development of a Code of Conduct. However, the task force can draw only on very limited resources compared with those of the SPA. Multilateral organisations also run their own working forums, whose membership includes the World Bank, IMF and regional development banks.

We also advocate continued *collaboration between bilateral donors,* and the possible creation of special forums for this. In our opinion, a continued and closer partnership between Norway and Sweden in this area has many potential advantages.

Our assessment is that the current redrawing of the development map as described in this report – in particular the effect of World Bank initiatives on bilateral donors – will prove to be a more radical shift than the introduction of sector programme support two years ago. Bilateral donors that want to be active participants and not merely assigned an implementation role must review how their development agencies work in terms of structure, information flows and employees' competencies.

9.8 Recommendations

Our belief is that individual bilateral donors like Sida have a good opportunity to be part of and help shape current trends within development assistance as described in this report. Pursuing an active approach is essential for this, in which respect bilateral donors have much to learn from DFID. For Nordic donors, there may be even more to learn from NORAD and its actions during the changes now under way. Sida also has much to teach others in the areas of public administration development and capacity-building for institutions.

We recommend Sida conducts a probe into its existing structures and ways of working in those parts of the organisation mentioned in Chapter 8. Such an investigation will better enable Sida to participate actively in the contexts in question. In our opinion, a donor of Sida's type and size should pay special attention to preserving the expertise it has amassed in public administration issues over the years. With this in mind, Sida should participate as an alternative dialogue partner in the processes we have attempted to describe (see model in Ch. 7).

Earlier in the report we attempted to depict what we see as weaknesses in the poverty reduction model now being promoted by the BWIs. These limitations increase the need for bilateral donors to be present and participate actively in the current development phase. We believe such involvement should be targeted directly at the BWIs, and in particular at the World Bank's methodology and developmental work.

At the same time, there is a great need for dialogue between active bilateral donors and with partner country governments. This dialogue should always involve a range of donors. Insofar as is possible, Sida should strive to establish a regular presence in partner countries – and in the delegations of the BWIs – when poverty reduction credits are to be introduced or renegotiated. Sida should also have a presence in the international forums discussed earlier, particularly the SPA. When it comes to Nordic co-operation, or Nordic-based co-operation with other bilateral donors, proprietary development projects can be launched. Examples include agreements on joint analysis and diagnosis materials in specific areas.

For Sida to structure its work on these lines would probably entail co-ordinated management.

In accordance with our Terms of Reference, our analysis explicitly addresses the starting points and structures of lenders and donors and their need to change. In order for the new model to be feasible, there is an additional need to strengthen partner countries when it comes to dialogue surrounding these issues. Sida and other bilateral donors can contribute greatly to this by initiating dialogue with involved parties, particularly African partner countries. This is addressed in the next chapter.

Next step: Partnership in current development. The mandate of partner countries

CHAPTER 10

10.1. Need for an organised African counterpart

The World Bank's work in introducing new poverty-focused credits and drawing up ancillary institutional reforms has involved co-operation with partner country governments. As previously noted, the World Bank and IMF share a stated ambition to formulate poverty reduction strategies together with partner countries, and with their ownership. So far, this ambition remains largely theoretical and has yet to be implemented on a broad scale. The World Bank's aspirations are visible in its opinion that the dialogue concerning the format of Uganda's PRSC was a product of equal-sided agreements with the Ugandan government. However, other sources have reported that the PRSC work in Uganda was less than wholly based on a true partnership of equals.

In financial management, methodologies and implementation of reforms appear to have been driven largely by the World Bank, either alone or with the IMF. Our visit to Washington did not give us an impression that such questions were explicitly discussed with partner countries. For instance, it was clear that a decision to change the classification structure of Mozambique's accounting system was rooted in the need of the IMF and World Bank to have access to comparable data on poverty. This is arguably not the information that Mozambique needs most at the present moment.

The World Bank has many facets and accepts the need for a more holistic approach – something it is currently trying to move towards. In financial management it is working to promote active participation by partner countries in the PER and PEAS processes. *"Reforming Public Institutions and Strengthening Governance"*, to which we referred earlier in the report, describes the *Partnership for Capacity-building in Africa*, known as the PACT initiative.

PACT is an organisation for African members of the World Bank which agree that implementation capacity in their countries must be strengthened in order for development to be successful. The organisation has African leadership and has three aims:

- To create the right environment for capacity development.
- To devise goals and programmes which all involved parties – governments, lenders, donors, business and civil society – can endorse.
- To ensure that programmes are based on reality and on feasible timetables.

The World Bank supports PACT financially, having lent it US$ 30 million with an option for up to US$ 150 million. A few bilateral donors have also worked with PACT. Views on this collaboration vary, but our conversations with the bilateral donors involved suggest it has been of limited success.

10.2. Regional institutions should be co-opted

Regardless of whether PACT develops into the effective partner in dialogue that donors need, Sida and other bilateral donors should support efforts to develop the institutional base in partner countries under current programmes. This can be done by taking special initiatives within the bilateral group and by supporting World Bank efforts already in progress. The aim should be to pave the way for a dialogue about the current process and which can reflect partner countries' positions and preferences. Such an initiative could be taken at country level, but preferably at regional level so as to achieve maximum unity between different nations' policy perspectives. There is an evident need to introduce processes that allow the parliaments of the countries concerned to take part in decision-making.

Regional institutions should also be invited to participate as a negotiation and policy-making partner between the various countries. The international audit organisation INTOSAI is one such example in the area of financial management. Another is ESAAG, the regional organisation for government accounting issues in southern and eastern Africa. ESAAG is of interest with regard to the new classification structure for government accounting recently introduced in Mozambique at the behest of the BWIs. Had ESAAG been able to participate in the preparatory phase the classification structure may have looked different.

In this context it should be stressed that Africa's regional development banks and the Economic Commission for Africa (ECA) already participate in the SPA initiative. However, their influence so far appears to have been limited, judging from the progress of the dialogue between donors/lenders and partner countries. The UNDP's Africa Bureau is also involved in the SPA initiative.

Sida is in a position to work with other bilateral donors and start a process whereby relevant African-led organisations are co-opted into the work of assessing and gauging the implementability of different reform programmes. Where necessary, technical assistance should also be provided to these organisations.

Appendix:
Issues to consider when evaluating public finance management systems in countries that receive programme support

Table of contents

Introduction

This appendix aims to provide a view of several issues that should be taken into consideration when evaluating the status of public finance management systems in countries that receive programme support. The material can be used when preparing decisions on programme support for the first time and when new support is to be approved. This appendix can be used in a dialogue between donors and recipients and discusses the demands that both parties may make. The descriptions are primarily based on experience from Portuguese-speaking and English-speaking countries in Africa. Yet the functions described are just as appropriate to French-speaking Africa, or to countries like Sweden.

In the countries concerned, the government dominates resources and influence in the public sector. Some of them also have autonomous municipal (provincial, district or territorial) administrations, but in this presentation the public sphere is defined as that controlled by the central government.

The government's management of its own resources

This presentation concerns the government's management of its own resources: that is, those collected inside the country (customs, taxes, fees), those borrowed (within the country, from Bretton Woods institutions and from others), or those received as a gift (development assistance from bilateral donors and others). The government also controls resources in other sectors through various kinds of regulation, but in this context we consider only those resources at its disposal (primarily through the state budget).

"Programme support" refers to one of the three forms discussed in the main report: budget support through debt relief, general budget support, or sector programme budget support.[54]

The appendix also discusses the most common functions within an ordinary ministry of finance in the countries dealt with here (primarily IDA

54. Sida has already issued guidelines concerning sector programme support. Here we will deal with sector programme budget support on the same basis as other programme support, i.e. how the flow of money should be tracked. Accordingly, this document does not touch upon Sida's guidelines for sector programme support.

countries in Africa) and the relationship between these functions and the government's accounts.

No assessment is made of what quality standard governmental financial management systems should meet in order to qualify as conduits for programme support transfers. Many factors influence donors to give programme support, of which the quality of financial management systems is but one. In general, many donors have chosen (to date, at least) to transfer programme support to financial management systems in partner countries, well aware that these systems were unable to guarantee that funds would be assigned to their intended purposes and to account properly for them.

Integrated with capacity-building and good governance

The options for improving the technical aspects of government financial management systems must be considered as integral to capacity-building and institution-building. Accordingly, this presentation deals with certain aspects of this and what one should consider in these areas when evaluating development potential and long-term sustainability in each country covered and primarily within the ministry of finance.

Besides the need for capacity-building and institution-building, there is also a need for good governance. This is not treated in the appendix but is included in the main report (section 6.3).

Simplified presentation

The discussion in the appendix is simplified and does not take account of all the sometimes-complex circumstances that occur in reality. Thus, certain areas within this field are not dealt with at all, except where they are pertinent to or in some other way affect programme support. (Budgeting techniques, for example, are not dealt with in this document.) The issues discussed therefore represent a sample, first and foremost linked to the modality of programme support.

This presentation is primarily intended for the "average" interested individual at Sida or the Swedish Ministry for Foreign Affairs or, as applicable, for bilateral donors with procedures and policy briefs similar to those of Sweden. Consultants and others who work in the field may also benefit from this material. Some categories of staff with a particular interest in this field will require more information than is contained in this presentation. For that purpose, we highly recommend Stefan Falk's *Overview of Budget Issues* (2000), the World Bank's exceptional *Public Expenditure Management Handbook* (1998), and DFID's employee guidelines *Understanding and reforming public expenditure management* (2001) as well as our previous report *Sector programme support and macroeconomic development* (1999).[55] However, not all the issues dealt with in this presentation are found in the publications mentioned.

55. The report is available in Swedish and English. See Sjölander/Brobäck, 1999.

Subsectors of public finance management

Financial management of the government's own resources consists of several blocs, as shown below:

Development functions

Control functions

Planning & Budget	Accounting	Payments	Audit	Revenues
Work plans	Bookkeeping	Tranches	Internal audit	Customs/taxes
Multiyear plans	Statistics	Periodicity	Independent audit	Fees
One-year plans	Operational accounting	Payment system	Own/External audit	Donations
Annual budgets	Quarterly reports	Treasury account	Financial/Management audit	Loans
Multiyear budgets	Mid-annual reports	Bank statement	Performance/ Value-for-money-audit	Direct/Indirect taxes
Poverty strategy	Annual reports	Liquidity		Revenue ratio
MTFF/MTEF	(Annual) final accounts	Reconciliation		Collection of taxes/fees
Sector programme	Result reports	Disbursement audit		
Recurrent budget	Chart of accounts	Disbursement		
Capital/ Investment budget	Classification	Payment authorisation		
	Tracking studies	Bank account		

The outline above presents the various subsectors of public finance management together with a range of concepts (there are many more!) that can be seen as linked to each subsector and that often recur in different documents and presentations. (Some designations in the outline are explained below, in their respective subsectors.) It is important to remember that the potential for reforming any of these subsectors of finance management is connected to developments in the others. Thus, reforms in one subsector can trigger reform initiatives in another. Consequently, it is preferable that a reform effort is conducted within the framework of a *programme* that describes current conditions within the subsectors and portrays the mutual interdependencies that exist in the particular country.

Use of the partner country's systems

A government's various financial management systems need not be rejected or accepted in full by the donor organisation when considering whether to use them for the transfer of its own loans or donations.

The key decision to be made by the individual donor, at least initially, is often whether the partner country's government payment system can be used – i.e. whether the money can be considered safe in the payment system and whether it is likely that the funds will be disbursed – and at the right time – for their intended purposes if they are deposited there.

If the answers to these questions are no, the donor may opt not to transfer money to the government payment system.[56] But this does not mean that no other parts of the financial management systems can be used, assuming that support is made available anyhow.

If sector programme budget support donors believe financial support should be given to the sector programme outside the government's payment system, such as through a pool in which different donors' money is deposited in the same external bank account, this does not mean the donors have to stay outside the government's budget, accounting and audit systems.

Donors that decide to give programme support automatically undertake to follow the regulations for financial management applied in the partner country. Today, many donors attempt to do both: subscribe to the partner country's system but simultaneously demand that the systems provide more information than they are able. A basic precondition for donors that want to obtain a complete picture of available resources is for the donors themselves to ensure that the funds they make available are also known to the ministry of finance.

If the recipient's financial management systems are weak, donors should therefore as a guiding principle ensure they present information on newly available funds in a way that enables the ministry of finance in

56. This happens with sector programme budget support but seldom with general budget support. Sometimes, it is the same donor that makes the different decisions on how and why the payment system can and yet cannot be used.

the partner country to include them in the state budget, to present them in the government's accounts and to include them in some form of government audit. This requires a dialogue with the ministry of finance on how to structure information on the new funds (preferably the same structure as applied for other domestic expenditure and revenue in the state budget). In the context of the government budget process, this requires a dialogue surrounding the date by which the ministry needs the information to include it in the state budget.

The question of when to present information about new financial resources to the partner country also has an effect on the money's *fungibility*. Fungibility[57] occurs when a recipient knows it will receive an external resource and can thereby simultaneously allocate its own resources in a way it could not have done otherwise. This aspect will not be discussed further here.

A provider of programme support should always strive to have that support reported in the recipient country's state budget and government accounting system. This is important for achieving the goal of programme support: to help finance expenditure programmes formulated and approved by the partner country's government and parliament. In many cases, this requires that the partner country and donors together change the rules for how (and when) information about new funding is presented to the partner country. It also demands that this information is shared with the operative functions at the ministry of finance.[58] A prerequisite for involvement in programme support is that donors to some extent commit to multiyear (three-year) support and specify the amount of the support for each of those years. This requirement is no more far-reaching than the one that donors themselves place on their current partner countries, and the reason behind it is the same: it is impossible to plan and carry out comprehensive expenditure programmes if the funds are guaranteed and known for only one year at a time.

Legislation-driven usage options

Prospects for using the partner country's system often depend on legislation in the partner country. Statutes and ordinances were often written during, and for, colonial conditions. They therefore do not make provi-

57. See also 'Definitions and concepts' in the main report.

58. This means the budget and accounting departments directly and not merely the department for registering external resources that is found in many of the countries concerned; at the ministry of finance and linked to the foreign office function.

sion for external loans or donations and how these should be accounted for. As a result, it might not be possible for a variety of statutory reasons to report funding in the state budget and the government's accounting system – even if donors and the government want this. For example, a regulation might specify that only funds that pass through a certain bank account structure (the same as for domestic taxes) can be presented in the accounting system. For this reason, it is important to find out how current legislation in the partner country governs options for actually using the country's system, what information is available on this, and whether any initiatives are under way to adapt legislation to actual circumstances.

Control and development functions of the systems

It is apparent that the different blocs in public finance management (as outlined earlier) emphasise different functions. The accounting, payment and audit areas can be said to have a control function, i.e. monitoring how money is used. The other blocs also have control functions, although they are not as obvious in their "official" roles. All blocs can be said to have a development function, i.e. all systems are important for the country's development and the execution of government policy. In Chapter 6 in the main report, we present our view of how donors have until now taken into consideration and emphasised these two aspects of public finance management.

Control and development aspects are both important to the governments concerned as well as to donors and lenders. The different basic principles of these two aspects are, however, integrated and must ultimately be treated in a single context. The following is a presentation of the most important current issues in the blocs outlined above and how the modality of programme support affects the demands of the government and donors on the systems. The presentation begins with the blocs that represent the control functions.

Issues to consider in payments

Payments in the central payment system

The first question one should ask when funds for programme support are transferred to the partner country's payment system is how it is done. In simple terms, the most common model is for the money (all or part, called *tranches)* to be deposited ultimately in a "forex" bank account, usually in the partner country's central bank. This is a bank account denominated in a foreign currency, often US dollars.

The ministry of finance always operates a special function that is responsible for the government's cash management and payment system. In some of the countries discussed here, this function is called *Treasury,* or in Portuguese *Tesouro*. Treasury is a broad concept and in certain countries, such as South Africa, can comprise the entire ministry of finance, while in others it handles the payment system and other responsibilities[59] in the ministry of finance. In other African countries, this function is called something else or is included in the *Accountant General's Office* with no separate designation. In this report, Treasury refers to the function responsible for the government's payment system at the ministry of finance.

As the representative for the ministry of finance and the government, the Treasury has its own bank accounts at the central bank. When programme support funds are transferred to the Treasury's bank account(s) from the forex account, they move from the donor(s) to the government in the partner country. The usual intended route is for the money to be transferred to the bank account used for financing expenditure in the state budget. (This is sometimes called the *Treasury account* but has many other names, such as the *Static Revenue Fund account* or the *Consolidated Fund account.)*

Important questions in this context are:

- Is there any *registration* via account statements or through separate accounting routines (from the ministry of finance or the central bank) *showing the transfer of money from the forex account to the intended bank account for payment of state budget operating expenditure?* Is there any particular agreement between donors and the government (the ministry of finance) for

59. The Treasury department may also be responsible for other functions.

such a separate accounting routine? Certain countries may have individual agreements between a donor and the government on what accounts are supposed to be reported. In other countries, a group of bilateral donors may agree to follow a common and co-ordinated routine. Regardless of the system used, it is vital that the transfer of funds from the forex bank account to the account for financing expenditure in the state budget (and no other bank account) be accounted for and that the money deposited in the account denominated in the country's own currency, corresponds to the value of the foreign currency that was in the forex account[60] based on the official exchange rate. If this type of accounting is not already in use it should be introduced as soon as possible. The central bank's overall reporting of transactions between all the bank accounts at the central bank (which includes accounts held by the Treasury function at the ministry of finance) is often inadequate as an instrument for ensuring that programme support funds reach the bank account that finances operating expenditure in the state budget. Funds for programme support often require the additional, independent accounting routine just mentioned.

- Are fund transfers for programme support audited periodically? Is there an agreement that the transfer from the forex account to the bank account that finances the state budget should be audited, and do donors have access to these audit reports? What sanctions apply if these audits show that the money transferred to the bank account for the state budget does not correspond to the money withdrawn from the forex account? This type of audit can be included in an audit of all the central bank's cash flows but usually also needs to be performed separately, by special agreement, for the transfer of programme support funds alone.

Examining the transfer between the forex account and the account for financing expenditure in the state budget is not in itself sufficient to ensure that all funds for programme support have ended up in the latter. One must also, for a variety of reasons, including fungibility, also be aware of

60. On top of this, in certain countries funds are still transferred via a so-called "counter value" account, but we will not deal with that issue here.

other bank accounts held at the central bank, or in other banks, by the Treasury function at the ministry of finance and how these accounts are linked, i.e. which transfers can be made and are actually made between these accounts. This raises the following questions:

- Is there awareness of the structure of bank accounts in the government's payment system that are held by the Treasury function at the ministry of finance? Do you know which of these accounts are linked and how money can be transferred between them? Are regular, separate and independent audits performed on the bank accounts held by the Treasury at the central bank (and other banks)? Are the audit reports public or available to donors?

- Is the bank account for state budget operating expenditure audited under a separate routine? If not, how can one compare the money used to cover operating expenditure in the state budget with the balance on that account? In other words, how does one know that money has not been withdrawn from this bank account for purposes other than paying budgeted expenditure? Note that this bank account receives funds from various sources: national taxes, customs and other revenues, loans from various lenders, and donations.

In addition, there are macroeconomic aspects to the scheduling of disbursements of programme support and the effects of the supply of foreign exchange. However, these are not discussed here.

Payments for state budget expenditure

Money is disbursed centrally from the bank account for state budget expenditure to the government ministries for expenditures specified in the state budget. Money must also be disbursed to provinces, regions and districts primarily for expenditure on various welfare services included in the state budget. Sometimes payments are made to the lower levels of government via government ministries; sometimes they are paid directly from the ministry of finance to the corresponding financial administration at the provincial, regional, or district level. Disbursements are paid in a variety of ways, but in one model the particular agencies receive a portion in advance, after which they must requisition money when they can show how they used the money they received first. Some countries have introduced a strict cash disbursement system *(cash budget)* in which money is disbursed only if a corresponding amount is physically on deposit in the bank account for state budget operating expenditure. The *cash budget* system is extremely effective from the point of view of control but also has a somewhat restrictive impact on development.

Most countries differentiate between disbursements for salaries and for other costs. Salaries are often paid centrally (directly via the ministry of finance or the particular ministry concerned), while funds for other expenditure are transferred to lower administrative levels for disbursement there. Consequently, welfare services are often paid centrally (a large part of welfare expenditure finances teachers' salaries, for example) and locally. There are special payment routines for investment funds, depending on how much money is needed in a particular period. Funds referred to in the budget as "investment or capital budget" are often used to cover recurrent expenditure – despite their designation and actual purpose.

- The most important issue for donors when it comes to the disbursement system is *whether the system works for getting the funds to the payment centre where they can be applied for the purposes intended in the state budget* – and whether this can be done within a reasonable time, i.e. on a rolling basis during the budget year for which they are allocated. For donors, the most important expenditure is almost always that targeted at welfare services at provincial, district or regional level (health care, education, roads, water etc.). In other words, this system must be able to guarantee that the money can reach these levels within a reasonable time, whether or not they are disbursed directly centrally or via administrative structures at a lower level.

In many countries, this part of the government's payment and disbursement system is weak. Indeed, it can be difficult for the partner country to guarantee that the money will reach the intended payment centres within a reasonable time. It may also be difficult for the partner country to provide reasonable guarantees that the money will be used in the manner intended. In such cases, donors should consider alternative means of transferring programme support, especially sector programme budget support. One way is to transfer the money outside the government's payment system via a "pool account" in which several donors have deposited their programme support funds. This is discussed in more detail later in the presentation.

Problems are created by weak disbursement systems in many of the countries discussed here. One of the biggest headaches is that it is often difficult or impossible to forecast cash flow, i.e. to find out how much money there is in the entire payment system at any given moment. One reason for this is that in some of the countries the system contains a large number of bank accounts at different levels. Another reason is lack of computerisation, which makes it impossible to access information quickly about how much money is available in a group of bank accounts, or overall, at a specific moment.

As a result, the various government administrations and agencies often suffer cash crunches: they receive no money, though they are entitled to it in the state budget. This means the central authorities are forced to borrow at a high rate, even if there is money in the system. This is because they rarely know how much there is – or where it is – as mentioned above. Because no one knows how much money there is, or where, a risk exists that funds will be misappropriated. We should bear in mind that almost all money is disbursed in cash or by cheque, which increases the risk of misappropriation. Most finance ministries are attempting to improve forecasts for cash requirements. By asking relevant agencies to provide some kind of forecast of payments for the year, the ministries are attempting to satisfy their need to know how much money is needed at specific points in time to cover current expenditure.

- Computerisation of the government's payment system would enable the ministries to forecast day-to-day cash flow and keep track of how much money is available in each of the various bank accounts in the system. Thus, computerisation is a key issue for continued programme support and for partner countries to be able to guarantee that the support can actually reach the groups for which it is intended. Computerisation can be implemented in stages. Initially, the treasury function at the ministry of finance could obtain information that shows balances and transfers in a certain group of closely related bank accounts. This information would come from the banks where the accounts are held. The final, long-term goal should be to implement *one* daily clearing account[61] (corresponding to the Swedish government's cheque account

61. A clearing account is used to net all assets in all other relevant bank accounts in the payment system. Thus, the surplus or deficit can be calculated (instantaneously), enabling decisions whether to invest or borrow funds for financing operating expenditure in the state budget.

with the Bank of Sweden) and to make this information available on-line for the treasury function at the ministry of finance.

Registration and reconciliation of payments

Payments made must be registered. Like for private individuals with bank accounts, registration can be checked using an account statement, i.e. a paper showing all transfers to and from a certain bank account during a certain period. The purpose of registration in a system using one-dimensional bookkeeping is to allow the bank account statement to be compared subsequently[62] with accounts of how the money was used, based on the classifications on which the state budget and the accounting system are structured. This comparison is called reconciliation of the bank accounts. In countries where double-entry bookkeeping is used, the bank account statement is compared with the account in the books for "bank" and with the prevailing functional or economic classification.

- The reconciliation process is very important and is the only way to guarantee that the actual payments are captured and reflected in the accounts. Donors in the countries concerned increasingly use (fortunately) information from each government's own accounting system. A basic prerequisite for this information's reliability is that the expenditures registered in the accounts have been based on reconciliation with actual disbursements made. Of the many important variables in the government's payment functions, donors should at least explore (or have someone explore) the reconciliation process's reliability. For this process to be considered completely reliable, it must be computerised.

Which resources are known?

Programme support is based on donors using the planning instruments of the government in each partner country as the basis for determining how their loans or development assistance will be used. The model assumes that the government and the ministry of finance are aware of all funds avail-

62. Usually each month and year, sometimes also half-yearly or quarterly.

able for financing expenditure in the sectors or functional areas for which the government is responsible.

In the countries concerned, that is not the case. Large portions of available funds are unknown to the government, government ministries and ministry of finance (or donors). In the payment system, the primary reason for this is that ministry of finance staff working at the centre often have no knowledge about all the bank accounts accessible to the government ministries or at the provincial, regional, or district level. As long as these resources are unknown to the ministry of finance, it is impossible to present final accounts for the government showing the actual funds used under the expenditure areas included in the state budget.

There are several reasons for the ministry of finance/treasury function not knowing all the bank accounts in the government's payment system. One reason is that many donors (including those providing programme support today) have put, and continue to put, resources at the disposal of a particular ministry in a separate, proprietary bank account which is not reported to the treasury function at the ministry of finance (though there are often legal requirements to report such information). It might also be the case that when (project) co-operation previously financed from such a bank account has ceased, the account remains open with some funds on deposit, though not reported.

It is also important to remember that many bilateral donors still provide project support and intend to continue doing so. Money for project support is almost always disbursed via a separate bank account. Thus, new proprietary bank accounts will continue to be opened in the future. Another reason is that historically a large number of bank accounts were opened in the payment system and it is no longer possible for the centralised treasury function at the ministry of finance to control or even be aware of this account structure.

- For the idea of programme support to work, all relevant financial resources must be known. As long as the bank accounts that can contain funds for financing government-approved expenditures have not been mapped out, it is impossible to prepare meaningful budgets or final accounts. It is also vital for donors that the structure of bank accounts be known – in the centralised payment system and the disbursement system – and that bank accounts be closed when they no longer correspond to an expenditure area or a resource designated in a budget. In many of the countries concerned, extensive technical support must be provided to the central treasury function at the ministry of finance to correct problems in this context. These problems also concern legislative issues, and in many cases the laws that regulate government payments need reform.

Issues to consider in accounting

Accounting systems under development

Government accounting systems in the countries concerned are in many cases undergoing reforms of one type or another. The reasons for this vary (and include the IMF's involvement in this area), but the reforms share the same aim: to enhance the value of the information that the system provides – and from a poverty perspective. Donors promote these issues in different ways and with varied results. As emphasised earlier, there are strong contradictions in the behaviour of most donors. On the one hand, they adhere to the government's accounting structures, which contain limited information in many cases. On the other hand, they simultaneously impose demands on reporting information that are considerably more complex, particularly in conjunction with the formulation of sector programmes. These requirements often result in a ministry being compelled to introduce its own accounting functions within the framework of its sector programme. These functions are more sophisticated than those the ministry of finance can offer. Consequently, they are normally not linked to or based on the government's own accounting system, for which the ministry of finance is responsible.

The system for financial accounting used in the countries concerned is often cash-based,[63] not based on accruals (which precludes depreciation of assets). In addition, these accounts are based on single-entry bookkeeping (or rather one-dimensional bookkeeping), i.e. a payment is entered only in one location (such as in a cash book for a household's expenses), usually against one source of income. In most cases, we might just as well talk about "bookkeeping" as "accounting".

The accounting structure normally reflects the budget's structure. This means that the accounts serve, in practice, as budget follow-up. In several of the countries concerned, budgets are followed up through the registration of payments made. The purpose is to try to capture certain off-budget resources (money outside the state budget). This issue is not discussed further here.

63. This means that the registration in the accounts is made when the payment is made.

Work under way to reform accounting systems

Classification systems

At present, development work being carried out on accounting systems concerns two areas and levels.

The first area concerns the current systems' classification options; in other words, what kind of financial information one can obtain from the accounting system based on a given structure. The classifications that can be reported are 1) *economic* (usually the base of and starting point for the presentation of account data in donor countries) which consists of reporting salaries and other expenditure, often on a detailed level; 2) *organisational,* e.g. costs within a ministry; 3) *geographic/territorial;* and 4) *functional.*

Functional accounts represent areas of expenditure that can be found in many sectors and are not confined to one sector or specialised field. They have recently attracted intense interest as a basis for following up governments' poverty reduction strategies (PRS). Partly as a result of World Bank and IMF initiatives, many of the countries concerned are in the process of revising their current (chiefly functional) account classification systems into a common UN-based system. The World Bank and IMF aim to gain access to comparable statistics on poverty and to find out how governments use money to fight poverty. At the same time, improvements in the functional division of accounts often lead to better organisational reporting on a more detailed level than previously.

If these changes are made with an open mind and sensitivity to the partner country's demands and desires, they can make a powerful contribution to better information on how funds in the state budget are used, for example within a sector and thus for a sector programme. As a result, one should not need to push strongly demands for proprietary accounting structures within sector programmes.

Modern accounting models

The second major reform issue is the introduction of modern accounting models related to the principles commented on previously: double-entry bookkeeping with accruals and deferrals, including principles for depreciation. The use of modern accounting models in relevant computer models allows information to be presented in several dimensions and thus in many ways, such as for different activities or programmes. Financial accounting can also be linked to operational reporting to obtain a presentation of unit costs, key indicators and costs for other performance indicators or particular expenditure fields.[64] Reform efforts under way in the

64. This could e.g. be about how much money has been allocated to girls in a certain form of schooling.

countries concerned often refer to the principles in GAAP, *Generally Accepted Accounting Principles,* for their accounting structures. However, there is no automatic link between GAAP principles of promptness, completeness, comparability and appropriateness, and the multidimensional accounting structure of modern accounting models (or their computerised versions).

Modern accounting models are based on insight into the needs of various institutions for information at different levels of detail. One implication of this is that while the ministry of finance through reform of accounting structures is usually satisfied to gain future access to complete reporting in the economic classification structure (instead of in the state budget structure, as now), the sector ministries want much more information in several different structures, and with considerably more detail. Thus, a new accounting model should primarily satisfy the need for more specialised information among people responsible for operations, rather than the needs of the ministry of finance.

- Demands from donors for reform of government accounting systems are balanced on the one hand between their responsibility when giving programme support to submit to the government's systems and the limited information they can provide, and on the other hand to want access to more information than these systems can produce. *Donors should be satisfied for now with the improvements being made to the classification structures of accounting systems in most of the countries concerned.* They should concentrate their efforts on limiting demands for much more specialised feedback data until modern accounting models are implemented. Such demands are often made when sector programmes are decided on. What donors (and especially lenders) often forget is that each additional demand for a new type of financial information requires its entry through all levels of the administration – including in the provinces and districts where capacity is often considerably less than at the centre. A desire for an additional piece of data to be entered not only requires a new classification in the accounting model; someone must also register and report on it. Demands for additional data can lead to increased errors in reporting as well as additional delays.

  Donors should, however, demand a time limit on the interval between the end of a fiscal period and the date when reports for that period are disclosed, which is unreasonably long in many countries.[65] With an annual transfer of programme support, say during Year 1, one should not have to wait until Year 3 for the accounts and audit of how the funds were used.

Another reform in the spotlight, also related to accounting, is the introduction of Integrated Financial Management Systems (IFMS). This appendix does not address this issue (but see the comment in the box under Closing Remarks).

Which resources are included in the government's accounts?

The GAAP state that information in accounts should be current, complete, comparable and appropriate.

Because a government's accounts often correspond to the state budget, the budget funds are those included in the accounts. Most of the countries concerned therefore enter in their government accounts only a limited portion of actual expenditures in the areas or sectors included in the budget (since significant resources usually are off-budget). This means the accounts breach – often blatantly – the GAAP requirement of completeness. Completeness is usually also required by law.

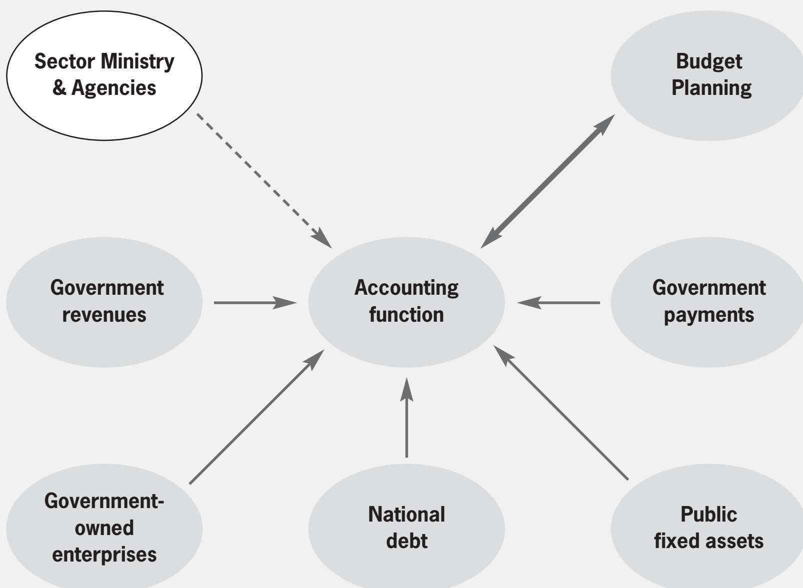
Complete accounting of all relevant resources is the very basis of programme support. But bringing off-budget funds on-budget, and thus *into the accounts,* is a long process that requires short-term as well as long-term action. Thus, donors should have as a basic principle that they try to ensure new programme support (and other resources) is always included in the government accounts. If this is not feasible, for legal or other reasons, they should work to introduce temporarily accounts that *simultaneously* can register the expenditure through the state budget *and* known off-budget resources, such as resources from an external sector programme pool. In order to make it possible to introduce such consolidated accounting of various sources of expenditure, donors must be prepared to co-operate so that all off-budget resources in which they are involved in financing are systematically reported to the ministry of finance.

65. The same applies to the audit reports that follow final accounts.

Financial reporting from ministry of finance departments

A complete annual report for the central government based on modern accounting principles requires that all finance ministry departments report their economic activities to the function at the ministry responsible for the government's consolidated accounts. The ministries of finance in the countries concerned have different structures (and sometimes are split among multiple ministries!), but the following functions are typical:

The ministry also includes administrative functions and sometimes, equally important, personnel functions responsible for training and skills development.



The ministry of finance functions included in this outline are often underdeveloped and/or operate with limited capacity. Technical development projects are appropriate in all areas. The following are a few common weaknesses exhibited by these functions in relation to central government accounts:

- Reporting to the *revenue function* from the revenue collecting administration can be weak. It is not unusual for the accounting function to obtain this data faster from a different source – directly from the collection offices or the payment function (which has to know how much revenue has been received to manage recurring cash crunches).

- *Privatisation and divestiture of government-owned enterprises* have been under way in these countries for some time. Reporting the proceeds from sales, principles for valuing companies, and the timing of payments are not always explained clearly to the accounting function. Government-owned enterprises often have no book value in the accounts. This is also true of the government's contributions and loans to enterprises and the conditions for (repayment of) them.

- The absence of reporting and valuations is usually more obvious for *state-owned fixed assets*. The countries concerned lack a complete and current valuation of state-owned buildings, properties, factories, inventories and other materials. Thus, these assets cannot be depreciated in the accounts (depreciation is impossible anyway in cash-based accounts).

- *Public debt and the interest on it* require active management (a debt strategy) to find the least expensive borrowing options for old and new loans. A good computerised system is a prerequisite for having continuous access to data on borrowed and amortised amounts, interest paid and outstanding debt. Accounting functions have access to this sort of precise, up-to-date information much less often than one would expect.

The government's undertakings go beyond loans. Various types of financial obligations may apply, e.g. pension commitments. It is vital that the government has a clear picture of its financial undertakings, on and off-budget. The accounting function also needs this information so it can assess the current financial position at any time.

- There is a particularly strong need for *co-operation between the accounting function and the payment function (treasury)*. To reconcile bank statements, accounting needs to know how much money is available and how it has been used. In most of

> the countries concerned, this is still not possible. Ministry of finance treasury departments have increasingly proved itself essential, and quite often a hindrance, to continued system development.

The absence of, or limits to, information from within the ministry of finance undermines the value of budgeting and accounts. The lack of a clear picture of actual total expenditures and revenues for a specific period means no one knows what resources are actually at their disposal even in the short term. This makes it difficult to pursue a proper budget policy. Donors are advised to accept this situation for now – provided governments are acting to correct the situation and improve information in the long run. Otherwise donors should spearhead calls for corrective action. The programme support principle of adhering to the government's own system must (for the time being) take precedence over donors' special demands on reporting.

For now, the top priority of donors should be to make visible all the resources of the sector ministries for their respective portfolios so the funds can be included in the state budget. This does not obscure the fact that the departments within the ministry of finance discussed above need corrective action – within a medium term perspective at latest.

Reporting of programme support as revenue

Another vital issue for programme support is how revenues are reported in the state budget and subsequently in the accounts. Programme support is income – a source of financing – for the government's expenditure. No conditionality is attached to standard budget support regarded as income in the state budget. But in practice it is intended to finance poverty alleviation programmes. However, sector programme budget support is expected to fund corresponding expenditure (increases) for the sector concerned. External revenues[66] are reported in state budgets based on different principles. Legislation often determines what may or can be reported as income in the state budget, whether or not the income can be earmarked and so forth.

- *At the same time, as part of discussions about (new) programme support, it should be made clear that nothing prevents programme support*

66. Revenues that are not the country's own customs duties, taxes or fees.

from being included in the state budget or being reported in the government accounting system. It is vital that these funds are able to be included. They are often much more secure if included in the state budget. They become part of the process for reporting resources in the state budget, just like domestic revenues. It is especially important that these funds are included for the benefit of budget policy and for helping to determine what funds the government has for carrying out policy. If there are legislative or other impediments to programme support being included in the budget or accounts, donors should work to help remove them as soon as possible.

The above does not apply to provision of sector programme budget support where it is decided that the government's payment system cannot be used. As mentioned earlier, options for including the funds in the budget and accounts should always be explored, even when it is agreed that physical disbursements (mainly of sector programme budget support) are to pass through external channels.

Execution and feedback information from many sources

As already stated, the information that can be obtained from government accounts in the countries concerned remains of limited quality. This situation must be accepted for the time being, provided the information is correct. The parties involved have access to other reports and other reporting, which also contain figures from operations. Individual donors therefore often attempt to patch together information from several sources to acquire a broader or deeper understanding than that available through national reports of budget expenditures and revenues. The following are examples of other information sources:

- Sector programmes have often included agreements for *reporting various kinds of performance indicators*. Often this information is not available, but sometimes it is. It can provide a picture of a trend or progression if monitored periodically for an extended period. By contrast, information on the cost of activities or programmes is still difficult to come by, even in reports from sector programmes.

- Traditionally some sectors – especially education – make available *operational statistics* (number of students, teachers, schools, etc.) that can be matched to expenditures in the state budget in the same field (divided among several institutions and purposes) to derive ratios and indicators for an extended period.

- *For individual projects*, the ministries and donors involved sometimes produce operational information and financial reports.

- At best, the government can itself *produce statistics* for different fields. The keeping of statistics and the importance of cultivating this practice has grown as development assistance has shifted its focus to poverty.

- Before launching initiatives, the major international financial institutions (IFIs), especially the World Bank, often *conduct comprehensive surveys of what information – operational and financial* – is available. A donor that is active, or plans to become active, in a particular area should always check what information is available from the World Bank. The World Bank will in future conduct many analyses that touch upon public administration, as reported in Chapter 5 of the main report. These analyses are required reading.

- The need to learn from existing studies by *other major donors*, such as DFID, increases. One example is the material that DFID produced in conjunction with its ten-year credit to Rwanda.

- In Chapter 6 of the main report, we describe many diagnostic and analytical instruments in the *financial management* field. Today, all these instruments are being operated to some extent (though several are being revised or combined) by various groups. A donor that desires information about the status of financial management in a particular country should always check to see if an analysis has been conducted and whether a report is available.

- The World Bank and others also use *tracking studies* or *surveys*. In the absence of regular and local information disclosure, these share the aim of ascertaining actual circumstances, often locally, often within a limited, selected geographic area and for a specific purpose, such as health care. These reports are always worth reading for people involved in the activities and can be useful in discussing the true effect on poverty of government policy and donors' involvement.

Reports on actual circumstances are also released periodically by UN organisations (excluding the World Bank and IMF) and non-governmental organisations (NGOs), a group that has hitherto focused predominantly on software issues. NGOs often work locally, giving them access to materials about what effects the policy aims of the government, IFIs and bilateral donors have at the point of welfare service provision. This information about actual circumstances and the mechanisms triggered when large sums of money reach an impoverished environment is invaluable for understanding how genuine welfare is attained.

- The government accounting bodies in the countries concerned – often formed at the behest of donors but to a growing extent by their own initiative – produce reports that monitor how money is used. In addition, external auditors examine operations and finances in those areas that receive donor support. These reports can provide a good picture of how programme funds are actually used. Audit issues are treated in more detail in the next section.

Issues to consider in auditing

Different audit bodies

The countries concerned often have three government accounting bodies that audit government funds:[67]

- Sector ministries and independent government agencies should have an *internal audit office* to monitor internal control systems and comment on them.

- The most important accounting body is the *supreme audit institution*. In most of the countries concerned, this authority reports to parliament, to which it is subordinate. The supreme audit institution is led by an auditor general and is entitled to perform audits anywhere in the public sector.

- Several of the countries also have an *audit function at the ministry of finance,* under the control of the minister of finance. This body is entitled to audit or inspect any of the government's institutions or fields of activity.

Typically, these bodies often lack capacity, perform few audits, concentrate exclusively on financial auditing, co-ordinate their activities with one another to a limited extent (if at all) and have poor knowledge of modern auditing principles. They are also often poorly received by the principals to which they report (parliament and the finance minister) in terms of specific actions to correct qualifications attached to the audits.

Provision of programme support dramatically increases the need for these bodies to function well and produce reliable audit reports. In several of the countries concerned, reform efforts are in progress at these bodies. The Swedish National Audit Office, which is active in several of the countries, is involved in this process.

During provision of project support donors co-operated regularly with external accounting firms, usually the local representatives of a global ac-

67. Several of the countries have additional government accounting or regulatory bodies with other tasks. Besides the three presented here, there may be accounting bodies linked to the presidency and the organisation responsible for government employees. There may also be institutions with the brief of ombudsman. These are in addition to the tax audit authority.

counting firm. This co-operation continues, for example in the auditing of programme support funds. Happily, it is increasing and being expanded to collaboration between multiple donors. Several circumstances have arisen that donors would do well to observe:

- An audit of programme support funds usually entails auditing operations in which it is no longer possible to distinguish individual donor funds from one another. Moreover, it is usually impossible to distinguish between the government's contributions (often financed by unconditional programme support!) to a sector programme and those of donors. The country's laws may not allow external auditors to conduct an audit that also scrutinised government money. It is important to explore these aspects and ascertain what one can do to enable a proper audit, such as requesting permission in each case or enlisting one of the government accounting bodies to lead the audit, assisted by external auditors. In a programme support model, it is just as important for donors to allow audits of government money as it is for the government auditing bodies to audit donors' contributions. This option must be guaranteed in an agreement between the parties.

- When donors engage *external auditors it is vital to co-ordinate* this with other donors and lenders as well as with representatives from government auditing bodies. As a rule, government representatives should always be asked to take part in audits prompted or financed by donors. This creates an invaluable opportunity for institution-building.

- *Competency requirements* may even make it necessary to rely on government audit bodies. Employees at the local offices of large, international audit firms often fail to provide value that corresponds to the size of their audit fees. They seldom have better superior training or skills than staff at government audit bodies. One could almost say this situation is exploited by the international audit giants, and there is good reason for donors to make their views felt in this regard. In another context we have proposed *shortlist and certification procedures* for hiring external audit firms, i.e. that they can show their personnel have sufficient qualifications and skills. The shortlist should be prepared jointly by donors.

- A not-insignificant resource which so far has not been harnessed in this area are *regional, international accounting bodies* such as SADCOSAI and AFROSAI. These are often highly respected by the governments of the countries concerned. There are currently proposals to use SADCOSAI as a certification body for national accounting bodies.

- Audits of central government payment systems (see previous section), have proven inaccessible to donors. This makes it vital to agree early on with the partner country's representatives that *all kinds of audit or follow-up reports* or the background data for these – especially *in the field of payments* – should also be available to donors and other organisations involved.

- Projects for institution-building in co-operation between an external party and a government accounting body often have value-for-money audits[68] as an area of focus. *Value-for-money audits* are not only interesting but must eventually be introduced in the countries concerned. Nevertheless, efforts to develop this type of audit should not make it impossible to introduce a comprehensive system for financial audits. It is important to prioritise development of basic management and control systems before investing large sums in producing more sophisticated information as part of a system for routine information disclosure.[69]

68. One should differentiate between: management audits = how the leadership performs its obligations; legality audits = how the reviewed party has complied with laws and regulations; value-for-money audits = whether the right things were done and whether things were done right; financial audits = financial reviews to ensure that the financial accounts are correct and provide a true and fair view.

69. See sections 6.3.2 and 6.4.1 in the main report.

Issues to consider in planning and budget

Wide-ranging access to materials

Planning and budget are the areas of public finance management that, without a doubt, attract most attention from donors. This is due to macro-economics and budget policy: the budget is perceived (correctly) as the leading tool for carrying out the government's economic policy and converting it into actual welfare services. Other subsectors of public finance management described in this appendix have accordingly been deemed less important. This bias is now recognised as an obstacle to the development of budget policy instruments in many of the countries concerned.

The massive attention to planning and budget has also resulted in much more literature and reporting for this field than for other subsectors of public finance management. As mentioned previously, Stefan Falk's *Overview of Budget Issues*[70] is highly recommended as is the World Bank's *Public Expenditure Management Handbook* and DFID's new *Understanding and reforming public expenditure management*. This appendix focuses on the core issue – in this case planning and budget – in relation to the modality of programme support.

Is there really a connection between planning and budgets?

Many of the countries have a wide range of planning instruments. Most went through a phase of central economic planning in the 1970s and 1980s. In some cases, planning instruments introduced in that era remain *in situ*. Here we refer primarily to multiyear investment plans. There are also political planning processes, which span several years. Other instruments include social and economic plans, which can span one or more years.

Problems concerning poverty reduction strategies and multiyear budgets

In the latter half of the 1990s, *poverty reduction strategies* (PRSs) were introduced. These were to be implemented via a special kind of document: the PRSP (poverty reduction strategy paper). Poverty reduction strategies have dif-

70. As guidance for development assistance staff, in particular appendix 2.

ferent names in different countries (PEAP, PARPA etc.), but all aim to indicate how the government best and most efficiently intends to fight poverty in its country, e.g. through efforts included in the state budget. As stated in our main report, we are to some extent critical of the poverty reduction strategies we have read, though some weaknesses are understandable considering the newness of the process.

Working with IFIs and bilateral donors, most of the countries concerned began to introduce multiyear budget documents even before they introduced poverty reduction strategies. Like poverty reduction strategies, multiyear budget documents now have several names, such as *Medium Term Expenditure Framework* (MTEF), *Medium Term Fiscal Framework* (MTFF), *Medium Term Development Framework* (MTDF) and *Budget Framework Paper* (BFP). This appendix will refer to all as MTEF.

Another multiyear document that governments have developed jointly with the World Bank is the *Poverty Reduction Support Credit* (PRSC). It has been introduced in Uganda, where it in effect a multiyear document for administrative reform of the public sector that is subordinate to the aims and structure of Uganda's poverty reduction strategy.

Multiyear planning and budgeting thus existed before poverty reduction strategies were launched. However, the process worked poorly for several reasons. One main factor was the fact that ministry of finance functions are often divided between a planning ministry and the ministry of finance, the latter being responsible for different parts of the state budget and with different roles in the planning and implementation stages of the budget process. In addition, the planning ministry often has sole control of donor funds, owing to anachronistic rules harking back to previous models in which aid was provided solely for investment and capital expenditure programmes. The goal of programme support to finance poverty reduction strategies is rather to finance capital and recurrent expenditure together (though this responsibility can be split between the government and donors). Dividing budget responsibilities between two sector ministries also contributes to the unfortunate situation in which the governments concerned often cannot present a political action plan for the entire budget that can be translated into clear expenditure targets.

The idea behind the new model for poverty reduction strategies is to achieve close links between these and the multiyear budget documents (MTEFs) mentioned above. The aim is that the MTEF should share the same structure as the poverty reduction strategy and reflect its intentions and priorities. Funding limits in the poverty reduction strategy should be based on a macroeconomic evaluation. The strategy and funding limits should be reflected in the MTEF and the "resource envelope", which can be derived from the analysis. The next stage is for the allocations in the one-year budget to reflect all previous analyses and platforms.

In most cases things work differently in reality. It is difficult in many of the countries concerned to see how the different planning instruments are connected (often they are not) and how they are expected to produce the analysis that should precede a poverty strategy. It can also be difficult to see how, or if, priorities have been set that reflect an analysis of which measures would most effectively reduce poverty. As yet, poverty reduction strategies have no field of their own and are not based on a broad analysis that includes the effects of diverse budget priorities on the macro economy. Multiyear budget instruments (MTEFs) have thus proven pretty useless as managements tools and serve mainly to reiterate the poverty strategy in a budget context. This weakness is exacerbated by the fact that poverty reduction strategy papers only cover part of a government's activities. The government's responsibilities go beyond the poverty reduction strategy's expenditure headings, yet there is a risk that the latter are used as parallel multiyear budgets covering the government's entire expenditure area. This is deeply regrettable, not least because of the status of poverty reduction strategies in donor circles and among partner countries' governments. The situation is further complicated by the programme that determines the World Bank's PRSC. This programme possesses the unfortunate potential to become a third parallel multiyear control document, equivalent to the state budget.

Problems in the transition from multiyear frameworks to one-year budgets

The biggest weakness is in the translation of multiyear budget frameworks to a one-year budget (usually the first year of the multiyear budget and the period for which parliament decides on "hard" budget allocations). It is often difficult to see any sign that a multiyear budget analysis influences the way resources are allocated in the annual budget. Most countries struggle to rectify this weakness. Even so, it fundamentally affects the intended use of programme support (and other funding). The lack of correlation between planning and budget instruments is not helped by the split between a planning ministry responsible for the multiyear budget and a ministry of finance responsible for the one-year budget. Changing this situation may require institutional changes.

- The countries concerned have in most cases already introduced the planning instruments they need to *create the requisite link between poverty reduction strategies and actual one-year budget allocations*. However, in many cases the process still does not work (for the reasons given above). Further efforts are required. Some responses are political and demand that sector ministries become involved in a process that will force the planning and finance ministries to account for how allocations in the one-year budget correspond to the funding framework and direction of the multiyear budget and poverty strategy. Donors that at present provide programme support are entirely justified to demand that existing planning and budget processes be revised to solve this problem. Programme support is nowadays almost always justified by the goal of supporting the poverty strategy. Unless the current situation changes in most of the countries concerned, it is uncertain whether the support will ever meet this goal.

Departing from long-established incremental budgeting principles is no easy task. The incremental method increases everyone's appropriation for the year more or less equally. No ministry likes to give up basic funding to which it has had access for decades, even if it no longer agrees with the priorities of poverty reduction strategies. Donors must nevertheless insist on this change if the state budget is to become the instrument for implementing poverty reduction strategies that it is intended to be under the programme support strategy model. Reconciling actual and budgeted expenditures will also require corrections of accounting and payment practices, as discussed earlier in this appendix.

Problems of different decision-making processes and unannounced funding

- Another problem is that many donor countries *approve the framework for sector programme budget support separately from debt relief funding and general budget support.* This means that sector programme budget support is often not subjected to the macroeconomic scrutiny that determines the size of government expenditure as a proportion of GDP that is consistent with stable macroeconomic development. Moreover, donors often use sector programmes as an opening for development assistance funds which they have been unable to disburse by year-end but for which there is domestic political pressure to do so. As a result, a sector programme might receive extra funding that is out of step with the funding framework derived from the ministry of finance's planning and budget process. In a worst case scenario, these funds could also be channelled off-budget and not be reported within the framework for the government's funding limits. This is very much *a question of discipline for donors, where limits agreed for sector programme budget support and other programme support must not be stretched without prior consultation* with partner governments or the ministry of finance's macroeconomic representatives and budget chiefs.

Earlier in this appendix, we emphasised the importance of including all relevant resources in the state budget. Besides government funds of which the ministry of finance is unaware, other funding that is often off-budget for various reasons[71] includes support to NGOs. In some countries, this is a major part of the total funds available *de facto* for the expenditure areas accorded high government priority. Support to NGOs consists primarily of donor funds.

- For the programme support model to work, the state budget must include everything, or the government must at least be *aware* of the resources at its disposal. This is predominantly a duty of donors. Donors must structure new funding so it can be accounted for in the government's budget. Donors must notify the ministry of finance's operative units – at least the budget and accounting functions – of new contributions. Donors must help ensure that bank accounts containing money earmarked for completed projects are closed and that the money is transferred to a ministry of finance-approved bank account. Donors that continue to open individual bank accounts in their own name or a ministry's name must be instructed to notify without fail the ministry of finance's operative departments. Donors must catalogue and report all support to NGOs active in the country concerned and must request periodic reports from the NGOs on the support's value and how it is being applied so they can inform the government/ministry of finance directly or indirectly. Also, the government's payment system needs to be computerised and catalogued (as discussed in the Payments section). Sida can play an active role, in the bilateral group in particular, by initiating co-ordinated efforts among donors that focus on the activities listed here.

71. Usually previous or current donor contributions.

The planning and budget process in the countries concerned is often determined by legislation. Correcting the problems pointed out in this section may require changes in laws.

Issues to consider concerning revenues

While donors and lenders have focused on developing public finance management systems, government revenues have not received high priority in analyses. One exception has been the financing of several public administration projects by Sida, working with the Swedish National Tax Board, to *bolster tax authorities* in several countries. Nowadays, taxes are also a key institutional area for the IMF, which works with governments in many countries on tax policy in particular. The IMF also helps (through short-term activities) to realise proposed tax policies. This often entails the introduction of value-added tax *(VAT)*. In various studies, tax policies proposed by the IMF have proven regressive, i.e. they increase the relative tax burden on the poor. The tax policies have also attracted criticism for being unrealistic and for making it extremely difficult to collect taxes in local conditions. The IMF's commitment to improving *tax collection* has not been particularly strong until now. Rather, this hands-on fieldwork has been carried out – in frequently difficult circumstances – by donors and organisations such as Sida and the Swedish National Tax Board.

Donors are generally aware these days that tax collection and the tax:GDP ratio must increase in the long run in the countries concerned and that development assistance must be treated as a source of funding that is available for a limited time only. All the same, many find it difficult to adhere to these principles. There are several reasons for this. One is the donor's "disbursement targets" that may be provided to reach a specific level of development assistance in a particular year. These targets are unfortunate and seem to be invoked regardless of logic, effectiveness or actual need. They stem from political pressures brought to bear on development assistance organisations (and also now on IFIs). They make it difficult to conduct a serious discussion with partner country governments about the fundamental need for them to assume long-term responsibility for financing a larger proportion of state budget expenditure.

The situation is not helped by the unfortunate division of work between the World Bank and the IMF in poverty strategy work: the World Bank is the partner for discussing issues concerning budget expenditure, while the IMF handles government revenue issues. The PRSC in Uganda is a striking example of how this split, despite initial intentions to the contrary, created a buffer between the ultimate size of the World Bank credit and any ambition that it would prompt greater effort by the government to increase its own funding of the state budget.

- Donors must make a serious attempt to realise the concept that *partner countries must be able to fend for themselves in the long run without development assistance*. In principle, this means that no additional, new or expanded programme support can, will or should be discussed without linkage to efforts and improvements in the area of taxes and other government revenues. This means in practice that Sida, together with other bilateral programme support donors, must formulate new instructions for programme support decision-making. These must clearly state that efforts to replace development assistance with domestic funding must now be undertaken earnestly and that domestic mobilisation of resources from now on must be linked to all discussions about new external financial support.

This requirement should apply to all new programme support across the board, but is probably easiest to incorporate in sector programme budget support. There are already examples of sector programmes in which donors and governments have agreed gradually to increase the domestic share of programme financing during the programme period. However, the effects are restricted by the frequent practice of governments to use others forms of development assistance – specifically, standard budget support – to fund their (growing) share of financing. It is therefore important to advocate an increased domestic share of financing for the *total* budget.

Closing remarks and summary

Priorities

The partner countries discussed here are under intense pressure from donors to reform their public finance management systems so that programme support can continue as a form of co-operation. Demands for improvements in the most fundamental parts of these systems are mixed with a quick introduction of technically advanced budget and planning structures that only recently have been implemented in the donor countries themselves. Insistence on the application of these advanced systems can in fact be counterproductive vis à vis more basic accounting and payment functions. The impact on control is often minimal, in spite of – or perhaps because of – the systems' sophistication.

The following box, Getting the Basics Right, is taken from the *Public Expenditure Management Handbook* (p. 8), an extremely informative World Bank publication referred to earlier.

- Foster an environment that supports and demands performance before introducing performance or outcome-based budgeting.
- Control inputs before seeking to control outputs.
- Account for cash before accounting for accruals.
- Establish external controls before introducing internal control.
- Establish internal control before introducing managerial accountability.
- Operate a reliable accounting system before installing an integrated financial management system.
- Budget for work to be done before budgeting for results to be achieved.
- Have effective financial auditing before moving to performance auditing.
- Adopt and implement predictable budgets before insisting that managers efficiently use t*he resources entrusted to them.*

The opinions shown in the box are based on the premise that one must first gain basic control over government financial flows before starting to demand that the systems produce information on the efficiency or appropriateness of resource utilisation.

We share this view and believe one need only look at developments in donor countries to understand how difficult, not to say impossible, it is for the partner countries quickly to satisfy donors' complex demands. Just introducing the basic control mechanisms listed in the box is an extraordinary challenge. We believe the prospects are bright for governments and donors to define which fundamental control issues should be included in the first generation of reform programmes in this area. From that starting point, it should be possible to follow up and compare development in a number of countries. However, we recommend the adoption of methods slightly different from the 15 points in the World Bank's and IMF's *HIPC tracking study* (2000a) and that boast a greater degree of sophistication.

This does not mean that issues connected with outcome-based budgeting, value-for-money audits or the effects of state budget resource allocation, for example, are in any way unimportant or uninteresting. All aspects connected with these types of quality and content concepts must be introduced sooner or later, particularly with respect to poverty reduction. Rather, the priorities set below define what an organisation must achieve before moving to the next level. Any attempt to do everything at once can produce a fearful backlash. This is already apparent in some cases.

Fundamental requirements

Based on the issues discussed in this appendix and the needs of the modality of programme support, the fulfilment of the following requirements can be considered a fundamental prerequisite for success:

- The budget must be made to include all relevant resources, or at least the resources must be made known to the planning process when budgets are being prepared.

- The planning and budget process must be linked in reality. The one-year budget must be made to reflect in practice the priorities contained in the poverty reduction strategies.

- Accounts must be reliable, include all resources and be reported within a reasonable time after the end of the fiscal period. Accounts should include all donor funds and other revenues as well as all economic activities, including those of the ministry of finance.

- The payment system must be mapped out and computerised. The system should be reconciled, preferably daily and reformed (this includes closing old bank accounts). It should also be revised periodically.

- Agreement must be reached with the governments concerned on efforts to increase steadily the proportion of the budget financed by funds raised domestically.

- The preconditions for auditing donor and government funds within the framework of a programme support project must be elucidated.

All these requirements should be combined with offers of technical assistance across the board – preferably in co-ordinated programmes – to enhance the systems in individual countries that are not yet capable of producing the information needed.

Capacity-building and human resources

Merely improving public finance management systems is not enough to achieve the objective of programme support aiding the poorest people. The government's other administrative functions, discussed in detail in our main report, must also be made to work smoothly. There is now a general consensus on this issue, especially within the World Bank (see Chapters 5 and 6 in the main report).

The ministry of finance's position in this respect closely resembles that of any other ministry. The ministry of finance depends just as much on efficient government personnel, payroll and pension systems as other ministries do when recruiting the staff they need. Below we draw attention to a few more specialised issues of capacity-building and cultivating human resources.

- What is the state of *skills development at the ministry of finance?* What are the institutional prerequisites for recruitment and training of personnel at the ministry? Does the ministry conduct an active personnel policy and is there any kind of training department that can guarantee employee development?

  In some of the countries concerned, these questions might appear unrealistic at present, but they are truly fundamental. Donors should not become involved in system development at a ministry of finance in any of these countries without considering the ministry of finance's long-term human resources policy.

These human resources issues are just as important at other sector ministries. All sector programmes should include a programme for developing human resources at the relevant ministry (and the ministry's agencies in the provinces, regions and territories or districts), combined with the system initiatives deemed necessary.

Urban areas in the partner countries are currently home to many newly established enterprises. As a result, individuals with the training and knowledge needed by the ministry of finance and others are in short supply. This situation heightens the importance of donors becoming involved in competency development by supporting relevant educational institutions.

- Thus, *competency outside the ministry of finance* is an equally important issue. Are there any educational institutions at any level that can satisfy the (increased) demand for personnel in this field, e.g. auditors with knowledge of public sector accounting? If the answer is no, donors must be prepared to commit themselves to developing this type of institution.

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Acronyms

AfDB	African Development Bank
APL/C	Adaptable Program Loan/Credit
BFP	Budget Framework Paper
BWI	Bretton Woods Institutions
CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
COFOG	Classifiers of Functions of Government
CPAR	Procurement Assessment Review
CPIA	Country Policy Institutional Assessment
DAC	Development Assistance Committee (OECD)
DESA	Division for Democratic Governance (Sida)
DFID	Department for International Development, UK
ECA	Economic Commission for Africa
ESAF	Enhanced Structural Adjustment Facility
ESAAG	East and Southern African Association of Accountants General
EU	European Union
GAAP	General Accepted Accounting Principles
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
IASC	International Accounting Standards Committee
IC	Department for International Development Cooperation, Swedish Ministry for Foreign Affairs
IDA	International Development Association
IDASA	Institute for Democracy in South Africa

IDG	International Development Goals
IFAC	International Federation of Accountants
IFI	International Financial Institutions
IGR	Institutional Governance Review
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
I-PRSP	Interim Poverty Reduction Strategy Paper
JDR	Joint Donor Review
JSA	Joint Staff Assessment
MTDF	Medium Term Development Framework
MTEF	Medium Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
NGO	Non-governmental organisation
NORAD	Norwegian Agency for Development Cooperation
ODI	Overseas Development Institute (Centre for Aid and Public Expenditure)
PACT	Partnership for Capacity Building in Africa
PAF	Poverty Action Fund
PARPA	Plano de Accao para a Reducao da Pobreza Absoluta (Mozambique PRSP, Action Plan for the Reduction of Absolute Poverty)
PEAP	Poverty Eradication Action Plan (Uganda PRSP)
PEAS	Public Expenditure Analysis and Support
PEM	Public Expenditure Management
PER	Public Expenditure Review
PFP	Policy Framework Paper
PREM	Poverty Reduction and Economic Management
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit

PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PSAL/C	Programmatic Structural Adjustment Loan/Credit
PSM	Public Sector Management
QDA	Quick Disbursing Assistance
ROSC	Report on Observance of Standards and Codes
SAL/C	Structural Adjustment Loan/Credit
SECAL	Sector Adjustment Loan
Sida	Swedish International Development Cooperation Agency
SIM	Sector Investment and Maintenance Loan
SIP	Sector Investment Programme
SPA	Strategic Partnership with Africa
SWAp	Sector-wide Approach
TA	Technical Assistance
UNDP	United Nations Development Programme
VAT	Value Added Tax
WB	The World Bank

Glossary of abbreviations and concepts

Bilateral debt is a debt between two countries (governments), usually a development assistance loan or guaranteed export credits.

Budget process and budget system. The budget process can cover multiyear and single-year resource allocation and be based on previous planning processes – in this context principally poverty reduction strategies and multiyear budgets (see under Multiyear budgets and MTEF/MTFF). The budget process covers all steps from eventual appropriation statements by parties who are to receive funds and implement government policies, to the consideration of and decisions on allocation of budget resources by government and parliament, and disbursements of budgetary funds to intended targets. Also included are decisions about, and evaluations of, government revenues. Among the methods used to implement this process are political definitions for various areas, planning instruments, single-year and multiyear budgetary instruments, accounting systems of different kinds and audit systems and follow-up methods.

BWI (Bretton Woods Institutions) is a common name for the IMF and World Bank, which were founded in 1944 in Bretton Woods, USA, and which in 1947 came under the auspices of the United Nations. The two institutions were created to support economic stability and development after World War II. The World Bank's original mission was to rebuild Europe after the war and to promote progress in developing countries. The IMF was responsible for stability under the then-prevailing monetary system, the Bretton Woods System – a fixed exchange rate system. The idea was that a stable currency and payments system would promote international trade and economic growth among the 40 or so member countries.

As Europe recovered, the World Bank concentrated on its other main task, i.e. development work in developing countries. When Bretton Woods collapsed in 1971 the IMF's role and future became uncertain. However the IMF reincarnated itself at the end of the 1970s as an agency for helping developing countries with external (payment) problems. The IMF played an important role during the debt crisis in the 1980s that hit developing countries hard. It has since continued working on economic problems in developing countries.

CAS (Country Assistance Strategy) is the World Bank's central tool for overseeing and piloting its country programmes for IDA and IBRD borrowers. The aim of CAS is to identify key areas where World Bank efforts are likely to have the greatest impact on reducing poverty. A CAS document should:

- Describe the World Bank's strategy based on assessments of priorities in the country.
- Indicate the level and composition of efforts based on the strategy and the country's performance.

CDF (Comprehensive Development Framework) is based on certain principles of development assistance: land ownership; partnership with all donors and stakeholders; a long-term and comprehensive attack plan for development (where social, structural and institutional questions are treated on a par with macroeconomic issues); and a focus on development-based results, primarily poverty reduction. PRSPs are based on these principles.

DAC (Development Assistance Committee) is a department of the OECD (Organisation for Economic Co-operation and Development) that handles co-operation issues related to developing countries. DAC's role is one of coordination, integration, promoting effectiveness and providing sufficient funding in support of sustainable economic and social development. It is also a forum within which the principal bilateral donors collaborate to improve the effectiveness of their efforts to support lasting development. DAC has formed a Task Force on Donor Practices to improve harmonisation of donor efforts in partner countries with regard to capacity building in the public sector (including financial management systems).

A series of **diagnostic instruments** has been developed by the IMF and, in particular, the World Bank to assess governmental financial management systems in recipient countries. Chapter 5 contains a short description of ROSC (Reports on Observance of Standards and Codes), CFAA (Country Financial Accountability Assessment), CPAR (Procurement Assessment Review), IGR (Institutional Governance Review), PEAS (Public Expenditure Analysis and Support), PER (Public Expenditure Review), CPIA (Country Policy Institutional Assessment) and a number of other instruments.

Fungibility is a term that arises frequently in development assistance contexts. That money is fungible means it is "exchangeable". This makes it impossible to follow up disbursed development assistance funds with complete accuracy. This, in turn, is because a partner country that receives financial assistance allocated for a specific purpose can alter its expenditure programme and use funds released by the financial assistance for other purposes.

HIPC (Heavily Indebted Poor Country) is a debt relief initiative that for the first time includes the multilateral debts of the poorest and most indebted countries. The aim is that funds released by providing debt relief result in increased social spending on the poor, in absolute terms as well as a proportion of the overall budget.

Under the original HIPC Initiative, debt relief was approved at the "decision point", whereupon the country was given three years to implement the measures and reach the "completion point". This system has developed into an "expanded HIPC", which shortens the three-year period by applying a "floating completion point". As part of the expanded HIPC, the definition of a "sustainable debt" was lowered. By November 2001, 24 countries had reached decision point under the expanded HIPC. The estimated cost of the new rules is in excess of US$28 million (present value in 1999), split roughly equally between bilateral donors and multilateral creditors.[72] (See Chapter 1.)

IDA (International Development Association) is part of the World Bank Group, which also includes the IBRD (International Bank of Reconstruction and Development), MIGA (Multilateral Debt Investment Guarantee Agency), IFC (International Finance Corporation) and ICSID (International Centre for Settlement of Investment Disputes). The IDA is the World Bank Group's concessional lending arm, providing favourable, long-term loans (called credits) to the poorest countries. The IDA's role is to build up human capital, policies, institutions and infrastructure to create equality and sustainable growth. The organisation lends only to countries with a certain level of income per capita (US$ 885 in 1999). Eighty one countries were eligible for IDA support during the fiscal year 2000.

IDG (International Development Goals) date back to agreements and resolutions taken at world conferences organised by the United Nations in the first half of the 1990s.The conferences led to agreement among development organisations on the steps needed to achieve the goal of reducing poverty and attaining sustainable development. The IDG consist of seven goals, each concerning an aspect of poverty that includes indicators for

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72. These figures are based on World Bank and IMF estimates. (www.worldbank.org/hipc/about/hipcbr/hipcbr.htm)

the relevant area. The IDG have been accepted by, among others, the UN, OECD/DAC, IMF and the World Bank.

IFI (International Financial Institution) is often used as a moniker for the IMF and World Bank. In reality, though, IFI is a wider term that includes all international financial institutions, including the World Bank and IMF.

JDR (Joint Donor Review) is produced by a group of like-minded bilateral donors who provide programme support to the same country. It handles and analyses issues concerning disbursed programme support and pertinent financial management questions.

JSA (Joint Staff Assessment) is conducted by officials from the IMF and the World Bank and is an evaluation of a partner country's PRSP. The PRSP and JSA report are then presented to the respective boards of the World Bank and IMF, which decide whether the poverty strategy is of a sufficient standard to entitle the country to favourable loans from the institutions.

Macroeconomic stability. One cannot put an exact value on the macroeconomic variables that denote whether the macroeconomic situation in a country is stable or unstable. Rather, a comprehensive assessment of different key macroeconomic variables is what denotes a country's macroeconomic status. Key variables are growth, inflation, financial (budget) deficit, balance of payments deficit and size of international reserves. Through macroeconomic policies it is possible to influence, and create conditions for, sustainable economic growth. Within a PRSP, the stabilisation process includes various macroeconomic areas, each of which has consequences for individuals (not least the poor) and for growth.

Multilateral debts are a country's debts to multilateral organisations, i.e. organisations owned by many states (governments). The IMF, World Bank and regional development banks are examples of multilateral organisations.

Multiyear budgets, which usually cover a three-year period, have been adopted in many partner countries. These documents are based on macroeconomic assessments and on funds received from donors for appropriate allocation according to government policy. Multiyear budgets are important for the planning of partner countries' financing of poverty-focused programmes within the context of stated macroeconomic targets. The documents have different names: **BFP** (Budget Framework Paper), **MTDF**

(Medium Term Development Framework), **MTEF** (Medium Term Expenditure Framework), **MTFF** (Medium Term Fiscal Framework).

NGO (Non-governmental Organisation) can be defined as an independent (from the state or government), not-for-profit organisation. NGOs are wholly or partly dependent on charitable donations and private funds. The term NGO includes a wide range of organisations, such as large established charities, research institutes, churches and lobbyist groups. The World Bank classifies NGOs as belonging to one of three groups:

(I) Community-based/Grassroots NGOs: work for the inhabitants of a small geographic area.
(II) National NGOs: operate in individual developing countries.
(III) International NGOs: often have their headquarters in an industrialised country and operate in more than one developing country.

The grassroots organisation category differs from the other two. While (II) and (III) are NGOs founded to help others, (I) is usually a membership organisation for people who together promote their own interests (e.g. women's groups, credit circles, youth clubs and farming organisations).

PAF (Poverty Action Fund) was set up in Uganda to improve transparency and control of budget resources released as a result of HIPC debt relief and other donor resources earmarked for financing poverty-oriented programmes.

PRGF (Poverty Reduction and Growth Facility) has replaced the IMF's former **ESAF (Enhanced Structural Adjustment Facility)** as an instrument for supporting partner countries in their implementation of PRSPs. The PRGF should accord with the comprehensive framework that covers macroeconomic, structural and social policies aimed at promoting growth and reducing poverty. Payment periods and conditionality in connection with PRGF loans are the same as those previously applied to ESAF loans. Applicant countries are granted PRGF credits on the same grounds as through ESAF. Loans are based on three-year undertakings and subject to scrutiny of performance. They are paid on a half-yearly basis and carry an interest rate of 0.5 percent, in those cases when the loan's maturity exceeds ten years.

Programme support or **programme aid** can be defined as policy-based development assistance not earmarked for financing a specific project. In other words, it is a modality aimed at supporting implementation of a general policy or expenditure programme developed by a partner country.

Financial programme support can be divided between balance of payments support and budget support (including sector budget support). The difference is that the donor provides balance of payments support in foreign currency, while budget support is provided in local currency. Budget support is also provided in foreign currency but is converted in the partner country to local currency.

Balance of payments support and budget support are largely the same from a macroeconomic perspective because both consist of a foreign currency component and a domestic currency component. Depending on the form of support chosen, donors tend to focus on different components with different effects in the respective area.[73] Balance of payments support with a foreign currency focus is tied to debt management efforts, while budget support with a local currency focus is tied to effects on the budget process, budget allocations, transparency and financial management efforts. The HIPC initiative has resulted in an increasing tendency to give balance of payments support by way of debt relief in local currencies. In practice, therefore, this support works like budget support. All forms of programme support are tied to policy reforms in the partner country. Poverty issues are today deemed of key importance in this context.

PRSC (Poverty Reduction Support Credit) is a new World Bank instrument that covers the most important structural and social areas in an IDA country and aims to support implementation of its overall poverty reduction strategy. The PRSP and JSA must in the medium term jointly devise a framework for structural and social reform programmes supported by the PRSC. This framework consists of annual credits determined according to need.

Other traditional lending instruments used by the World Bank in building up public institutions in IDA countries are: SAC (Structural Adjustment Credit), SECAL (Sector Adjustment Loan), APC (Adaptable Programme Credit) SIP (Sector Investment Programme) and technical assistance.

PRSP (Poverty Reduction Strategy Paper) has replaced the former **PFP (Policy Framework Paper)** and summarises a partner country's poverty reduction strategy. A PRSP is thus a precondition for a country receiving debt relief under the HIPC initiative and being granted access to soft loans from the World Bank and IMF. A PRSP is preceded by an I-PRSP (Interim PRSP), which summarises what is known about a country's poverty situation and government policy in the area. An I-PRSP also describes the process leading

73. Part of this explanation is based on Howard White's rapport *"Dollar, Dialogue and Development"*, Sida, 1999, which is recommended for further explanation.

up to a full PRSP. A PRSP is drawn up during a democratic process by the country's government, supported by the IMF, the World Bank and other partners such as bilateral donors and NGOs. A PRSP must cover a number of different areas: poverty diagnosis; links between political actions and poverty-reducing results; and a system for monitoring progress in poverty alleviation.

PRSPs are formulated differently between countries and have different names. Uganda's poverty strategy is called PEAP (Poverty Eradication Action Plan) and Mozambique's is known as PARPA (Plano de Accao para a Reducao da Pobreza Absoluta). (The PRSP process is discussed in more detail in Chapter 1.)

SPA was founded in 1987 with the title Special Programme of Assistance to African Countries. Its main goal was to increase the flow of aid to highly indebted countries in Africa that have undergone structural adjustments. The name was changed in December 1999 to **Strategic Partnership with Africa.** This reflects a major change from the previous focus on resource mobilisation to the wide-ranging activities of today. Seven task groups have been created to make development assistance more effective. The areas covered are:

- Growth and Equity.
- PRSP Process.
- Poverty Monitoring.
- Aid and Fiscal Policy.
- Financial Management and Accountability.
- Sector Programmes.
- New Contractual Relationships and Selectivity.

The SPA partnership includes bilateral donors and multilateral institutions. The group includes: Belgium, Canada, Denmark, Finland, France, Germany, Italy, Ireland, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland, the UK, USA, the World Bank, IMF, DAC, EU, UNDP, African Development Bank (AfDB), UNDP Africa Bureau and the Economic Commission for Africa (ECA). SPA is an important forum for donors to co-ordinate joint efforts, particularly in the institutional arena.

SWAp (Sector-wide Approach) can be defined as a process in which donors provide financial support for a sector within a common direction and planning framework for the purpose of implementing a sector strategy agreed with the government. Donors can contribute via sector programme budget support or specific programme funding. The government also contributes with funds earmarked for financing sector programmes. SWAp's purpose is to reduce the risk of fragmentation in assistance efforts (project support) and to bolster institutional capacity in the relevant sector. This wide-ranging approach facilitates more rational and long-term resource planning and use. But it also makes demands on public expenditure management. The advantage is that the programme is entirely subordinate to parliament and its decisions.

Traditional World Bank lending instruments:

- ***SAL/C (Structural Adjustment Loan/Credit)***[3] is the World Bank's quick disbursing assistance, which is chiefly used to increase effectiveness and productivity in the public sector and to stimulate good governance. Its primary use is for political initiatives, e.g. reducing trade barriers. The SAL/C is inadequate when it comes to the development of sustainable institutional reforms because its conditionality is often too restrictive and based on very short timeframes. Countries in need of longer-term support for structural and social reforms, including institution-building, may instead benefit from ***PSAL/C (Programmatic Structural Adjustment Loan/Credit),*** a new programming form of SAL/C. PSAL/C supports medium-term reforms including a multiyear matrix of policy and institutional reforms, with indicators and follow-up for each loan. Every PSAL/C includes new conditionality and institutional reforms based on the previous ones.

- ***SECAL (Sector Adjustment Loan)*** aims to support specific sectors that carry out policy and institutional reforms. SECAL focuses on private sector development, institutional capacity-building and sector expenditure programmes. Like SAL/Cs, SECALs have a short-term focus.

- The World Bank's traditional ***investment lending*** and ***SIP (Sector Investment Programme)*** are other instruments used to bolster institutions. SIP is an umbrella for institutional programmes within specific sectors and which, like PRSPs, is intended to pilot institutional reforms at partner countries' behest. A more result-oriented focus is achieved by measuring performance – also in line with PRSP principles.

3. The conditions under which a country may borrow money from the World Bank are based on the country's creditworthiness and income per capita. Loans provided by the *International Bank for Reconstruction and Development* (IBRD), party of the World Bank group, are termed loans, while funds provided by the *International Development Association* (IDA) are called credits.

- ***SIMs (Sector Investment and Maintenance Loan/Credit)*** usually contain an agreement on the composition of a SIP and focus on public expenditure programmes in specific sectors. Besides capital investment and institutional capacity-building, SIMs also cover operating costs as part of an expenditure or investment programme. SIMs normally comprise co-ordinated multilateral and bilateral support to the specific sector.

- The World Bank's ***TA-loans (Technical Assistance Loan)*** allow e.g. staff in partner country institutions to be trained even after the completion of a SAL or SECAL. The aim is for the institutions to be able to continue with their activities after credits have been used up. Timeframes are flexible so that institutional objectives can be met. The problem with TA support is that it is uncoordinated (unless connected to existing programmes and/or with the government and other donors). The World Bank's TA loans are regarded as far too expensive in partner countries where other bilateral donors are active and can provide technical assistance in the form of donor funds.

- ***APL/Cs (Adaptable Programme Loan/Credit)*** are relatively new instruments for underpinning institutional reforms, mainly in specific sectors or the civil service. The loans are tied to a programme-based reform package with a ten-year loan period that is divided into phases.

UNDP (United Nation Development Programme) is part of the UN's Economic and Social Council, which also includes UNICEF (United Nations Children Fund), UNFPA (United Nations Population Fund), UNHCR (Office of the United Nations High Commissioner for Refugees) and UNEP (United Nations Environment Programme). Autonomous organisations, including the World Bank and IMF, are also members of the council.

As the UN's development programme, the UNDP is charged with providing developing countries with knowledge-based policy advice in areas that include poverty alleviation and capacity building for institutions. UNEP is present in virtually all developing countries via a network of more than 130 field offices. UN agencies that follow and assess different activities do so using a tool called CCA (Common Country Assessment). With regard to development work, which includes a range of activities and follow-up of indicators, the relevant blueprint is UNDAF (United Nation Development Framework). Following the emergence of

SWAps, all UN agencies involved in these programmes now seek to use UNDAF, which acts as a co-ordinating mechanism.

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