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## Changing approaches to public expenditure management in low-income aid dependent countries

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## **Changing Approaches to Public Expenditure Management in Low-income Aid Dependent Countries**

Adrian Fozzard and Mick Foster\*

October 2001

### **Abstract**

The present paper critically examines how aid dependent low-income countries have approached the process of public expenditure management reform during the 1990s. It begins with an overview of broader public sector reform initiatives in LDCs which provide the backdrop against which expenditure management reform has taken place. It then assesses progress in six key areas of reform: the role and structure of the State; attempts to improve agency performance; the introduction of resource and expenditure planning tools; measures to improve the governance of public expenditure; the development of new aid management instruments; and finally, recent experiences in improving the poverty reduction impact of public expenditure. It concludes with an assessment of the likely success of these initiatives and the priorities for future interventions.

Keywords: public expenditure management; aid management; public sector reform

JEL classification: O23, H50

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## **1 Introduction**

The present paper critically examines how aid dependent low-income countries have approached the process of public expenditure management reform. It begins with an overview of broader public sector reform initiatives in LDCs which provide the backdrop against which expenditure management reform has taken place. It then assesses progress in six key areas of reform: the role and structure of the State; attempts to improve agency performance; the introduction of resource and expenditure planning tools; measures to improve governance; the development of new aid management instruments; and finally, recent experiences in improving the poverty reduction impact of public expenditure. It concludes with a somewhat premature assessment of the likely success of these initiatives and the priorities for future interventions.

Throughout the paper reference is made to the experience of OECD countries which, led by New Zealand, Australia, the United Kingdom and the United States, represent the cutting edge of public expenditure management innovation. This experience is frequently referred to in the literature on public expenditure management reform prepared by international institutions and targeted at developing countries (World Bank 1998; Schiavo-Campo and Tommasi, 1999). The authors recognise that the conditions for and problems of public expenditure management are markedly different in aid-dependent low-income countries. Poverty, limited technical capacity, economic instability, a narrow revenue base and weak systems of governance represent significant constraints on effective expenditure management in all LDCs. Aid-dependent countries, where aid inflows commonly account for over 10% of GDP, must also contend with multiple donors and reliance on aid inflows to finance a substantial part of their budget. Consequently, while OECD experience suggests a possible direction of reform—and may provide a standard against which to measure the progress of LDCs—the paper will critically assess the relevance of these models.

## **2 A reform agenda**

Public administration in both OECD countries and LDCs has traditionally emphasised control over achievement. Public agencies and programmes have tended to expand inexorably, whether or not there is a continued rationale for their existence. Highly centralised decision making and control systems have left public servants unable to take initiative to secure improved results even if they should wish to do so. Often the public service has settled into a low-level equilibrium, in which low expectations, the dead weight of bureaucracy, lack of incentives and weak accountability combine to generate low performance.

On the basis of this depressing diagnosis, economists, management theorists and politicians in many OECD countries, notably New Zealand, Australia, the United Kingdom and the USA, set about revitalising the public sector during the 1980s. In these countries, reforms have been inspired by a belief in the efficacy of market solutions, leading not only to an attempt to withdraw the State from areas where the private sector can operate but also to find ways in which the market can improve performance in areas that remain the preserve of the public sector. This has entailed

fundamental changes in the role of the state, its institutional structure and management systems. Six key elements of this New Public Management model (NPM) can be identified:

- The role of the State has been redefined and its scope for intervention in the economy curtailed through the privatisation of public enterprises, economic liberalisation, the promotion of non-governmental service providers and, to some extent, a downsizing of state institutions.
- Policy and implementation functions have been separated by creating executive agencies and decentralising responsibility for the management of service delivery to units closer to clients.
- Managers have been liberated from bureaucratic controls, giving them greater autonomy in the application of resources and in the recruitment and remuneration of staff.
- Incentives for agencies and personnel have been aligned with policy goals, by setting out and monitoring performance targets, often through formal agency and personnel performance contracts, and introducing performance related pay.
- Agencies have been subjected to competitive pressures through compulsory tendering, internal markets and benchmarking of performance between service delivery units.
- Mechanisms have been put in place to ensure feedback from and accountability to the public, by creating opportunities for “exit” (facilitating access to alternative private and public providers) and “voice” (through, for instance, client surveys and the participation of representatives on management boards).

The elements of the New Public Management model have not been applied systematically throughout the OECD countries: New Zealand, Australia and the United Kingdom have been at the vanguard of reform, while traditional, administrative models have proved more resilient in others, notably France and Italy. Nor is the NPM model without critics, particularly as regards the applicability of private sector practices to the realm of public service (see for instance Stewart and Ranson, 1988). Nevertheless, the “model” has exerted a powerful influence on the public sector reform agenda and has been elevated to the status of a management paradigm in much of the recent literature.

Changes in public expenditure management practice have followed and accommodated these broader public sector reforms, driven by a change in the perceived purpose of public expenditure management systems. Traditional administrative approaches emphasised expenditure control, assessed in terms of compliance with procedures and legislatively mandated expenditure policies, as expressed in the annual budget. Public expenditure management now emphasises performance, assessed in relation to the goals of macro-economic stabilisation and economy, efficiency and effectiveness in the use of public funds—Premchand’s SEEE paradigm (1993: 37-40). Achievement of these goals entails a broad managerial perspective, in which: financial resources are managed along with other key resources, such as personnel and information; plans and decisions are resource-constrained rather than needs based; and performance assessment contributes to planning and decision-making.

The managerial approach also implies a wider institutional scope than has traditionally been the case, extending beyond the core functions of Ministries of Finance to include

expenditure management at agency level, down to the point where clients and citizens access public services. At the same time, public expenditure management has also moved upstream, recognising that policy decisions are expenditure decisions and that system performance can only be assessed in relation to policy goals. In tandem with the new focus on performance, public expenditure management systems have also come to be viewed as a key instrument of governance. This requires that public expenditure management systems are not only transparent and accountable to parliament, but also involve citizens in decision making.

More recently, the renewed emphasis on poverty, which has seen countries sign up to the IDTs, and the introduction of Poverty Reduction Strategy Papers (PRSPs) as the focus of policy dialogue with LDCs, as well as the gateway to IMF, IDA, HIPC and bilateral support, has drawn attention to the policy goals which the public expenditure management system in LDCs should serve. Under structural adjustment, public expenditure management systems gave priority to the goal of macro-economic stabilisation, often to the detriment of performance against other criteria. To the extent that distributional consequences were addressed, for much of the 1980s and early 1990s, the emphasis was on mitigating the adverse impact of adjustment and protecting expenditures on social services. Today, Bretton Woods partner countries are encouraged to give priority to the goal of sustainable poverty reduction, which introduces a far stronger distributional dimension to the assessment of performance in public expenditure management.

### **3 Changing the role and structure of the state**

The World Bank's approach to public sector reform during the 1980s and early 90s focused on the reduction in the size of the public sector, through civil service reform and privatisation of public enterprises, in order to reduce public expenditure and thereby achieve macro-economic stabilisation goals (Nunberg, 1999: 1). In many LDCs, ill conceived cuts in public spending led to a situation where poorly paid staff lacked the means to adequately fulfil their functions—teachers without materials and health centres without medicines—so that short-term stabilisation was achieved at the expense of efficiency and effectiveness in the public sector. This was understandable in the context of the fiscal crisis experienced by many countries at the time, but the World Bank now recognises the need for a more balanced approach.

In the 1997 World Development Report, the World Bank advocates a strategy that seeks to address the goals of stabilisation and effectiveness simultaneously: firstly, by rationalising State interventions, focusing on those functions that are consistent with its capability and placing increased reliance on alternative non-governmental providers; and secondly by strengthening mechanisms of accountability, providing incentives and subjecting institutions to competitive pressures so that state institutions become more effective (World Bank, 1997: 25-28). While the World Bank and other prominent international institutions, such as the Commonwealth Secretariat, often hold up the experience of OECD countries as an example for LDCs in implementing this strategy, they have eschewed reform blueprints (see for example, Bale and Dale, 1998; Kaul and Collins, 1995; Kaul, 1996; World Bank, 1997). Instead, it is argued that the validity of OECD experience should be tested in each country context and that LDCs should innovate rather than simply imitate OECD solutions.

It is also recognised that conditions in LDCs for NPM models are often far from propitious because, as Schick (1998a) points out, the fiduciary and management systems and culture required to ensure effective management and accountability are often not in place: contracts may not be enforced; the prevalence of patron-client relationships makes it difficult to associate performance or non-performance with credible rewards or sanctions; and management may apply “informal” practices that, whilst generating results, are inimical to accountable government. Such fundamental changes in public sector culture will take years if not decades to implement. The development of effective judicial and oversight institutions, such as auditors, is a crucial first step in this process (see Section 6). But this too is a lengthy process. Moreover, success will require high level political commitment to reform and willingness to confront entrenched vested interests.

In this context, the World Bank’s approach to public sector reform is cautious and long-term. Recent World Bank sponsored programmes for Ghana, Tanzania and Zambia, allude to the key elements of the NPM model, but place greater emphasis on the reform process than specific measures. Priority is given to the development of high level structures to oversee the reform process and the identification of quick-win interventions that can mobilise and sustain the momentum of reform. Finance is to be provided through Adaptable Program Loans, which provide greater flexibility in terms of the timing and object of disbursement than projects (see Section 7).

Perhaps the most intractable problem for any Government is to match expectations concerning the State’s role with the resources available. The World Bank has addressed this issue at a conceptual level by distinguishing a hierarchy of State functions, reflecting differing levels of financial and managerial capability, ranging from minimal functions (the provision of pure public goods and safety nets for the poor) through intermediate (addressing market failures) to activist functions (which seek to coordinate private activity and redistribute assets) (World Bank, 1997: 27). Following this logic, much progress was made in getting Government out of costly interventions with a weak rationale during the 1980s and early 90s, especially in countries undergoing structural adjustment, through the privatisation of state enterprises and the reduction of price subsidies. This process went further in Africa than in South Asia, where there was less urgent external pressure for reform and, in the absence of a fiscal crisis, politicians were unwilling to confront those vested interests that benefit from public expenditures on state enterprises and subsidies.

For poor countries, even after cuts in redundant functions, the resources available are often insufficient to fund adequately even those services with a strong justification. Attempts can be made to prioritise expenditures through a process of functional analysis, by which agencies clarify their mission and objectives, allowing decision makers to distinguish between core, peripheral and superfluous functions and thereby streamline the services they provide. Some countries, Malawi and Jamaica, for instance, have carried out functional analyses systematically throughout government. Unfortunately, this rarely results on a radical cutbacks or reorientation of public services. Instead, consultations tend to reaffirm existing institutional arrangements and may even identify a range of functions that are not adequately fulfilled at present, providing a rationale for institutional expansion rather than contraction. Politicians too are reluctant to reduce the range of services that they will provide to reflect resource availability when, for example, this requires the definition of a health package that can be financed from less than \$5 per capita. Consequently, although there has been some

success in rationalising administrative structures—for example, Uganda reduced the number of Ministries from 38 to 21 in 1992—it has proved more difficult to cut back on existing functions and programmes, or eliminate redundant personnel, which are instead, merely consolidated under broader institutional mandates. As a result, Governments continue to provide services that are over-stretched, of poor quality, and in practice rationed by the application of formal charges or unofficial inducements to public servants.

Since the 1980s LDCs, and South Asia in particular, have seen a rapid expansion in the number of private sector and non-governmental organisations involved in the provision of—formerly—“public” services. This has often been a response to government failure, with “social” entrepreneurs, private sector providers and community based organisations filling the gaps where the quality of the services has deteriorated and the public sector has failed to accommodate the growth in demand. It is now common to find that household spending on education and health exceeds State expenditures, even where Governments claim to offer free services (see for instance, Government of Bangladesh, 1998). Governments, recognising their reduced capacity to provide services, have facilitated this process. Those countries where the State formerly held a monopoly on health and education services, such as Mozambique, have mostly rescinded restrictive legislation, to allow the creation of private and community schools and private clinics (Government of Mozambique, 1999). In India, State Governments have forged partnerships with local NGOs and CBOs to improve co-ordination, provide support and ensure standards. Donors have contributed to this trend by channelling funds directly to NGO service providers. For the most part, however, the private sector and non-governmental organisations tend to be seen as alternative service providers rather than an alternative mechanism for public service delivery, as proposed in the New Public Management model. There are exceptions: a number of Latin American countries have used public-private partnerships in the education sector, channelling public funds through private schools to deliver primary education on a more cost-effective basis than the public sector institutions (Turner and Hulme, 1997: 127). Similarly, there is a long tradition of public financing of mission schools in some African countries, notably Ghana. Nevertheless, for most LDC Governments, the public and non-governmental sectors occupy distinct and often competing realms.

Some progress has been achieved in the reform of agency management structures along the lines suggested by the New Public Management model. Ghana has, perhaps, gone furthest along this road. Its Civil Service Law of 1996 institutionalised a distinction between the policy and regulatory functions of Ministries and the executive functions of agencies, some of which have been granted autonomous status. Extensive use is made of performance contracts, not only between the central finance ministry and line ministries, but also between line ministries themselves and budget holders down to district level. Attempts have also been made to align incentives with agency goals through the introduction of performance related pay (Dadoo 1997). Elsewhere, elements of NPM have been adopted, usually in specific sectors or institutions rather than government-wide. The autonomous agency model has been particularly favoured for tax administration agencies, with examples in Malawi, Zambia and Uganda, since this has allowed the payment of more attractive salaries, with the objective of reducing corruption, and protecting day-to-day management from political interference. The model has also been applied to universities, hospitals, and road authorities. However, as a rule, core Government institutions in LDCs continue to apply traditional, administrative models that entail centralised control of resources.



#### **4 Improving agency performance**

There is widespread recognition that the centralised top-down planning and control that characterises traditional budgeting systems fails to ensure the efficient and effective use of resources and results in institutions that are unresponsive to the clients' needs. The dilemma is how to allow managers to improve performance while ensuring that they continue to implement government policy and provide value-for-money.

Moves towards performance management and performance budgeting in some OECD countries, and in increasing numbers of low-income countries, are a response to this dilemma. The central idea is that line ministries are given more autonomy over how they manage their budgets, but have to agree performance targets, which they are accountable for achieving with the resources provided. In OECD countries, this has entailed significant changes in the public expenditure management system. The role of Ministries of Finance in agencies' day-to-day financial management has been reduced, by giving agencies increased authority to incur expenditures and vire between expenditure items, ultimately moving towards the provision of block allocations. Agencies have been allowed to retain fees generated through cost recovery mechanisms and carry-over savings between years. Budget structures have been aligned with agencies mission and activities, by introducing programme budgets, or, as is now the practice in New Zealand, budgets based on outputs, and linking these to standards of service delivery and performance targets. Expenditure proposals are appraised for the purpose of 'strategic control', in relation to agencies' policy relevance, performance and performance targets. Both compliance and performance audits are conducted. Resource accounting systems have been introduced, replacing cash with accrual accounts, and, in the case of the UK and New Zealand, additional capital charges, so that services are fully costed on a comparable basis to the private sector (Blondal 1998; Parry et al., 1997; Premchand 1999).

LDCs are unlikely to achieve such radical changes in their public expenditure management systems in the short term, partly because the maintenance of traditional administrative structures precludes effective managerial autonomy, but also because weak technical and managerial capacity make it difficult to manage comprehensive reforms. Nevertheless, progress has been made in some countries in four key areas: firstly, reduction in central control by Ministries of Finance; secondly, improvements in the flow of resources down to the field level; thirdly, restructuring budgets so that resource allocations are consistent with agencies' missions, objectives and activities; and lastly, increased emphasis on performance measurement and, to a far lesser degree, performance management.

Most LDCs' Ministries of Finance are reluctant to relax central controls for fear that agencies will act irresponsibly, thereby undermining aggregate fiscal discipline, and because they are constrained by legislation where institutions have not been granted formal financial and administrative autonomy. Where expenditure controls have been relaxed this has usually been achieved through administrative measures, such as the simplification of budget line item accounts, increased authority for agencies to vire between accounts and increased authority to incur expenditures without prior Ministry of Finance approval. Managers continue to be held accountable to the Ministries of Finance for inputs rather than outputs. Furthermore, their discretion remains limited, particularly as regards recurrent expenditures. Personnel appointments and levels of remuneration, for instance, continue to be controlled by central Civil Service Boards,

with multiple institutional controls, involving, in the case of Mozambique, approval by three institutions, including the Administrative Court (Auditor). More fundamental changes in the nature of expenditure controls have generally been associated with the introduction of a programme approach supported by donors (see Section 7). Under the Bangladesh Health and Population Sector Programme, for instance, the Ministry of Health has been granted a block allocation for the Development Budget which it is free to allocate between programme activities. Similarly, Uganda, Tanzania and Mozambique are moving towards block allocations for sector programmes (Brown et al., 2000). Even so, in all these countries the Ministries of Finance still retain authority to intervene in agency expenditure management, input controls remain in place and development and recurrent expenditures continue to be segregated, with limited authority to vire between the two.

Measures have also been taken to channel resources directly to field level service delivery units. Where resources are channelled through agency hierarchies, with each responsible for the allocation of resources to subordinate institutions, funds intended for service delivery are often used by administrative bodies. In Uganda, expenditure tracking surveys revealed that only 30% of resources intended for non-salary education and health services actually reached the field level (Ablo and Reinikka, 1998). The Government of Uganda's solution has been to introduce conditional grants, paid by Ministry of Finance and Economic Planning to Districts, who are required to pass the full amount on to schools at a standard rate per pupil enrolled, with mechanisms to ensure transparency (see Section 6). As a result, approximately 90% of funds now reach the schools they were intended for (DfID, 1998).

Elsewhere, cost recovery mechanisms have been used to ensure that funds are available for schools, clinics and other public facilities to cover non-salary expenditures and, in some cases, to pay salary supplements to staff. These can present a major barrier to access by the poor, as has been demonstrated most dramatically by the doubling of primary school enrolments which followed their abolition in Malawi and Uganda. Besides, the actual contributions to total expenditure are usually modest. In Bangladesh, a pilot programme in Thana Health Complexes managed to recover funds equivalent to 5% of their budget allocations (Pearson, 1999), in Ghana locally generated revenues amount to 10% of the health sector budgets (Government of Ghana, 1999). Problems arise where, in the absence of autonomous status, legislation requires fees to be surrendered to the consolidated fund and subsequently reclaimed, usually in the following fiscal year. As in the Bangladesh example, line agencies in most countries have simply ignored this procedure. Nevertheless, the problem illustrates the contradictions that arise when attempts are made to give managers flexibility within traditional administrative structures.

Most budget systems were designed to support systems of accountability based on administrative structures: funds are allocated to Ministries who, in turn, allocate funds to subordinate institutions and departments. This provides little information on the purpose of spending, particularly where allocations are consolidated and controlled at Ministry level, or several agencies are involved in the delivery of a particular service. Similarly, line item account structures have been designed to facilitate administrative control of expenditure, focusing on departmental running costs and components of remuneration. This structure tends to obscure analysis of the economic impact of expenditures, particularly as regards recurrent and capital expenditures and transfers. The first step in budget reform programmes in LDCs—including Mozambique,

Bangladesh, Vietnam, and Uganda - has been to restructure budget classifications so that they support meaningful analysis. This has entailed the introduction of economic functional classifications, based on the international standards established by the UN and IMF, usually through adaptations of existing line item and administrative classifications of expenditure.

Classifications that reflect the purpose of expenditure are more difficult to design and implement. The approach developed in the 1950's and 60's in the USA, and subsequently extended to many OECD and developing countries, was to structure expenditure according to programmes, comprising activities intended to achieve clearly defined objectives. The difficulties encountered in defining appropriate programmes, relating them to goals, assigning expenditures—particularly overheads—and relating programme resources to administrative responsibilities were identified at an early stage and led many countries to abandon this approach (Caidan and Wildavsky, 1980: 159-160; Dean, 1989: 43-70; Schiavo-Campo and Tommasi 1999: Web Version). Notwithstanding these difficulties, a programme structure remains the most effective means of linking resources to government activities and, ultimately, the outputs it achieves. It is, therefore, a useful component of performance management systems. For this reason, several countries are trying to devise simplified programme classifications, often linked to the departmental structures of agencies, which can then be related to agency objectives and activities through functional analysis and so establish clear lines of responsibility.

The design of appropriate performance indicators and targets, comprising a hierarchy of measures of inputs, processes, outputs and outcomes, is crucial to the success of performance management systems. Care should be taken to align indicators with the agencies' mission and objectives, so as to avoid creating perverse incentives: assessing schools on the basis of exam performance, as in the UK, encourages them to exclude less able pupils. They must also be consistent with the responsibilities of various levels of an institution: a nurse may be held responsible for the output of vaccinations, for example, but cannot be held responsible for the overall health status of the population (Schiavo-Campo and Tommasi, 1999: Web Version). Since the collection of information is demanding and expensive, agencies tend to adapt existing information systems that may not fulfil these criteria. Performance information may also become tainted, particularly where it is linked to resource allocations or personal remuneration. In Mozambique, for instance, the use of clinic attendance as the basis for the distribution of medical supplies led to clinics exaggerating their attendance returns. Clearly, triangulation of data, through client surveys for instance, is crucial in these circumstances. Where these problems can be overcome, performance appraisals can spur improved performance by managers, particularly if it allows peer comparisons and benchmarking (Cowper and Samuels, 1999). This can work very powerfully at district level, enabling managers to compare and contrast their performance with other districts and can help to build a spirit of emulation and healthy competition.

Application of performance information in resource allocation decisions is more problematic (Pollitt, 1999). In the absence of programme expenditure classifications it is difficult to assign resources to particular activities and their outputs, instead performance has to be measured at agency level where expenditures cover a wide range of services with different measures of performance. Measures of outcome may suffer from time-lag and sufficiency effects and so may be inappropriate as a basis of resource allocation: increases in spending on vaccinations, for instance, may have an impact on

child mortality rates years ahead and the impact of spending on vaccinations is difficult to discriminate from other variables. Since it is difficult to arrive at standard measures of benefits (outcomes such as increased literacy, reduced mortality, and reductions in criminality), performance information can only support political—rather than purely technical—decisions regarding government-wide spending priorities. It is just as difficult to interpret performance data and formulate an appropriate response at the agency level. Poor performance may result from inadequate financing as well as poor management. It is particularly difficult for politicians and senior managers to rigorously apply sanctions, where—as is often the case in LDCs—managers are not provided with a predictable and reliable flow of funds. Besides, even where managerial failure has contributed to poor performance, reduced funding is hardly a credible threat where key services such as health, education and police are concerned.

Notwithstanding these difficulties, there is a growing awareness that measures of institutional performance are an essential if the efficiency and effectiveness of public spending is to be improved. The key issue is to determine how often performance reviews should take place and the appropriate framework for such analysis. Experience from OECD countries suggests annual reviews do not generate much additional information—particularly where progress is slow—overload Ministries of Finance’s limited analytical capacity and, by constant repetition, dull policy messages. For these reasons, most OECD countries have opted for periodic agency performance reviews, usually on a three or five year cycle, instead of detailed annual monitoring, supplemented by limited information on a range of key indicators presented within the budget documents (Mackay,1996). A longer-term review cycle, however, can only be justified where there is policy stability and a long-term perspective for expenditure planning.

## **5 Improving resource and expenditure planning**

Traditional budgets tend to divorce agency spending decisions from the consideration of aggregate resource constraints. Typically, responsibility for the control of aggregate spending is seen as the sole responsibility of the Ministry of Finance: spending agencies are expected to demand additional resources to meet planned targets and the public’s demand for services. This tension is resolved through an annual negotiation process in which agencies have every incentive to bid high, even where indicative spending limits are set, since proposals will be cut back by the Ministry of Finance anyway. Agency spending demands can be fuelled by the planning process where, as is often the case, Ministries of Finance fail to provide forward expenditure limits or such limits lack credibility (Allan, 1996: 98). Lacking a firm resource constraint, agencies tend to set ambitious targets for the expansion of services which cannot be financed with available resources, undermining confidence in both the planning and budget processes. Politicians can compound these difficulties by making policy decisions relating to investment and service provision outside the context of the planning and budget process or by failing to take into consideration their long-term expenditure implications.

While the weak linkages between planning and budgeting are common world wide, they are particularly acute where Government lacks a comprehensive expenditure plan and the recurrent and development budgets are prepared separately by Ministries of Finance (and Finance Departments in line agencies) and Ministries of Planning (and Planning

Departments in line agencies), often using different time-frames and resource projections. Development budgets and investment programmes tend to be led by donor financed investment without adequate consideration of its impact on recurrent costs, which are mainly financed domestically. Inevitably, this exerts upward pressure on recurrent expenditure until, when government can no longer support recurrent costs, investments are left abandoned, under-utilised or poorly maintained. Paradoxically, owing to this segregation, funds may be allocated to investment in new infrastructure, financed from development budgets, even where operations and maintenance expenditures, financed from recurrent budgets, would generate higher rates of economic return (Pradhan, 1996: 46). Expenditures on road maintenance in Vietnam, for instance, are estimated to meet less than two thirds of the requirement, yet current expenditures amount to scarcely 15% of total sector expenditure (Government of Vietnam, 2000: 69-70).

Effective resource planning is also handicapped by the limited scope for resource reallocation during the budget's annual time-frame. Annual budgets suffer from inheritance and inertia effects, particularly where—as in many LDCs—upwards of 70% of recurrent expenditures are allocated to staff that cannot readily be transferred between institutions. Expenditure analysis to support greater allocative efficiency is constrained by the limited time for review during budget preparation and the institutional separation of expenditure management and planning, monitoring and evaluation functions. Ministries of Finance generally focus attention on agencies' historical expenditure performance, the justification for increases in spending and the composition of inputs, with little attempt to relate inputs to activities or performance as measured by the services provided (outputs) or their impact on the public (outcomes). As a result, little consideration is given to the continued relevance or performance of on-going programmes, even though these constitute the bulk of agency expenditure.

To address these concerns many OECD countries have introduced medium-term resource and expenditure planning tools as a guide for the annual budget process or, in the case of Sweden and the UK, have moved to rolling, multi-year budgets (Allen, 1997: 199-210; Premchand, 1999: 91). Following this trend, the Bretton Woods institutions began to promote Medium Term Budget Frameworks (MTBF) or a Medium Term Expenditure Frameworks (MTEF), with a similar resource and expenditure planning function, in LDCs from the mid 1990s (World Bank, 1997: 27; World Bank 1998: 39-44).

In essence, the MTEF consists of: a “top-down” resource envelope consistent with macro-economic stability and both internal and external resource availability, prepared by core financial management and planning agencies; a “bottom-up” estimate of the current and medium term cost of existing national priorities prepared by line agencies; and a negotiation process which matches the demand for resources with availability through iterative decision making. The first year of the MTEF establishes the budget limits for the coming year; the outer years are indicative, rolled forward by one year and revised during the next budget cycle. Ideally, MTEF expenditure projections are broken down to programme level and linked to output indicators.

The MTEF supports decisions regarding the level and allocation of resources, both government-wide and within spending agencies. It focuses attention on policy rather than the minute detail of budget submissions, by presenting aggregate expenditure projections by sector and programmes. Using alternative scenarios, decision makers can

match aggregate expenditure with resource availability and assess the costs and benefits of policy options. The MTEF also helps to communicate policy, by setting out clear priorities, and provides a basis for negotiations with external financing partners. At a tactical level, forward projections of expenditure allocations help to guide and track the reallocation of resources in line with government's development priorities. Forward projections also facilitate sector planning by indicating the likely flow of resources over a three to five year period, thereby allowing spending agencies to take into account the operations and maintenance requirements of investments and target levels of service delivery. Efficiency and effectiveness can be improved by requiring line agencies to define their mission, objectives and activities and linking expenditure to measures of performance in terms of outputs and outcomes.

MTEFs have been implemented with various degrees of success in Ethiopia, Ghana, Malawi, Mozambique, Tanzania and Uganda, though similar exercises are currently being introduced in a far wider range of countries. In some respects the Uganda MTEF is most advanced of these: the MTEF is now routinely used as the basis for agency budget submissions and forward projections are submitted to parliament. In Malawi and Mozambique, by contrast, the MTEF is prepared for information purposes only, since budget allocations continue to be set largely on an incremental basis. This is partly owing to differences in approach: whereas Uganda started from centrally defined sectoral resource allocations, Malawi and Mozambique began with bottom-up, needs based sector proposals and then sought to match needs with resources. Uganda also accepted that sectoral proposals would, initially, be prepared as rough estimates, while Ghana and Malawi have prepared detailed costings of sector programmes, as the basis of annual budget submissions. Most important of all, the Uganda MTEF has been accepted as a tool of political decision making at Cabinet level, forcing line agencies to take the MoF initiative seriously. It is interesting to note that the factors underlying the success of the Uganda MTEF have been identified as crucial to the successful reintroduction of an MTEF in South Africa in 1998 after a failed attempt in 1994 (Bates, 1997).

A preliminary assessment suggests that MTEFs can improve budgetary outcomes, particularly with regard to expenditure prioritisation. Experience suggests a number of critical success factors:

- Allocational decisions require clearly defined goals and priorities, since there are no hard and fast rules or rigorous techniques to guide the inter-sectoral allocation of resources that lies at the very heart of the MTEF process. In Ghana and Uganda, overall guidance is provided by a long-term “development vision”, supported by sector programmes (see Section 0) jointly developed with donor agencies and reconciled to available resources through the MTEF process.
- Expenditure planning should cover a time-frame that allows decision makers to assess the expenditure implications of policies. For most purposes the three to five year time-frame of a typical MTEF is sufficient to enable resource shifts to be planned, while being short enough for realistic forecasting to be feasible. However, Uganda concluded that longer-term forecasts of resources were also needed, particularly to inform decisions concerning the range, coverage and quality of services that the country can afford to sustain and the feasibility of

achieving long-term development targets, such as the Universal Primary Education.

- Political commitment to the process and willingness to make choices between rival spending priorities are needed if Government is to succeed in reallocating resources, since the MTEF is, after all, merely a tool that presents information to decision makers. In Uganda, the MTEF has been used to identify high priority programmes within the Poverty Action Plan for protection from any cuts which prove necessary. Where ad hoc and inconsistent reallocations of expenditure continue, the MTEF process will lack real content.
- Expenditure priorities should be communicated to spending agencies through hard budget constraints, ideally expressed in cash terms (Allan 1996: 105). Where Ministries of Finance fail to provide expenditure limits, as in Mozambique, spending agencies will fail to prioritise, revert to needs based planning or use the availability of external resources as the basis for setting expenditure and operational targets. If expenditure allocations are revised outside the MTEF process, the MTEF will lack credibility.
- The effort in preparing medium-term forecasts of expenditure is likely to be lost where funds are not released to spending agencies as programmed. This is certainly the experience in Malawi, where discrepancies between the budget and the funds released have undermined the validity and confidence in detailed budget preparation and forward forecasts of expenditure (OPM 2000: 4).
- Expenditure decisions should be taken following an analysis of all the resources available to government. This is only possible where donors provide forward forecasts of resource availability and Government's own resources are consolidated. Where a large proportion of revenues are earmarked for particular purposes, a situation that reaches its extreme in several Latin American countries, but is also common in Africa, Government may be prevented from allocating resources to priority activities. If key programmes are implemented by local government, it may be necessary to extend the MTEF process to this level, as South Africa and Uganda are now doing, if there is to be a meaningful basis for expenditure planning.

Resource allocation decisions undertaken through MTEFs should be informed by feedback on the efficiency and effectiveness of public expenditure. Periodic Public Expenditure Reviews (PERs) assume particular importance in this context, providing more detailed analysis of the structure of expenditure and its outcomes than would be generated through routine budgeting and planning (see Section 4). These reviews fulfil a similar purpose as the periodic expenditure reviews undertaken by the UK Treasury, with parallels in other OECD countries, by providing an opportunity to assess the relevance, efficiency and effectiveness of agency expenditure policy and guide the reallocation of resources (Allen, 1996: 210-220; Premchand, 1999: 91).

Initially developed by the World Bank as a tool to assess compliance with and the impact of structural adjustment reforms, many early PERs were prepared with limited government participation. Inevitably, this undermined the credibility of PERs as a tool for policy makers (World Bank 1998; Toye and Jackson, 1996: 60). Government partnership in the preparation of PERs and ownership of the final report is now the ideal if not the norm, with greater acceptance of the limitations on the scope of analysis and nature of policy prescriptions this may imply. In some cases, notably Uganda and

Tanzania, the PER has been established as a routine integrated within the annual budget process through a formal review of policies and programmes during which agencies prepare their medium term plans and budgets (World Bank 1999). Even so, donors continue to play a significant and occasionally overwhelming role, through sectoral working groups and by providing consultancy inputs, not least because donors view the PER as a means of influencing government policy.

Although most PERs continue to follow the three steps of expenditure analysis—rationale for public spending, allocative efficiency and distributional impact—advocated by Pradhan (1996), there is a growing diversity of approaches and methodologies to suite the requirements of each country and specific sectors. Recent PERs, have tended to focus on the poverty reduction impact of public expenditure, using such techniques as benefit incidence analysis. Increasing attention is also given to the adequacy of public expenditure management systems and governance structures, in recognition of the fact that these are crucial to effective reallocation of resources and improvements in the efficiency and effectiveness of public expenditure.

## **6 Strengthening governance**

From the mid-1990s increasing attention has been given to the role of public expenditure management systems as tools of governance. Governance, in this context, extends beyond the issue of compliance with legislative mandates, in terms of procedure and expenditure policy, which was the central concern of “traditional” public expenditure management. Today, good governance is assessed primarily in terms of the degree of transparency of decision making and policy implementation and, through disclosure, the adequate functioning of mechanisms of public accountability. This reflects a trend towards open-government that is exemplified by the United States and has been followed by most OECD countries.

LDCs are also under pressure to establish effective mechanisms for open, transparent government. The creation of multi-party democracies in the 1990s has been particularly important in this regard by strengthening the role of parliament and creating a demand amongst politicians, the media and constituents for information concerning the use of public funds and the performance of public institutions. Donors and the Bretton Woods institutions have also played a part. Since the early 1990s, most donors have placed much greater emphasis on the quality of governance in determining eligibility for external assistance. For the World Bank, the development of adequate mechanisms of governance is not just seen as a goal worthy in itself but also as a means of improving the efficiency and effectiveness of the public sector and economic performance (World Bank, 1997). Similarly, the IMF stresses that fiscal transparency—and transparency of the banking sector—is crucial in reducing vulnerability to economic shocks (IMF, 2000), particularly so following the Asian Economic Crisis of 1997 which stemmed, in large measure, from inadequate disclosure of risks by governments and banks.

The IMF has assumed a leading role in establishing standards for fiscal transparency. Its “Code of Good Practice”, first issued in 1998 (IMF, 2000: Web Version), sets out four general principles:



- Clarity of the role and responsibilities of government and public financial management institutions. This should be reflected in a clear legal and administrative framework for fiscal management, ideally, laid out in a Framework Law, such as promulgated by Mozambique in 1997;
- Public availability of information on government's fiscal activity, through the publication of historical series on budgets and timely publication of budgets and accounts;
- Open budget preparation, execution and reporting. Under this heading, the Fund calls for budget documentation that specifies the policy basis for the budget decisions, identifies major fiscal risks, and systems for classifying expenditures which facilitate budget analysis. There should be clear and explicit procedures for execution and monitoring, and timely and comprehensive budget reporting systems; and
- An independent national audit body, providing public reporting on the reliability of public expenditure accounting.

Adherence to the Code is voluntary. The intention is to provide a checklist of legislative, institutional and technical requirements to guide Governments in implementing reforms at their own pace. For this purpose, the Code is supported by a questionnaire which enables governments to assess the extent to which their fiscal systems comply with international standards. Most OECD countries have carried out self-assessments (see for instance, HM Treasury (2000: Web Version)) while the IMF has provided assistance to LDCs in carrying out similar reviews (IMF 2000). Furthermore, the standards set by the Code constitute an ideal. Indeed, few OECD countries, let alone LDCs, can be said to comply with its requirements entirely, particularly as regards technically demanding requirements such as the assessment of contingent liabilities. This is unfortunate, since, by failing to set a minimum standard for compliance, there is no benchmark for realistically assessing government's performance. Inevitably, this reduces the value of the Code as a tool for advocacy by local pressure groups and international institutions.

The extent to which improved fiscal transparency can improve governance and performance hinges on the independence, integrity and capacity of parliament, to oversee the budget process and verify budgetary outcomes. In LDCs, however, the scope for parliamentary scrutiny, debate and amendment of Government budget proposals is often extremely limited. Even in a democratic South Africa, parliament has no power to amend the budget and the budget proposal is rushed through the Finance Committee in only seven days (Folscher et al, 1999: 64). Where procedures require parliament to approve or reject the budget in its entirety, without amendment, party loyalties will discourage critical analysis. The work of Parliamentary committees is also handicapped by poor quality budget documentation and lack of independent research facilities. Accounting information, essential to assessments of compliance and performance, is often deficient in terms of its timeliness and coverage (Dean, 1996: 272). In the worst cases, governments simply fail to present final accounts. Mozambique, for instance, presented accounts to parliament in 2000 (covering fiscal year 1998) for the first time since Independence. Parliamentary scrutiny also requires effective support from an independent auditor. Unfortunately, auditors often lack capacity and are not truly independent of the executive. Some governments, notably Kenya, simply ignore auditors' reports, with parliament and courts lacking the authority

to enforce compliance (Zody, 1996: 289). Clearly, development of these democratic and oversight institutions is a long term process.

Progress in improving transparency depends on high level political commitment, which, in turn, often reflects pressures arising from democratisation. Where the democratic transition has advanced, as in South Africa, Mozambique and Uganda, much has been done to open up the public expenditure management system to parliamentary and public scrutiny. Where the democratic transition has stalled, as in Vietnam, progress is painfully slow. International institutions can only provide encouragement in such circumstances. In the case of Vietnam, for instance, the IMF has proposed a gradualist approach, whereby progress can be made by ensuring internal transparency, where decision makers within Government have access to necessary information, and international transparency, for donors and IFIs, before achieving the ultimate goal of public disclosure (IMF and World Bank, 1999). The prospects for success of this gradualist approach in the absence of more fundamental changes in the political system are poor. Where single-party political systems continue, it is difficult to imagine how pressure can be exerted to overcome the vested interest in bureaucratic secrecy and political complicity.

Nevertheless, it is far too simplistic to assume that multi-party elections are a sufficient condition for improvements in transparency and public accountability. Attempts to demonstrate such a link have been ambiguous in their findings (Moore and Putzel, 2000). A few counter examples can be found of relatively undemocratic countries with relatively open and effective public expenditure management (Singapore and, until recently, Uganda, for instance), as well as many more examples of nominally democratic countries where there is little public disclosure and public expenditure management is weak (such as Bangladesh and some Indian States). Clearly, factors other than the electoral process are also important. Moore has suggested, for instance, that the source of Government revenue is extremely important, since countries that obtain most of their revenue from mineral extraction can afford to be less responsive to service users than those countries which rely on a broad based tax system, requiring compliance from a large section of the population. Evidently, our understanding of the relationship between political processes and public sector reform is still limited other than to demonstrate the importance of high level commitment and policy stability in implementing reforms.

For many, good governance extends beyond the public disclosure of information and development of formal mechanisms of accountability through parliament advocated by the IMF to include public involvement in decision making and mechanisms that make decision makers directly accountable to citizens and the clients of public services. It is hoped that, by involving those who are supposed to benefit from government services in decision making, the efficiency and effectiveness of public expenditure will be improved and fraud reduced.

There is a wide spectrum of possible involvement, from simply consulting the users for views on priorities and performance, through to the users having an important role in managing the government funded service or even participating in the budget process. At one level, consultation mechanisms may be introduced as a support to policy formulation. Policy consultation bodies exist in most LDCs, often informally, though these tend to incorporate organised interest groups, such as private sector and union representatives. Direct consultation with the poor is often overlooked. Participatory

Poverty Assessments (PPAs) have proved useful in this context. In Uganda, linkages between the PPA process and planning and budget decisions are facilitated by basing the PPA unit within the Ministry of Finance. This has contributed to a realignment of expenditure priorities, with significant increases in spending on rural water supplies which was identified as a priority by rural women (Norton et al., 2000). Consultation mechanisms may also provide an independent assessment of the quality of services provided by the public sector. Exit surveys have been used to assess waiting times, prescribing practices and informal charges in health facilities in Bangladesh (Government of Bangladesh, 2000). In Bangalore, India, “report cards” have been used to allow citizens and businesses to rate the quality of services, providing a spur to improved performance in the weakest institutions (Gopakumar, 1997: 281-282).

Uganda’s education system provides an example of how public agencies can empower citizens and provide an impetus to performance and accountability in service delivery. Details of all fund releases and how they are spent are published and displayed at all levels down to the school. A June 1998 sample survey found that over 90% of schools and districts do display this information. Government also publishes details of releases, the schools they are intended for, and the use to be made of them, in national and local media. A School Management Committee and School Finance Sub Committee (SFSC), with teachers and non-teachers, approves the school budget and signs the school accounts. One non-teaching member of SFSC is a signatory on the school bank account. These mechanisms have significantly increased the proportion of funds actually reaching schools and the quality of services provided (DfID, 1998). Uganda’s innovative approach is seen as a model for other countries to emulate (IMF and World Bank, 1999b; Web Version).

Experience from elsewhere in Africa suggests that community participation is most effective in the management of village level service delivery units, since villagers have an incentive to ensure that adequate services are provided and can clearly identify when they are not—if, for example, teachers are absent or supplies are not available. Efforts to promote district councils as a representative body with authority over the allocation of resources, as in Zambia, have often foundered because the district may appear as distant and alien as the capital when seen from a village. Particular difficulties are encountered in trying to build in participatory management for services that cover a wide area, where access is competitive and asymmetric knowledge makes it difficult for users to judge quality.

Nevertheless, there are successful experiences of community participation in public expenditure management at local government level. Since 1989 the city of Porto Alegre (Brazil), of 1.3 million citizens, has piloted a “participatory budgeting” process whereby investment budget priorities are debated and proposed by district and neighbourhood assemblies and finally agreed with the city administration (de Sousa Santos, 1998). The poor are active participants in these meetings because they provide an opportunity to determine—not merely influence—the allocation of resources. Such a radical participatory process requires strong political commitment to override the opposition of vested interests. Unsurprisingly, it has often proved difficult to mobilise support from the middle-class. This makes participatory budgeting vulnerable to political change, since it has no legislative basis and can be abolished when political opponents are voted into office. Despite these constraints, participatory budgeting has now been introduced in about 70 cities and two States in Brazil and cities in El Salvador and Ecuador (Drosdoff, 2000). Moreover, advocates propose to extend the approach beyond the

current narrow focus on public works, to address recurrent expenditures—which constitute the bulk of spending—and tax issues which may have greater impact on the middle class (Bretas, 1996: 222).

Jenkins and Goetz (1999: 47-48) argue that the accommodation of civil society within government-led participatory approaches tends to inhibit confrontation with vested, bureaucratic and political interests on key issues, reducing their effectiveness as a means of tackling corruption or poor performance. They suggest that participation is likely to be more effective where institutions are subject to public auditing through full disclosure of information and the confrontation of failure and corrupt practices in local-level, public meetings, following the example of a national NGO in Rajasthan, India. NGOs can provide a useful role at this level, educating citizens about the budget process, its implications and their rights, and supporting them in confrontations with authorities—school directors, politicians and bureaucrats—where their views might otherwise be ignored. Experiences in Brazil suggest that the budget process can provide a focus for debate on key resource allocation, performance and accountability issues even where Municipal Councils oppose public participation and disclosure (Scanlon, 1999).

IDASA's work in South Africa has demonstrated that independent advocacy on budget issues can play an important role at a national level in poorer countries. Through analytical publications—notably its *Women's and Children's Budgets*—media briefings, and advocacy work with politicians, IDASA has focused attention on budget issues and the budget process, contributing to expenditure policy and system reforms (for example IDASA, 1999; Folscher et al.: 1999). IDASA is now providing support to budget advocacy groups in Zambia and Tanzania and international NGOs have shown interest in supporting similar projects in Nigeria and Kenya. Hopefully, increased awareness and media interest in budget issues will provide an impetus to reform in these countries.

## **7 Integrating development assistance**

Since the 1960s stand-alone projects have been an important if not the preferred mechanism for the delivery of development assistance. Projects were seen as a means of targeting aid, thereby increasing the flow of resources to key sectors, regions or social groups. Projects were also considered efficient, since they could apply streamlined donor procedures that bypassed the bureaucratic and sometimes corrupt practices of the recipient government, and transparent, since the outputs could be clearly identified and donor funds could be segregated from those of the recipient government. Bilateral negotiations on the content of donor programmes, followed by project appraisal, leading to the inclusion of projects in a public investment programme, were thought to guarantee consistency with stated policy goals and the availability of adequate domestic resources to ensure project implementation and sustainability (OECD, 1992: 25-29).

In recent years, however, donors have come to recognise that the project mechanism may not support—indeed may undermine—their long-term development goals and, consequently, have begun to explore mechanisms that permit a broader framework for policy dialogue and an integrated, strategic approach to aid delivery. A number of factors lie behind these changes. First, the mobilisation of international support for

International Development Targets has focused attention on the macro-issues of poverty reduction and human development (IMF, OECD, UN and World Bank, 2000). This entails a broader dialogue with recipient governments than a project, or even a donor programme, will allow. The need for broader dialogue also reflects the findings of recent work on aid effectiveness (World Bank, 1998) and accumulated evidence from evaluation studies. It is clear that aid works best where there is a supportive policy environment and Government commitment to and ownership of its reform and development programme. It is also recognised that conditionality has a mixed and largely unsuccessful track record, hence emphasis has changed from coercive conditionality, towards assessment of Government track record and commitment, and encouraging the development of broad-based ownership of the policies being implemented.

Second, donors have come to recognise that aid may be fungible. The implication is that donors cannot target aid at the country level, since recipient governments can adjust the pattern of their spending or financing to offset donor project preferences. If this is true—and there may be grounds for doubt (McGillivray and Morrissey, 2000)—there is little point in earmarking donor support to specific projects or programmes. Instead, donors should appraise the overall pattern of public expenditure, including both domestic and donor financing, seek to influence expenditure policy in directions which are thought to be more effective in reaching donor objectives, and provide flexible programme aid to support the agreed package of reforms and policy measures.

Last, there is growing awareness that the proliferation of donor financed projects can overwhelm Governments in aid dependent countries. This can lead to inconsistencies between recipient government policies and resource allocations, and allocative and operational inefficiencies, where:

- external and domestic resource allocation decisions are segregated, the former conducted through bilateral negotiations and the latter through the budget process, governments feel pressurised to accept assistance or do not consider its opportunity cost;
- donor led investment outstrips domestic financing capacity leading to inadequate provision for operations and maintenance, thereby compromising project sustainability;
- isolated project interventions lead to wide differences in standards of service coverage and institutional performance;
- project specific issues distract attention from overall sector management thereby weakening managerial and administrative capacity; and
- Government officials feel little ownership of projects, and hence limited commitment to the achievement of project objectives and outputs.

The need for broad dialogue on policy issues and a comprehensive framework for assistance, has inspired a number of recent initiatives, notably: the World Bank's Comprehensive Development Framework, the United Nations Development Assistance Framework and the Poverty Reduction and Strategy Paper. These initiatives follow common principles, notably they should be: country led; present a long-term vision and strategy in support of a holistic economic and social-development program, based on broad consultative process; results oriented, with realistic objectives linked to resources and effective feedback mechanisms; and supported by a co-ordinated assistance

programme, integrating both donor and government resources. The World Bank's CDF has been piloted in eleven countries, of which seven are LDCs, since early 1999. A recent World Bank evaluation of these pilots suggests that most of the countries have made progress in developing a "clear vision" and in "strengthening partnership" (World Bank, 2000: 30-35), though what this means in practice is as yet far from clear. Certainly, the implications of the new approach for aid operations have yet to be fully worked out.

The comprehensive approach is not inconsistent with the delivery of project aid. Where recipient governments have the capacity and authority to ensure that project aid supports their development priorities and can be adequately absorbed, well targeted project aid will continue to fulfil a useful role in facilitating innovation and financing investment. China and India fall into this category. In aid dependent countries, however, more appropriate instruments are needed. Recognising the limitations of the project approach and the implications of fungibility, these instruments should integrate assistance within the government's expenditure planning system. The benefits—in terms of reduced transactions costs for government and increased allocative and operational efficiency—will be greater where donor agencies use common financial management and reporting procedures, and greater still where donors provide budget support, channelling funds through Government disbursement and accounting mechanisms. The need for longer-term assistance is also recognised, with the flow of funds in any given year determined on the basis of budgetary and implementation requirements, and the continuation of support over the medium and long-term tied to outputs and outcomes (Weissman and Foster, 2000).

The first step in the move towards a comprehensive framework for assistance for many countries has been the introduction of the Sector Wide Approach (SWAP). This is a process in which all significant funding supports a single sector policy and expenditure programme, Government leads the planning and implementation process, and common—ideally Government—procedures are adopted by donors. The approach has tended to be most successful where the sector is defined in terms of the areas of policy and budget responsibility of a single Ministry. Ideally, sector programmes follow an annual planning cycle synchronised with the budget, within a medium-term time frame synchronised with the MTEF. In Ghana, Uganda, Tanzania and Mozambique, the MTEF establishes the resource envelope within which sector programmes are planned and the annual sector budget (integrating both internal and external resources, and the recurrent and investment budgets) and operational plan are prepared. In this way Ministries of Finance, line agencies and donor agencies reach agreement concerning sector policy, implementation strategies and global resource allocations rather than the activities of individual projects and their budgets (Foster et al, 1999).

The CAPE database includes about eighty sector programmes in 33 countries, 67 of these programmes are in 23 African countries. The majority of the programmes are in the health, education, roads and agricultural sectors. Inevitably, a wide range of approaches and implementation arrangements are applied. Everywhere sector programmes co-exist with projectised aid delivery, though there are increased efforts to ensure government ownership and management of these interventions. Slower progress has been made in the adoption of common procedures and budgetary support. An SPA survey undertaken in mid-1999, suggested that 80% of assistance to sector programmes was provided through projects following donor-specific procedures and only 17% as sectoral budget support (SPA, 1999). There may be sound reasons for donors preferring

not to embark on a risky pooling arrangement in the short-term, not least of which may be the desire not to overwhelm fragile government accounting and treasury systems. Governments may share this concern, even though the pooling arrangements are clearly to their advantage. Progress has often been gradual: initially a few donors channel funds through the system, demonstrating that these can be successfully disbursed and accounted for, leading other donors to come on board once the teething problems have been overcome. There are encouraging signs that the volume of assistance disbursed through government channels will increase over time. In the Ghana Health Programme, pooling arrangements started with a single donor and minimal funding and now account for 40% of external financing.

Adoption of a comprehensive approach has required donors to develop broader, more flexible aid delivery mechanisms. In recent years, the World Bank, for instance, has moved from project aid, to Sector Investment and Maintenance loans (in the 1980s), which allow support to both the recurrent and investment costs, to Sector Programs loans (in the 1990s), supporting broader sector interventions, and then to Adaptable Programme Loans (introduced in 1997), which represent a longer-term commitment with greater flexibility as regards the level of disbursement and nature of outputs. The logical next step is to move upwards, from sector support to general budget support, allowing the Government flexibility in the allocation of resources to support its overall development strategy, as reflected in the PRSP, through its expenditure plan, the MTEF, and budget process. Uganda, Benin and Jordan have been working with the World Bank and other donors on the development of appropriate macro-instruments. These include instruments for investment lending, such as the proposed Public Expenditure Reform Loan, and adjustment lending through Programmatic Sector Adjustment Loans, to support sector work, and, at the macro-level, Poverty Reduction Support Credits as a counterpart to the IMF's Poverty Reduction and Growth Facility (Weissman and Foster, 2000). Bilateral donors are following suit, DFID for, example, has indicated its preference for programmatic instruments at a policy level (DfID, 1997: Web Version), and is currently exploring the possibility of extending the approach to a wide range of country programmes.

Clearly, this approach has implications for the design of other elements of the aid management process and public expenditure management in recipient countries. Owing to fiduciary concerns, donors will only be willing to channel their assistance through Government expenditure management systems where these are transparent and effective, or where the Government has a clear strategy and programme for addressing system weaknesses. Consequently, donors are paying closer attention to the diagnosis of public expenditure management systems through fiscal transparency reviews led by the IMF (see Section 6) and PERs (Section 5), and developing their own instruments and capacity for this purpose (DfID, 2000). The World Bank is now piloting Institutional and Governance Reviews (IGRs) which cover a wide range of policy making and accountability processes, including both core and service delivery functions, and Country Financial Accountability Assessments and Procurement Assessment Reviews (World Bank, 2000). These tools could provide the basis for Government action plans to improve performance in these critical areas, with periodic reviews conducted with other partners providing the basis for collective decisions regarding the Government's achievement of adequate standards. Such assessments of due diligence could, ultimately, become a pre-condition for disbursement of donor funds through government channels.

In order to satisfy fiduciary concerns, sector programme financing agreements often stipulate minimum accounting standards, usually based on those of Government. In Ghana, readiness criteria have been applied to ensure that health districts and other budget management centres in a highly decentralised system have the capacity to manage sector programme funds. Private sector accounting firms are employed to verify compliance, and those that fail to meet these criteria have funds managed at a higher level, for instance by regional authorities. Faced with this incentive, budget management centres have made a considerable effort to put in place the requisite financial controls and nearly all of them qualified to manage their funds. Subsequent audit reports have found few significant problems (Government of Ghana, 2000). Independent auditing, and multiple routes to checking on fund use and effectiveness as in Uganda can increase confidence, and help diagnose where and how the system needs to improve. In Mozambique, where sufficient audit capacity does not exist within government, the Government will contract private firms to carry out audits. At the same time, programme assistance will usually seek to address system weaknesses through a reform programme supported by technical assistance for agencies and Ministries of Finance. Under the Bangladesh Health and Population Sector Programme, for instance, donors provide support to a new ministerial Management Accounting Unit that consolidates accounting information and directs financial management reform and is linked to a government-wide reform programme based in the Ministry of Finance. The significant change in countries like Uganda, a change which is becoming more common, is that attempts to raise financial management performance are moving beyond partial project approaches, towards an overall action plan, based on a diagnosis shared between Government and donor partners, and subject to joint review or progress as part of the dialogue which takes place in the context of donor budget support.

The comprehensive approach also requires a change in focus of monitoring and evaluation. No longer can the activities and outputs of individual projects be the subject of detailed evaluation. Instead, donors must consider the efficiency and effectiveness of a comprehensive sector programme. In this context, the Public Expenditure Review (PER) becomes one of the key monitoring instruments at both sector and macro-level, providing a means of analysing a broad range of expenditure policy and management issues (see Section 5). This, in turn, will require improvements in Governments' monitoring systems so that they generate appropriate performance information and ensure transparency.

For donors, the programme approach offers the advantage of engagement in policy dialogue, reduced fungibility, and sustainable benefits by building capacity within rather than outside Government. The disadvantages are reduced visibility of donor efforts and reduced control, which can present a problem for those making a case for resources. Donors still have a tendency to micro-manage sector programmes as though they were large projects. In the Tanzania Health Programme, for instance, donors are involved in the approval of over one hundred district plans. Donors have also found it difficult to abandon attempts to earmark resources, particularly where the Government's programme includes activities that fall outside donor priorities or mandate. This has led some Governments to complain that donors are only interested in funding the attractive poverty reducing parts of the sector, leaving them excessive earmarked commitments for primary education, for instance, but insufficient funds to improve the quality and coverage of secondary education. Furthermore, donors, not least the World Bank, are still grappling with attempts to adapt their own fiduciary and management systems to accommodate programme instruments.



For Governments, the advantages are greater control of and so increased flexibility in the allocation and application of external assistance, reduced transactions costs in aid management, and the opportunity to mobilise increased volumes of assistance with longer term commitments. The disadvantages are high negotiation costs, which may require compromise, reduced flexibility to adjust the agreed strategy to meet domestic rather than foreign concerns, possible discomfort from intrusive donor scrutiny, and a risk of lost momentum if negotiations are prolonged (agreements on sector programmes have typically taken three years). Governments may fear that donor co-ordination creates opportunities for donors to gang up on Government, giving them undue influence over policy and operational issues. Moreover, budget support poses far higher risks to Government than project commitments. It is easier for donors to interrupt budget support disbursements, since (unlike project aid) they are not bound up in contracts with staff or suppliers, while at the same time it is more difficult for Government to adjust spending on personnel and other operating commitments in the light of lower levels of donor funding. Although donors may question the efficacy of conditionality, particularly where government ownership is considered paramount, it is still widely applied. In Bangladesh's Health and Population Sector Programme, for example, reductions in the proportion of Government expenditure reimbursed from pooled funds have been used to penalise failure to implement policy and operational measures identified in periodic Action Plans.

Furthermore, while there is clearly a trend towards the adoption of programmatic instruments in LDCs, this should not be seen as a panacea. Certainly, where there is no clear government policy, or policy is inconsistent with donors' goals, government systems are not transparent or properly accountable, and management capacity is weak, there is little to be gained from donors adopting a programme approach—though the rationale for project aid is also weak in these circumstances (Foster and Fozzard, 2000). Programmatic instruments are also only likely to be attractive to Governments where there is a substantial commonality of views between Governments and donors. Governments for whom problems of aid management do not loom large—where donor resources are effectively controlled through internal management systems—may prefer to continue with standalone projects with donor influence on the policy process and core management systems by invitation rather than by right.

## **8 Improving the poverty focus of public expenditure**

The introduction of Poverty Reduction Strategy Papers as the basis for accession to IMF, IDA, HIPC and bilateral assistance has placed poverty reduction firmly at the heart of the policy agenda. In all some 52 countries are expected to prepare PRSPs. As of August 2000, two full PRSPs (Uganda and Burkina Faso) and eleven interim-PRSPs have been presented. Attention so far has focused on the policy and planning process, which, in line with the comprehensive approach outlined in Section 6, should follow the principles of country-leadership, broad consultation, partnership between national and international stakeholders, and a focus on results, leading to the development of a medium to long-term strategy with realistic targets reflecting resource availability (IMF and World Bank, 1999b; Web Version). This experience, though admittedly limited, raises important issues regarding the appropriate approach for decision makers in improving the poverty focus of public expenditures, notably with respect to: improvements in the diagnostic basis for policy making; the basis for reallocating

resources to address poverty reduction goals; assessments of the adequacy and sustainability of expenditure; and lastly, the design of mechanisms that ensure transparency in the allocation of resources dedicated to poverty reduction and their protection from cuts during periodic fiscal stabilisation.

Public expenditure planning needs to be informed by a rich, disaggregated analysis of poverty drawing on a range of sources and methodologies. This should allow decision makers to identify which groups within the population are poor, where the poor are geographically, the location of communities with worst social and physical infrastructure and the groups making least use of public services, all of which are important in targeting public interventions. Benefit incidence analysis provides a useful tool in this context, particularly with regard to the distributional impact of public spending on services by income group (see McKay, 2000). However, it is equally important to get beyond this kind of statistical analysis to look at who uses services, who does not and why. Asking the poor directly, through PPAs and exit surveys yields valuable insights into the adequacy of services, the constraints that prevent the poor from using services, and peoples' priorities for improving them (see Section 6). More fundamentally, decision-makers must understand the root causes of poverty, so that these can be addressed.

A number of PRSPs have sought to identify sectors and programmes that are of particular importance to poverty reduction. At first glance, this appears deceptively simple. Priority has usually been given to spending on education, health, rural water supply and rural infrastructure. Finer targeting is supported by numerous studies which have demonstrated that differential access leads to the higher income groups benefiting disproportionately from tertiary and secondary level health and education services, and that spending on primary level services is more likely to benefit the poor (for instance, Castro-Leal et al., 1998). At the same time, an analysis of the current structure of expenditure will often reveal a range of programmes and subsidies that have little justification either in terms of market failure or the distributional impact. On this somewhat simplistic basis, pro-poor reallocations can readily be identified.

There is a danger, however, that a focus on short and medium-term poverty reduction will distract attention from other macro-economic and developmental goals and linkages within the national economy. While there may be a temptation to concentrate investment in rural roads, for instance, it should be remembered that feeder roads need to link into good quality trunk roads, and investments to improve the opportunities for rural traders need to consider the whole chain. There are trade-offs between investments which yield high returns for larger numbers of moderately poor, rather than possibly lower overall returns but more concentrated on the extreme poor. There are difficult judgements on whether the poor benefit more from investments in the areas where they live, or from investments which facilitate migration to areas with better natural resources and access to services. Although good quality of information and analysis will help decision-makers, there is no technically optimum answer to how to reallocate resources: the process remains political and a question of judgement. What is even more difficult, is to build a political consensus around spending priorities. In these circumstances, emphasis must be placed on the quality of policy dialogue and consultation as much as technical input.

The IDTs and the PRSP process encourage Governments to adopt ambitious targets for the expansion of public services. Ideally, these programmes should be fully costed and

the targets reconciled with the available resources, with particular attention to their long-term recurrent cost implications. Progress on this front has been slow. Uganda is perhaps furthest ahead in terms of costing the outputs required to achieve policy goals and relating these to long-term forecasts of resource availability (see Section 4). If this is not done, there is a danger that targets will be set without reference to realistic and sustainable levels of expenditure. Clearly, there is a need for Governments to develop medium and long-term resource and expenditure planning to support this work.

The identification of poverty reduction expenditures has been a matter of concern, both to ensure that funds released from debt service are actually applied in key poverty reduction programmes and that these expenditures are, to some extent, protected from cuts during periodic fiscal stabilisation. Uganda's approach to this issue has been to establish a "Poverty Action Fund" as a mechanism to ensure that resources were directed towards priority poverty reduction programmes identified in the Poverty Eradication Action Plan. The PAF, financed by both donors and government, including the additional resources released through debt relief, is channelled through a special account in the Consolidated Fund. Funds are subsequently allocated through the budget and MTEF process, accounted for using government procedures and consequently are indistinguishable from other releases. To ensure transparency, 5% of funds are retained to cover auditing and monitoring costs (IMF and World Bank, 1999b). This mechanism effectively ring-fences poverty reduction allocations so as to protect them from cuts should the Government become subject to fiscal stabilisation pressures.

The IMF and other observers have voiced scepticism regarding the transferability of the Uganda approach. It requires full transparency of the budget process, to ensure that PAF funds do not substitute for other budget resources and are genuinely additional (IMF and World Bank, 1999b: Web Version 15-17). In countries with a less transparent budget process, such as Mozambique, funds released from debt relief have been identified and allocated in the 2000 budget but changes in the allocation of "core" budget funds are not specifically identified, making debt relief fungible in practice. Concerns have also been raised that protecting PAF funds creates inflexibility and may encourage unsustainable patterns of expenditure. There is some evidence in Uganda that the process has produced an undesirable degree of rigidity, with for example, primary education expenditures protected at levels beyond the level at which they can be effectively spent in the short-term, while secondary education has faced undesirable cuts in fund releases.

## **9 Conclusions**

Given the track record of earlier attempts at public expenditure management reform in LDCs, notably the Planning Programming and Budgeting Systems of the 1970s and 1980s and the investment programmes of the 1980s and 1990s, it is natural for observers and practitioners to be sceptical regarding the likely impact and sustainability of the current wave of reforms. However, Professor Allen Schick—who was involved in previous reform attempts—argues that the new public expenditure management approach is more likely to succeed because it applies a fundamentally different approach. Earlier reforms were technocratic, they believed that expenditure outcomes could be improved by generating better quality information and refining administrative procedures. This approach failed largely because it did not address the underlying

incentives, and associated informational asymmetries, which lead to “good procedures producing bad results” (Schick, 1998b: 7). Public expenditure management has, in contrast, sought to align incentives for managers and agencies with policy goals, whilst simultaneously establishing mechanisms of accountability that can independently enforce rules and assess performance. The challenge for practitioners is to put these principles into practice. This raises a number of questions regarding the appropriate sequencing of reforms and the institutional focus of reform efforts.

Most reform initiatives have first addressed the budgeting and resource planning processes, which are primarily intended to improve allocational efficiency. Improvements in core expenditure management functions—such as treasury management, budget execution, accounting and auditing—which are primarily concerned with improved operational efficiency and accountability, have often lagged far behind. The wisdom of this approach is doubtful. Changes in budgeting and expenditure planning are unlikely to generate significantly improved performance where core functions continue to operate inadequately, since, as the experience of Mozambique and Malawi in introducing an MTEF demonstrates, resources may not be delivered or applied as intended. For the same reason, increased managerial flexibility—the central objective of New Public Management reforms—is unlikely to improve performance or generate the desired outcomes where adequate controls on the application of resources are not in place.

From this perspective, priority should be given to what Schick calls “getting the basics right”: establishing mechanisms that support both the control and management of public resources in order to achieve the goals of macro-economic stabilisation, allocational efficiency and operational efficiency. As adequate controls are put in place, managers can be given progressively more flexibility in the use of resources. The same logic can be applied at the technical level too, since it is clear that complex methods used in OECD countries, such as accrual accounting and performance auditing, are unlikely to succeed where “basic” techniques have failed, where cash accounting systems are not in place and financial audits are not conducted or heeded.

In practice, however, the sequencing of reforms is likely to reflect political expediency, taking into account likely sources of resistance to reform, rather than performance criteria alone. Governments may be keen to innovate and improve the resource allocation process, which, nominally at least, strengthens the role of politicians. They are often less willing to reform core functions, partly because they may face entrenched opposition from vested interests, but also because this will restrict their flexibility and—in the worst cases—reduce opportunities for corruption.

Obviously, reform of the public expenditure management system requires changes to the systems applied throughout the public sector, managed by core Government agencies, such as the Ministry of Finance and Ministries of Planning. This is not to say that initiatives cannot be taken by individual line agencies. Certainly, the introduction of a programme approach to aid delivery (see Section 7) provides both an opportunity and an incentive for line agencies to improve their expenditure planning and internal financial management mechanisms. This is particularly true where donors intend to channel funds through the government system and the requisite controls must be in place. Ultimately, however, the scope for sectoral innovation is constrained by legislation and government procedures, and the failure of government-wide systems and institutions will have to be addressed.

Successful public expenditure management reform cannot, therefore, be dissociated from more fundamental institutional reforms within government. This requires high level commitment to the reform process, in order to push through reforms against the opposition of vested interests both within and outside of government, and some measure of policy stability, since the institutional reforms will take years to implement. It is tempting to believe that a democracy should provide a strong driving force for this kind of change. The creation of representative bodies, through competitive, usually multi-party, elections, at the national and local level, supported by a free press and an independent judiciary, should exert pressure on government and agencies to improve performance and accountability. Unfortunately, the evidence for this assertion is by no means conclusive: progress has been made in the absence of a democratic process—as, until recently, in the case of Uganda—just as many nominal democracies suffer from poor public disclosure and weak public expenditure management. Autocratic regimes may, indeed, enjoy certain advantages in pushing through a reform agenda against vested interests. In the longer-term, however, the prospects for transparent and effective public expenditure management would seem, on balance, much brighter for countries that have passed through a democratic transition and where the institutional framework for adequate parliamentary and public oversight of the public sector have been put in place.

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