DAC Guidelines and Reference Series

Harmonising Donor Practices for Effective Aid Delivery

Volume 2:

BUDGET SUPPORT, SECTOR WIDE APPROACHES AND CAPACITY DEVELOPMENT IN PUBLIC FINANCIAL MANAGEMENT

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ET LE DÉVELOPPEMENT DES CAPACITÉS EN MATIÈRE DE GESTION DES FINANCES PUBLIQUES

Foreword

Aid is in the spotlight as never before. Following the recent commitments made at the Paris High Level Forum on Aid Effectiveness, the European Union Council of May 2005, the G8 summit at Gleneagles, the UN 2005 World summit, the amount of aid provided to less developed countries is expected to increase by nearly 60% (about an additional USD 50 billion) by 2010. Yet aid increases will not help reduce poverty in the absence of major reforms in the way aid is currently managed.

Effective public finance management, including the management of aid flows, is crucial to countries making progress in reducing poverty. Weaknesses in public financial management often reflect underlying interests and incentives, and the reform and strengthening of public financial management requires high-level political leadership and support as well as technical skills. For all these reasons, public financial management is likely to remain at the centre of dialogue between aid agencies and partner country governments. At the same time, donors have both a developmental and a fiduciary interest in the quality of their partners' public financial management. In many countries, especially the poorest ones, aid is a substantial share of public resources; yet donor practices have often inadvertently undermined governments' public financial management systems. The good practice presented in this volume shows how donor practices can instead reinforce, and strengthen the capacity of, public financial management in partner countries. It is based on the work of the Development Assistance Committee (DAC) Working Party on Aid Effectiveness. Building on the guiding principles presented in a first volume published by the OECD in 2003, this volume shows how the donor role is to support, not to substitute for, national efforts to strengthen public financial management. Delivering aid through partner public financial management systems should be at the core of donor support strategies. These should be sensitive to country contexts, make better use of shared analysis and provide more predictable aid within an explicit, government-owned framework that is strategic and programmatic.

More specifically, this second volume focuses on good practice in providing budget support (Chapter 2) and support to sector-wide approaches (Chapter 3). In doing so, it acknowledges the special relevance of public financial management issues for both of these modalities of aid delivery. The last chapter (Chapter 4) is accordingly devoted to setting out good practice in providing support to capacity development for public financial management. This volume is complemented by a substantive annex that outlines the strengthened approach to supporting public financial management reform, and the public financial management performance measurement framework for joint monitoring of progress, that were developed by the PEFA (Public Expenditure and Financial Accountability) programme in close consultation with the Joint Venture on Public Financial Management.

O. Ladipo

Gilles Hervio
For the European Commission
Co-Chair of the Joint Venture
on Public Financial Management

Omowunmi Ladipo
For the World Bank
Co-Chair of the Joint Venture
on Public Financial Management.

Acknowledgments

This volume is based on the work of the Development Assistance Committee (DAC) Working Party on Aid Effectiveness chaired by Michel Reveyrand (France). The working party was established by the DAC to help build partnerships between donors and partner developing countries that deliver more effective aid. Two subgroups of the Working Party produced this volume:

- *The Joint Venture on Public Financial Management, chaired by Paul Bermingham (World Bank) up to June 2004 and David Shand (World Bank) thereafter.*
- *The Task Team on Harmonisation and Alignment, chaired by Bo Westman (Sweden) and Colin Bruce (World Bank).*

The Working Party would like to acknowledge the special contributions of the authors of the various chapters of this volume:

Chapter 1	Introduction – *Stephen Lister (Consultant) in close collaboration with Simon Gill (UK Department for International Development [DfID]) for the section on predictability.*
Chapter 2	Budget Support – *Riccardo Maggi (European Commission [EC]) and Gilles Hervio (EC) in close collaboration with Elliott Harris (International Monetary Fund [IMF]), Jerry Wolgin (World Bank), Brian Ngo (World Bank) and David Shand (World Bank).* *Boxes were provided by Jonathan Beynon (DfID), Richard Gerster (Consultant), Jyette Laursen (Ministry of Foreign Affairs of Denmark), Peter Rundell (EC), Nicola Smithers (Public Expenditure and Financial Accountability [PEFA]) and Helen Tilley (EC).*
Chapter 3	Sector Approaches – *Stephen Lister (Consultant) in close collaboration with Virginia Manzitti (EC) and Nicoletta Merlo (EC). Important contributions were provided by Réal Lavergne (Canadian International Development Agency [CIDA]).*
Chapter 4	Capacity Development in Public Financial Management – *Matthias Witt (Gesellschaft für Technische Zusammenarbeit [GTZ]), Bernard Myers (PEFA), Jörg Oelschläger (GTZ), Nicola Smithers (PEFA).*
Annex	Towards a Strengthened Approach to Supporting Public Financial Management Reform – *Joint World Bank/IMF/PEFA Public Expenditure Working Group.*

The Working Party and its subgroups were open to all members and observer delegations to the DAC including those of the World Bank, the IMF and the United Nations Development Programme. Fifteen partner developing countries were associated with the work of the Working Party: Bangladesh, Bolivia, Cambodia, Ethiopia, Fiji, Kyrgyz Republic, Morocco, Mozambique, Nicaragua, Niger, Senegal, South Africa, Tanzania, Vietnam and Zambia.

Julie Harris edited this volume. It was prepared under the direction of Simon Mizrahi, Administrator at the OECD Directorate for Development Co-operation (DCD) with the assistance of Kjerstin Andreasen.

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Acronyms

DAC	Development Assistance Committee (OECD)
DfID	Department for International Development (United Kingdom)
FMIS	Financial management information system
HIPC	Heavily indebted poor countries
HIPC-AAP	HIPC Public Expenditure Tracking Assessment and Action Plan (IMF/World Bank)
IFI	International financial institution
IMF	International Monetary Fund
IoF	Institute of Finance (Lebanon)
JLOS	Justice, Law and Order Sector
M&E	Monitoring and evaluation
MDG	Millennium Development Goal
MoF	Ministry of Finance
MTEF	Medium-term expenditure framework
NGO	Non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PAF	Poverty Action Fund
PBA	Programme-based approach
PEFA	Public Expenditure and Financial Accountability
PER	Public expenditure review
PFM	Public financial management
PIP	Public investment programme
PRBS	Poverty reduction budget support
PRGF	Poverty reduction and growth facility
PRS	Poverty reduction strategy
PRSC	Poverty reduction support credit
PRSP	Poverty reduction strategy paper
RRA	Rwanda Revenue Authority
SDP	Sector development programme
SPA	Strategic Partnership with Africa
SWAp	Sector-wide approach
UNDP	United Nations Development Programme

Paris Declaration on Aid Effectiveness

The Paris Declaration on Aid Effectiveness was endorsed on 2 March 2005 at the Second High Level Forum by more than 100 donor and developing countries and multilateral agencies.

I. Statement of Resolve

1. We, Ministers of developed and developing countries responsible for promoting development and Heads of multilateral and bilateral development institutions, meeting in Paris on 2 March 2005, resolve to take far-reaching and monitorable actions to reform the ways we deliver and manage aid as we look ahead to the UN five-year review of the Millennium Declaration and the Millennium Development Goals (MDGs) later this year. As in Monterrey, we recognise that while the volumes of aid and other development resources must increase to achieve these goals, aid effectiveness must increase significantly as well to support partner country efforts to strengthen governance and improve development performance. This will be all the more important if existing and new bilateral and multilateral initiatives lead to significant further increases in aid.

2. At this High-Level Forum on Aid Effectiveness, we followed up on the Declaration adopted at the High-Level Forum on Harmonisation in Rome (February 2003) and the core principles put forward at the Marrakech Roundtable on Managing for Development Results (February 2004) because we believe they will increase the impact aid has in reducing poverty and inequality, increasing growth, building capacity and accelerating achievement of the MDGs.

Scale up for more effective aid

3. We reaffirm the commitments made at Rome to harmonise and align aid delivery. We are encouraged that many donors and partner countries are making aid effectiveness a high priority, and we reaffirm our commitment to accelerate progress in implementation, especially in the following areas:

i. Strengthening partner countries' national development strategies and associated operational frameworks *e.g.*, planning, budget, and performance assessment frameworks).

ii. Increasing alignment of aid with partner countries' priorities, systems and procedures and helping to strengthen their capacities.

iii. Enhancing donors' and partner countries' respective accountability to their citizens and parliaments for their development policies, strategies and performance.

iv. Eliminating duplication of efforts and rationalising donor activities to make them as cost-effective as possible.

v. Reforming and simplifying donor policies and procedures to encourage collaborative behaviour and progressive alignment with partner countries' priorities, systems and procedures.

vi. Defining measures and standards of performance and accountability of partner country systems in public financial management, procurement, fiduciary safeguards and environmental assessments, in line with broadly accepted good practices and their quick and widespread application.

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4. We commit ourselves to taking concrete and effective action to address the remaining challenges, including:

i. Weaknesses in partner countries' institutional capacities to develop and implement results-driven national development strategies.

ii. Failure to provide more predictable and multi-year commitments on aid flows to committed partner countries.

iii. Insufficient delegation of authority to donors' field staff, and inadequate attention to incentives for effective development partnerships between donors and partner countries.

iv. Insufficient integration of global programmes and initiatives into partner countries' broader development agendas, including in critical areas such as HIV/AIDS.

v. Corruption and lack of transparency, which erode public support, impede effective resource mobilisation and allocation and divert resources away from activities that are vital for poverty reduction and sustainable economic development. Where corruption exists, it inhibits donors from relying on partner country systems.

5. We acknowledge that enhancing the effectiveness of aid is feasible and necessary across all aid modalities. In determining the most effective modalities of aid delivery, we will be guided by development strategies and priorities established by partner countries. Individually and collectively, we will choose and design appropriate and complementary modalities so as to maximise their combined effectiveness.

6. In following up the Declaration, we will intensify our efforts to provide and use development assistance, including the increased flows as promised at Monterrey, in ways that rationalise the often excessive fragmentation of donor activities at the country and sector levels.

Adapt and apply to differing country situations

7. Enhancing the effectiveness of aid is also necessary in challenging and complex situations, such as the tsunami disaster that struck countries of the Indian Ocean rim on 26 December 2004. In such situations, worldwide humanitarian and development assistance must be harmonised within the growth and poverty reduction agendas of partner countries. In fragile states, as we support state-building and delivery of basic services, we will ensure that the principles of harmonisation, alignment and managing for results are adapted to environments of weak governance and capacity. Overall, we will give increased attention to such complex situations as we work toward greater aid effectiveness.

Specify indicators, timetable and targets

8. We accept that the reforms suggested in this Declaration will require continued high-level political support, peer pressure and coordinated actions at the global, regional and country levels. We commit to accelerate the pace of change by implementing, in a spirit of mutual accountability, the Partnership Commitments presented in Section II and to measure progress against 12 specific indicators that we have agreed today and that are set out in Section III of this Declaration.

9. As a further spur to progress, we will set targets for the year 2010. These targets, which will involve action by both donors and partner countries, are designed to track and encourage progress at the global level among the countries and agencies that have agreed to this Declaration. They are not intended to prejudge or substitute for any targets that individual partner countries may wish to set. We have agreed today to set five preliminary targets against indicators as shown in Section III. We agree to review these preliminary targets and to adopt targets against the remaining indicators as shown in Section III before the UNGA Summit in September 2005; and we

ask the partnership of donors and partner countries hosted by the DAC to prepare for this urgently[1]. Meanwhile, we welcome initiatives by partner countries and donors to establish their own targets for improved aid effectiveness within the framework of the agreed Partnership Commitments and Indicators of Progress. For example, a number of partner countries have presented action plans, and a large number of donors have announced important new commitments. We invite all participants who wish to provide information on such initiatives to submit it by 4 April 2005 for subsequent publication.

Monitor and evaluate implementation

10. Because demonstrating real progress at country level is critical, under the leadership of the partner country we will periodically assess, qualitatively as well as quantitatively, our mutual progress at country level in implementing agreed commitments on aid effectiveness. In doing so, we will make use of appropriate country level mechanisms.

11. At the international level, we call on the partnership of donors and partner countries hosted by the DAC to broaden partner country participation and, by the end of 2005, to propose arrangements for the medium term monitoring of the commitments in this Declaration. In the meantime, we ask the partnership to co-ordinate the international monitoring of the Indicators of Progress included in Section III; to refine targets as necessary; to provide appropriate guidance to establish baselines; and to enable consistent aggregation of information across a range of countries to be summed up in a periodic report. We will also use existing peer review mechanisms and regional reviews to support progress in this agenda. We will, in addition, explore independent cross-country monitoring and evaluation processes – which should be applied without imposing additional burdens on partners – to provide a more comprehensive understanding of how increased aid effectiveness contributes to meeting development objectives.

12. Consistent with the focus on implementation, we plan to meet again in 2008 in a developing country and conduct two rounds of monitoring before then to review progress in implementing this Declaration.

II. Partnership Commitments

13. Developed in a spirit of mutual accountability, these Partnership Commitments are based on the lessons of experience. We recognise that commitments need to be interpreted in the light of the specific situation of each partner country.

Ownership – Partner countries exercise effective leadership over their development policies, and strategies and co-ordinate development actions

14. **Partner countries** commit to:

- Exercise leadership in developing and implementing their national development strategies[2] through broad consultative processes.
- Translate these national development strategies into prioritised results-oriented operational programmes as expressed in medium-term expenditure frameworks and annual budgets **(Indicator 1).**
- Take the lead in co-ordinating aid at all levels in conjunction with other development resources in dialogue with donors and encouraging the participation of civil society and the private sector.

15. **Donors** commit to:

- Respect partner country leadership and help strengthen their capacity to exercise it.

Alignment – Donors base their overall support on partner countries' national development strategies, institutions and procedures

Donors align with partners' strategies

16. **Donors** commit to:

- Base their overall support – country strategies, policy dialogues and development co-operation programmes – on partners' national development strategies and periodic reviews of progress in implementing these strategies[3] (**Indicator 3**).
- Draw conditions, whenever possible, from a partner's national development strategy or its annual review of progress in implementing this strategy. Other conditions would be included only when a sound justification exists and would be undertaken transparently and in close consultation with other donors and stakeholders.
- Link funding to a single framework of conditions and/or a manageable set of indicators derived from the national development strategy. This does not mean that all donors have identical conditions, but that each donor's conditions should be derived from a common streamlined framework aimed at achieving lasting results.

Donors use strengthened country systems

17. Using a country's own institutions and systems, where these provide assurance that aid will be used for agreed purposes, increases aid effectiveness by strengthening the partner country's sustainable capacity to develop, implement and account for its policies to its citizens and parliament. Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management, accounting, auditing, procurement, results frameworks and monitoring.

18. Diagnostic reviews are an important – and growing – source of information to governments and donors on the state of country systems in partner countries. Partner countries and donors have a shared interest in being able to monitor progress over time in improving country systems. They are assisted by performance assessment frameworks, and an associated set of reform measures, that build on the information set out in diagnostic reviews and related analytical work.

19. **Partner countries** and **donors** jointly commit to:

- Work together to establish mutually agreed frameworks that provide reliable assessments of performance, transparency and accountability of country systems **(Indicator 2).**
- Integrate diagnostic reviews and performance assessment frameworks within country-led strategies for capacity development.

20. **Partner countries** commit to:

- Carry out diagnostic reviews that provide reliable assessments of country systems and procedures.
- On the basis of such diagnostic reviews, undertake reforms that may be necessary to ensure that national systems, institutions and procedures for managing aid and other development resources are effective, accountable and transparent.
- Undertake reforms, such as public management reform, that may be necessary to launch and fuel sustainable capacity development processes.

21. **Donors** commit to:

- Use country systems and procedures to the maximum extent possible. Where use of country systems is not feasible, establish additional safeguards and measures in ways that strengthen rather than undermine country systems and procedures **(Indicator 5).**
- Avoid, to the maximum extent possible, creating dedicated structures for day-to-day management and implementation of aid-financed projects and programmes **(Indicator 6).**
- Adopt harmonised performance assessment frameworks for country systems so as to avoid presenting partner countries with an excessive number of potentially conflicting targets.

Partner countries strengthen development capacity with support from donors

22. The capacity to plan, manage, implement, and account for results of policies and programmes, is critical for achieving development objectives – from analysis and dialogue through implementation, monitoring and evaluation. Capacity development is the responsibility of partner countries with donors playing a support role. It needs not only to be based on sound technical analysis, but also to be responsive to the broader social, political and economic environment, including the need to strengthen human resources.

23. **Partner countries** commit to:

- Integrate specific capacity strengthening objectives in national development strategies and pursue their implementation through country-led capacity development strategies where needed.

24. **Donors** commit to:

Align their analytic and financial support with partners' capacity development objectives and strategies, make effective use of existing capacities and harmonise support for capacity development accordingly **(Indicator 4)**.

Strengthen public financial management capacity

25. **Partner countries** commit to:

- Intensify efforts to mobilise domestic resources, strengthen fiscal sustainability, and create an enabling environment for public and private investments.
- Publish timely, transparent and reliable reporting on budget execution.
- Take leadership of the public financial management reform process.

26. **Donors** commit to:

- Provide reliable indicative commitments of aid over a multi-year framework and disburse aid in a timely and predictable fashion according to agreed schedules **(Indicator 7).**
- Rely to the maximum extent possible on transparent partner government budget and accounting mechanisms **(Indicator 5).**

27. **Partner countries** and **donors** jointly commit to:

- Implement harmonised diagnostic reviews and performance assessment frameworks in public financial management.

Strengthen national procurement systems

28. **Partner countries** and **donors** jointly commit to:

- Use mutually agreed standards and processes[4] to carry out diagnostics, develop sustainable reforms and monitor implementation.
- Commit sufficient resources to support and sustain medium and long-term procurement reforms and capacity development.
- Share feedback at the country level on recommended approaches so they can be improved over time.

29. **Partner countries** commit to take leadership and implement the procurement reform process.

30. **Donors** commit to:

- Progressively rely on partner country systems for procurement when the country has implemented mutually agreed standards and processes **(Indicator 5**).
- Adopt harmonised approaches when national systems do not meet mutually agreed levels of performance or donors do not use them.

Untie aid: getting better value for money

31. Untying aid generally increases aid effectiveness by reducing transaction costs for partner countries and improving country ownership and alignment. **DAC Donors** will continue to make progress on untying as encouraged by the 2001 DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries (**Indicator 8**).

Harmonisation – Donors' actions are more harmonised, transparent and collectively effective

Donors implement common arrangements and simplify procedures

32. **Donors** commit to:

- Implement the donor action plans that they have developed as part of the follow-up to the Rome High-Level Forum.
- Implement, where feasible, common arrangements at country level for planning, funding (*e.g.* joint financial arrangements), disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows. Increased use of programme-based aid modalities can contribute to this effort (**Indicator 9**).
- Work together to reduce the number of separate, duplicative, missions to the field and diagnostic reviews (**Indicator 10**); and promote joint training to share lessons learnt and build a community of practice.

Complementarity: more effective division of labour

33. Excessive fragmentation of aid at global, country or sector level impairs aid effectiveness. A pragmatic approach to the division of labour and burden sharing increases complementarity and can reduce transaction costs.

34. **Partner countries** commit to:

- Provide clear views on donors' comparative advantage and on how to achieve donor complementarity at country or sector level.

35. **Donors** commit to:

- Make full use of their respective comparative advantage at sector or country level by delegating, where appropriate, authority to lead donors for the execution of programmes, activities and tasks.
- Work together to harmonise separate procedures.

Incentives for collaborative behaviour

36. **Donors** and **partner countries** jointly commit to:

- Reform procedures and strengthen incentives–including for recruitment, appraisal and training–for management and staff to work towards harmonisation, alignment and results.

Delivering effective aid in fragile states[5]

37. The long-term vision for international engagement in fragile states is to build legitimate, effective and resilient state and other country institutions. While the guiding principles of effective aid apply equally to fragile states, they need to be adapted to environments of weak ownership and capacity and to immediate needs for basic service delivery.

38. **Partner countries** commit to:

- Make progress towards building institutions and establishing governance structures that deliver effective governance, public safety, security, and equitable access to basic social services for their citizens.
- Engage in dialogue with donors on developing simple planning tools, such as the transitional results matrix, where national development strategies are not yet in place.
- Encourage broad participation of a range of national actors in setting development priorities.

39. **Donors** commit to:

- Harmonise their activities. Harmonisation is all the more crucial in the absence of strong government leadership. It should focus on upstream analysis, joint assessments, joint strategies, co-ordination of political engagement; and practical initiatives such as the establishment of joint donor offices.
- Align to the maximum extent possible behind central government-led strategies or, if that is not possible, donors should make maximum use of country, regional, sector or non-government systems.
- Avoid activities that undermine national institution building, such as bypassing national budget processes or setting high salaries for local staff.
- Use an appropriate mix of aid instruments, including support for recurrent financing, particularly for countries in promising but high-risk transitions.

Promoting a harmonised approach to environmental assessments

40. Donors have achieved considerable progress in harmonisation around environmental impact assessment (EIA) including relevant health and social issues at the project level. This progress needs to be deepened, including on addressing implications of global environmental issues such as climate change, desertification and loss of biodiversity.

41. **Donors** and **partner countries** jointly commit to:

- Strengthen the application of EIAs and deepen common procedures for projects, including consultations with stakeholders; and develop and apply common approaches for “strategic environmental assessment” at the sector and national levels.
- Continue to develop the specialised technical and policy capacity necessary for environmental analysis and for enforcement of legislation.

42. Similar harmonisation efforts are also needed on other cross-cutting issues, such as gender equality and other thematic issues including those financed by dedicated funds.

Managing for results – Managing resources and improving decision-making for results

43. Managing for results means managing and implementing aid in a way that focuses on the desired results and uses information to improve decision-making.

44. **Partner countries** commit to:

- Strengthen the linkages between national development strategies and annual and multi-annual budget processes.
- Endeavour to establish results-oriented reporting and assessment frameworks that monitor progress against key dimensions of the national and sector development strategies; and that these frameworks should track a manageable number of indicators for which data are cost-effectively available **(Indicator 11).**

45. **Donors** commit to:

- Link country programming and resources to results and align them with effective partner country performance assessment frameworks, refraining from requesting the introduction of performance indicators that are not consistent with partners' national development strategies.
- Work with partner countries to rely, as far as possible, on partner countries' results-oriented reporting and monitoring frameworks.
- Harmonise their monitoring and reporting requirements, and, until they can rely more extensively on partner countries' statistical, monitoring and evaluation systems, with partner countries to the maximum extent possible on joint formats for periodic reporting.

46. **Partner countries** and **donors** jointly commit to:

- Work together in a participatory approach to strengthen country capacities and demand for results based management.

Mutual accountability – Donors and partners are accountable for development results

47. A major priority for partner countries and donors is to enhance mutual accountability and transparency in the use of development resources. This also helps strengthen public support for national policies and development assistance.

- 48. **Partner countries** commit to:
- Strengthen as appropriate the parliamentary role in national development strategies and/or budgets.
- Reinforce participatory approaches by systematically involving a broad range of development partners when formulating and assessing progress in implementing national development strategies.

49. **Donors** commit to:

- Provide timely, transparent and comprehensive information on aid flows so as to enable partner authorities to present comprehensive budget reports to their legislatures and citizens.

50. **Partner countries** and **donors** commit to:

- Jointly assess through existing and increasingly objective country level mechanisms mutual progress in implementing agreed commitments on aid effectiveness, including the Partnership Commitments **(Indicator 12).**

1. **Important Note:** In accordance with paragraph 9 of the Declaration, the partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) comprising OECD/DAC members, partner countries and multilateral institutions, met twice, on 30-31 May 2005 and on 7-8 July 2005 to adopt, and review where appropriate, the targets for the twelve Indicators of Progress. At these meetings an agreement was reached on the targets presented under Section III of the present Declaration. This agreement is subject to reservations by one donor on *a)* the methodology for assessing the quality of locally-managed procurement systems (relating to targets 2b and 5b) and *b)* the acceptable quality of public financial management reform programmes (relating to target 5a.ii). Further discussions are underway to address these issues. The targets, including the reservation, have been notified to the Chairs of the High-level Plenary Meeting of the 60th General Assembly of the United Nations in a letter of 9 September 2005 by Mr. Richard Manning, Chair of the OECD Development Assistance Committee (DAC).
2. The term "national development strategies" includes poverty reduction and similar overarching strategies as well as sector and thematic strategies.
3. This includes, for example, the Annual Progress Review of the Poverty Reduction Strategies (APR).
4. Such as the processes developed by the joint OECD-DAC/World Bank Round Table on Strengthening Procurement Capacities in Developing Countries.
5. The following section draws on the draft Principles for Good International Engagement in Fragile States, which emerged from the Senior Level Forum on Development Effectiveness in Fragile States (London, January 2005).

III. Indicators of Progress

To be measured nationally and monitored internationally

	Ownership		Target for 2010
1	*Partners have operational development strategies* – Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.		**At least 75% of partner countries** have operational development strategies.
	Alignment		**Targets for 2010**
2	*Reliable country systems* – Number of partner countries that have procurement and public financial management systems that either *a)* adhere to broadly accepted good practices or *b)* have a reform programme in place to achieve these.		**(a) Public financial management – Half of partner countries** move up at least one measure (*i.e.*, 0.5 points) on the PFM/CPIA (Country Policy and Institutional Assessment) scale of performance. **(b) Procurement – One-third of partner countries** move up at least one measure (*i.e.*, from D to C, C to B or B to A) on the four-point scale used to assess performance for this indicator.
3	*Aid flows are aligned on national priorities* – Per cent of aid flows to the government sector that is reported on partners' national budgets.		**Halve the gap –** halve the proportion of aid flows to government sector not reported on government's budget(s) (with at least 85% reported on budget).
4	*Strengthen capacity by co-ordinated support* – Per cent of donor capacity-development support provided through co-ordinated programmes consistent with partners' national development strategies.		**50% of technical co-operation flows** are implemented through co-ordinated programmes consistent with national development strategies.
5a	*Use of country public financial management systems* – Per cent of donors and of aid flows that use public financial management systems in partner countries, which either *a)* adhere to broadly accepted good practices or *b)* have a reform programme in place to achieve these.	**Score**[1]	**Target**
			Per cent of donors
		5+	**All donors** use partner countries' PFM systems.
		3.5 to 4.5	**90% of donors** use partner countries' PFM systems.
			Per cent of aid flows
		5+	**A two-thirds reduction** in the *% of aid* to the public sector not using partner countries' PFM systems.
		3.5 to 4.5	**A one-third reduction** in the *% of aid* to the public sector not using partner countries' PFM systems.
5b	*Use of country procurement systems* – Per cent of donors and of aid flows that use partner country procurement systems which either *a)* adhere to broadly accepted good practices or *b)* have a reform programme in place to achieve these.		**Per cent of donors**
		A	**All donors** use partner countries' procurement systems.
		B	**90% of donors** use partner countries' procurement systems.
			Per cent of aid flows
		A	**A two-thirds reduction** in the *% of aid* to the public sector not using partner countries' procurement systems.
		B	**A one-third reduction** in the *% of aid* to the public sector not using partner countries' procurement systems.
6	*Strengthen capacity by avoiding parallel implementation structures* – Number of parallel project implementation units (PIUs) per country.		**Reduce by two-thirds** the stock of parallel project implementation units (PIUs).
7	*Aid is more predictable* – Per cent of aid disbursements released according to agreed schedules in annual or multi-year frameworks.		**Halve the gap –** halve the proportion of aid not disbursed within the fiscal year for which it was scheduled.
8	*Aid is untied* – Per cent of bilateral aid that is untied.		**Continued progress over time.**
	Harmonisation		**Targets for 2010**
9	*Use of common arrangements or procedures* – Per cent of aid provided as programme-based approaches		**66% of aid flows** are provided in the context of programme-based approaches.
10	*Encourage shared analysis* – Per cent of *a)* field missions and/or *b)* country analytic work, including diagnostic reviews that are joint.		**(a) 40% of donor missions** to the field are joint. **(b) 66% of country analytic work is joint.**
	Managing for results		**Target for 2010**
11	*Results-oriented frameworks* – Number of countries with transparent and monitorable performance assessment frameworks to assess progress against *a)* the national development strategies and *b)* sector programmes.		**Reduce the gap by one-third –** Reduce the proportion of countries without transparent and monitorable performance assessment frameworks by one-third.
12	*Mutual accountability* – Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.		**All partner countries** have mutual assessment reviews in place.

1. **Note on Indicator 5:** Scores for Indicator 5 are determined by the methodology used to measure quality of procurement and public financial management systems under Indicator 2 above.

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Harmonising Donor Practices for Effective Aid Delivery

Chapter 1

Introduction

The Millennium Development Goals have provided a sharper focus – and an unmistakable challenge – to international aid efforts. The Monterrey Summit of 2002 proposed to approach this challenge through a new partnership based on mutual responsibility and accountability between developed and developing countries in support of sound policies, good governance and the rule of law (United Nations, 2002). The summit emphasised the principle that each country has primary responsibility for its own economic and social development.

The Monterrey Summit also specifically challenged development co-operation agencies to harmonise and strengthen their procedures so as to increase country ownership and support more effective utilisation of aid. An OECD Development Assistance Committee (DAC) Task Force on Donor Practices prepared a good practice paper on *Harmonising Donor Practices for Effective Aid Delivery* that was endorsed by the High-level Forum on Harmonisation that took place in Rome in February 2003. It puts forward practical guidance on how donors can support partner country ownership by harmonising their procedures. While this document is applicable to all modalities of aid delivery, it is of particular relevance to project support.

This second volume of good practices focuses more specifically on good practice in providing budget support (Chapter 2) and support to sector wide approaches (Chapter 3). In doing so, it acknowledges the special relevance of public financial management issues for both of these modalities of aid delivery (see below). This is why the last chapter of this volume (Chapter 4) is devoted to setting out good practice in providing support to capacity development for public financial management. This chapter, and the others, is complemented by a substantive annex that outlines a proposed approach to supporting improved public financial management performance. The annexe was developed by the PEFA programme (Public Expenditure and Financial Accountability) in close consultation with the DAC Joint Venture on Public Financial Management.

Purpose and relevance

Good practices are a point of reference

Good practices are a point of reference rather than a matter of prescription for all development agencies, in all countries, at all times. They should be applied with flexibility and take into account partner country circumstances and donors' institutional mandates.

What are "good practices"?

The DAC Working Party is a partnership that pools the experiences of donors (bilateral, multilateral and global funds) and partner countries.[1] The aim is to learn lessons and to disseminate good practices that can enhance future performance. The resulting good practice papers identify key principles and give practical examples of donor practices. It is recognised that good practices continue to evolve and need to be adapted to the circumstances of specific agencies and countries. Furthermore, good practices establish benchmarks for donor performance and provide a transparent basis for donor accountability.

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Guidance for whom?

DAC's mandate is to provide guidance primarily for donors. However this guidance, especially in the context of a partnership, is also likely to be of value to partner countries when they design their programmes. Donors, for example, will be more inclined to provide more predictable medium-term funding where partner countries have realistic and well-prioritised medium-term expenditure frameworks (MTEFs). An increasing emphasis on aligning with partner-country strategies requires broadly shared objectives, common diagnosis, and mutual accountability for performance. The aim is a virtuous circle where aid supports the strengthening of developing country capacity, which in turn encourages more effective, and integrated, use of aid. Thus, this volume outlines, in a spirit of mutual accountability, certain implications for partner countries' behaviour, and it proposes criteria for assessing donor performance. Partnerships require more collaboration not only between donors and partners but also between donors. Therefore, many of the good practices in this volume are about how donors can work together more effectively at the country level.

Why focus on public finance management and capacity development?

Effective public finance management is crucial to countries making progress in reducing poverty. It is fundamental both to government performance and to successful aid delivery. Problems in service delivery in key sectors often have their origins in weak public financial management (PFM). Moreover, PFM is much more than a technical matter – it encompasses sound policy formulation and budget prioritisation as well as effective and transparent financial management during implementation.

Donors have both a developmental and a fiduciary interest in the quality of their partners' PFM. In many countries, especially the poorest ones, aid is a substantial share of public resources and the way that aid is managed is an important determinant of overall PFM. Donor practices have often unwittingly exacerbated the weaknesses of governments' PFM. This volume shows how donor practices can instead reinforce, and strengthen the capacity of, PFM in partner countries. Weaknesses in PFM often reflect underlying interests and incentives, and the reform and strengthening of PFM requires high-level political leadership and support as well as technical skills. For all these reasons, PFM is likely to remain at the centre of dialogue between aid agencies and partner country governments.

Which aid modalities are relevant?

Aid is provided through a mix of modalities including project, sector and budget support. Within each of these modalities there are many possible aid instruments – *e.g.* poverty reduction support credits (PRSCs) and poverty reduction and growth facilities (PRGFs) are two instruments of budget support.[2] It is not the purpose of this volume to advocate one modality over another. This is not to say that the choice of modalities is unimportant: circumstances will determine which among different modalities and instruments are more effective, and more conducive to the strengthening of PFM. A key challenge for donors individually and collectively is to choose and design appropriate and complementary aid instruments so as to maximise their combined effectiveness.

This volume deals successively with budget support, sector-wide approaches and capacity building for PFM. These are all areas where collaboration among donors and with partner governments is essential. Although project-based aid is not treated as a separate topic, the good practices described do have a bearing on project aid as well as other modalities. Very often, technical co-operation and capacity-building assistance that supports PFM is delivered through projects, and the way that projects are managed has implications for partner PFM systems. Chapter 3 notes that they may be, and usually are, supported by a range of aid instruments: a successful sector approach will co-ordinate all forms of support to the sector. Thus, these good practices are relevant to all aid modalities.

Principal topics

Chapter 2 addresses the design and management issues that arise when donors have decided to provide **budget support**. It puts forward a set of good practices on how donors can best deliver budget support in ways that maximise its developmental benefits while reinforcing partners' capacity to achieve aggregate fiscal discipline, strategic allocation of funds, value for money, and probity in the use of public monies – these are all key objectives of public financial management systems. It also provides donors with benchmarks for behaviour when providing budget support.

Chapter 3 focuses on **sector approaches**. It provides operational guidance on how to establish, at the sector level, partnerships between governments and donors that improve the effectiveness of development policies and broaden government ownership over public sector policy and allocation of resources. Where such partnerships have already been established, it suggests how they may be further developed and enhanced. Again, the implications for public finance management are a crucial consideration.

Chapter 4 describes good practices donors can apply to support **capacity development in the area of PFM**. Case studies illustrate how effective support of capacity development is beginning to take shape in a few countries and it provides guidance to donor organisations looking to improve the effectiveness of aid delivery aimed at capacity development in PFM.

The Annex underpins all of the above chapters. It sets out a proposed approach to **supporting improved public financial management performance** through aligning donor and international financial institution (IFI) assistance to country-led programmes of work.

Guiding principles and common themes

Building on the guiding principles presented in the first good practice paper,[3] four basic principles underpin this volume:

1. **Partner country ownership is essential:** each country has responsibility for its own development, and the donor role is to *support*, *not to substitute for*, national efforts.
2. Effective and accountable **partner country PFM is vital** for effective poverty reduction, and delivering aid through partner PFM systems is at the core of strategies to strengthen PFM. The approach should be "concurrent capacity building" in which PFM systems are simultaneously used and strengthened.
3. **Donors need to act within an explicit, government-owned framework that is strategic and programmatic**. Fragmented and piecemeal initiatives by donors – whether in strengthening PFM or in substantive poverty reduction – are unlikely to be effective. Increasingly this requires that donors work jointly with governments and with each other.
4. **Donors need to be sensitive to country contexts**, taking account of country-specific institutions and priorities, recognising that donor behaviour may affect the in-country accountability relations of governments, the relations between tiers of government, and

the relations between various government agencies. Effective institutional development, in particular, should start from the premise of building on what already exists rather than transplanting entirely new systems.

All chapters also focus on **better use of shared analysis.** The large body of knowledge and diagnostic tools on the operation of PFM systems in partner countries that is now available should be used to achieve two complementary goals. First, in line with the 2003 OECD Good Practices on Measuring Performance in PFM,[4] there is a need to rationalise diagnostic and assessment work. This will help avoid duplication of work, reduce the burden on partner countries and allow a rigorous and consistent monitoring and evaluation of reform accomplishments. Secondly, there is a need to use the available knowledge to support the implementation of such reforms.

Finally, the onus on governments to be more strategic, and the onus on donors to support national strategies and, whenever practical, to operate through government budgets, have highlighted **the need for aid to be more predictable**, and for better information exchange concerning aid flows. The final section of this chapter describes the main issues involved.

Strategic frameworks and the predictability of aid

The importance of predictability

The need to support the long-term spending commitments required to achieve the Millennium Development Goals (MDGs) is a particular challenge to donors. For many countries, aid constitutes a significant proportion of total public resources, and potentially an even larger share of discretionary resources. Meeting the Monterrey commitments will mean substantially increasing the volume of aid flows. In many countries, achieving the MDGs will require a transitional period in which aid finances not only investments, but also some of the recurrent costs of poverty-reducing public expenditures. However, aid is frequently much less predictable than domestic revenue sources, and much aid that is disbursed is not included in public budgets and accounts. Partner governments' task of deploying scarce resources effectively is extraordinarily difficult if a significant part of public resources is unpredictable and/or non-transparent. Naturally, this matters most to the poorest countries, which are the most aid-dependent.

To achieve the MDGs, governments will need to plan consistently for the medium and long term and to optimise resource allocations within and across sectors. Good PFM practice entails: *i)* a comprehensive view of the resources available (as noted in Chapter 2, there should be only one budget and one national plan to be implemented through it); and *ii)* fitting annual budgets within a medium-term expenditure framework (MTEF). Reasonable predictability of budget implementation is necessary so that budget holders can utilise resources efficiently in service delivery and so that the planning and budgeting process itself is credible. For example, a sector ministry is unlikely to take the budget and the MTEF seriously unless there is both discipline and reasonable predictability in budget formulation and execution. For many countries, this in turn requires much greater predictability of aid.

In this connection, the following good practices were adopted at the Rome High-level Forum on Harmonisation:

- **Multi-year programming of aid** – Donors, wherever possible, should programme their aid over a multi-year time frame that is consistent with the financial planning horizon of the partner government, and are transparent about the circumstances under which aid flows may vary. The combination of longer-term and more predictable finance enables partner governments to have more trust in the reliability of donor finance. This is necessary to plan increases in service delivery capacity, and facilitates macroeconomic management.

- **Provide full information on aid flows** – Donors should provide partner governments with full information on aid flows. This should be done regularly and in a timely manner. This enables governments to integrate aid into macroeconomic and budgetary management and to publish details of aid received (OECD, 2003).

Experience, across a range of countries, shows that there is still a long way to go in realising these aspirations. Where donors do not currently have the authority to make these commitments, they should either make additional efforts to relax constraints or provide reliable indicative commitments where formal commitments cannot be made. Predictability has been a particularly salient topic in the context of budget support, largely because of the potential for volatility in budget support to be particularly destabilising; Chapter 2 addresses the related issues of predictability and conditionality as they affect budget support. However, the wider issues have implications for all aid modalities and all aid agencies.

Terminology

The term "predictability" is sometimes used in a rather broad way – which can confuse discussions. It is important to note that predictability has a number of dimensions, and to distinguish between predictability and volatility. Thus:

- **Predictability:** Aid is *predictable* when partner countries can be confident about the amounts and the timing of aid disbursements. There are several dimensions to this issue, starting from the extent to which partner countries can rely on donor pledges being translated into actual aid flows, and including non-arbitrary and transparent criteria for suspending or adjusting payments.
- **Volatility:** Aid is *volatile* when fluctuations in aid flows are large, relative to the volume involved.

These terms can be applied to the aid a partner country receives from an individual donor, and also to the aggregate volume of aid that it receives from all donors at the country level.

Factors that affect the predictability and volatility of aid

Time scale

- **Long term (more than five years)** – In the longer term, the predictability of aid is contingent upon donors' willingness to meet the commitments made at Monterrey to increase the volume of aid provided in support of the MDGs.
- **Medium term (two to five years)** – Medium-term predictability depends upon donors' capacity to fulfil their commitments (see OECD, 2003) to programme aid over a multi-year time frame and provide transparent and reliable information about the circumstances under which aid flows may vary. From this point of view, predictability largely depends on donors' ability to protect aid allocations in the course of their own budgetary process and to provide medium-term forecasts. Their commitments need to be translated into country-level projections that can be factored into national strategies and medium-term expenditure plans.

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- **Short term (less than two years)** – Over the short term volatility has been a particular concern. This depends not only on the actual availability of programmed funds in donors' budgets, but also on partner governments meeting any conditions attached to the aid and on the administrative capacities and procedures on both sides to ensure smooth and timely disbursement.

Improvements are needed over the short, medium and long term in order to maximise the potential for aid to support sustained poverty reduction strategies. It is also important to recognise that there are exceptional circumstances under which donors are legitimately entitled to suspend part of their aid. Long-term effectiveness of the aid envisaged at the Monterrey Summit could be undermined by short-term volatility in its disbursement; conversely, achieving zero in-year volatility will do little for partners' long-term financing needs if the resources that are required to maintain or increase annual flows are not available in the following years.

Other factors

- **Project aid should also be predictable.** Failure to deliver project aid on schedule may be less disruptive than volatility in budget support;[5] it does, nevertheless, seriously impair aid effectiveness. It disrupts execution of development programmes, represents an inefficient use of resources and is likely to undermine budget realism. This is why donors should seek to deliver project aid on schedule and should simplify and rationalise their procedures in ways that support timely and predictable project delivery.
- **Designing conditionality.** Appropriate conditionality is a crucial factor in improving predictability and reducing volatility. Unconditional aid is rare,[6] but much can be done to ensure that conditions are appropriate and transparent. Chapter 2 discusses the conditions that are appropriate for general budget support and Chapter 3 discusses the challenges of ensuring that the various conditions and performance indicators associated with a sector programme are relevant, adequate and economical. Donors have a collective responsibility to ensure that their conditions are aligned with the partner country's strategy and that they do not, in aggregate, place excessive demands on the performance or the reporting capacities of partner governments. Where disbursement is made conditional on specific performance conditions, *i)* the timescale should be appropriate (in-year withholding of aid should be a last resort); *ii)* the conditions should be transparent – so that the government knows what performance is expected and the criteria on which a donor decision will be based; and *iii)* targets and indicators should relate to factors over which the government has control or at least substantial influence. The aim should be to minimise the factors that are arbitrary or exogenous, and allow the partner country's budgetary authorities to rely on sound estimates of the funds likely to be available, as in the case of other revenues. Effective systems for dialogue should ensure that conditions are mutually acceptable and designed to reinforce country-owned strategies.
- **Transparent information on aid flows.** Transparency is also critical and the availability of information is clearly important in this regard. This volume emphasises good PFM practice in reporting aid flows at all stages: aid agencies and partner governments have a mutual interest both in *ex ante* predictions of aid and in *ex post* reporting of its uses. Work is currently under way on developing an international public sector accounting standard (IPSAS)[7] which will set out disclosure requirements for recipients of external assistance. It aims at improving reporting and is based on reciprocal and systematic

provision of information by aid agencies and partner governments. Sustained collaboration between aid agencies and partner governments is essential to ensure that aid flows are properly captured as a basis for accountability to the public, in both aid-giving and aid-receiving countries.

Concerted efforts to enhance information about aid flows and to improve the predictability of aid are relatively recent, and lessons of good practice are still emerging. As with much else in this volume, progress depends not only on individual aid agency behaviour, but on the ability of donors and governments to work effectively together at the country level.

Notes

1. The 15 partner countries associated with the Working Party on Aid Effectiveness include: Bangladesh, Bolivia, Cambodia, Ethiopia, Fiji, Kyrgyz Republic, Morocco, Mozambique, Nicaragua, Niger, Senegal, South Africa, Tanzania, Vietnam and Zambia.
2. An aid instrument is a specific intervention. Aid instruments within a generic aid modality may differ significantly, *e.g.* in their financial terms, in their procurement procedures, in whether disbursement takes place through the government's budget, and in the monitoring and reporting requirements attached.
3. See Box 1.1, "Guiding principles on providing co-ordinated aid", in OECD (2003) p. 19.
4. See Chapter 3, "Measuring Performance in Public Financial Management" in OECD (2003).
5. In principle, if expenditure fails to take place because aid fails to arrive, the effects on public expenditure and public revenue are the same and the budget deficit does not increase.
6. HIPC (heavily indebted poor country) debt relief, which awards irreversible budget support after the completion point, may be regarded as such, but is provided only after a lengthy track record has been established by meeting a set of pre-defined criteria.
7. See International Federation of Accountants (2004), "Financial Reporting under the Cash Basis of Accounting: Disclosure Requirements for Recipients of External Assistance", proposed International Public Sector Accounting Standard – draft for comment, October.

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Chapter 2

Budget Support

This chapter addresses the design and management issues that arise when donors have decided to provide budget support. It puts forward a set of good practices on how donors can best deliver budget support in ways that maximise its developmental benefits while reinforcing partners' capacity to achieve aggregate fiscal discipline, strategic allocation of funds, value for money, and probity in the use of public monies which are all key objectives of public financial management systems. It also provides donors with benchmarks for behaviour when providing budget support.

Key issues

For the purpose of this chapter, budget support is defined as a method of financing a partner country's budget through a transfer of resources from an external financing agency to the partner government's national treasury. The funds thus transferred are managed in accordance with the recipient's budgetary procedures. Funds transferred to the national treasury for financing programmes or projects managed according to different budgetary procedures from those of the partner country, with the intention of earmarking the resources for specific uses, are therefore excluded from this definition of budget support.

An additional distinction might be made between general budget support and sector budget support. In the case of general budget support, the dialogue between donors and partner governments focuses on overall policy and budget priorities, whereas for sector budget support the focus is on sector-specific concerns. While many of the good practices identified below apply to all types of budget support, the focus of this chapter is on *general budget support*. Sector programmes are dealt with in Chapter 3.

Apart from being particularly well-suited for macroeconomic stabilisation needs and for supporting poverty reduction and growth, budget support offers the prospect of reducing transaction costs, facilitating donors' co-ordination and enhancing the predictability of aid flows. It also constitutes a potentially effective tool to improve the allocation of funds in partner countries' public spending, and strengthen their policy ownership. Finally, by channelling aid resources through the partner government's budget, it fosters institutional development and increases accountability by underscoring the budget's role as the statement and tool of government policy.

Budget support, however, also has potential disadvantages for partner countries. It can increase volatility in aid flows, force costly fiscal adjustments when disbursements are suspended or delayed, create potentially intrusive and extensive conditionality and – at times – contribute to heavy reporting requirements.

A donor's decision to provide budget support is based on a range of factors, including: an assessment of the partner's public financial management systems, and the likelihood that resources would be used for agreed purposes. The specific criteria underlying a donor's decision, however, vary from donor to donor and are not analysed in this chapter. Generally speaking, donors balance the potential benefits of providing budget support against the risks. Once the decision of providing budget support has been made, it is important that it is delivered in ways that maximise its potential benefits (ownership, low transaction costs, etc.). Accordingly, this chapter identifies the good practices donors might adopt once such a decision has been made. In doing so, the chapter:

- Complements the OECD-DAC good practices on harmonisation (OECD, 2003).
- Draws from an increasing body of experience gained by the Development Assistance Committee (DAC) members, international financial institutions and partner countries.
- Approaches the issue from a public financial management (PFM) perspective given its special relevance to budget support.

Further insights on good practices will become available following the finalisation of the ongoing multi-donor evaluation of the impact of budget support in 2005.

Purpose

The purpose of this chapter is to put forward a set of good practices on how donors can best deliver budget support in ways that maximise its developmental benefits while reinforcing partners' capacity to achieve aggregate fiscal discipline, strategic allocation of funds, value for money, and probity in the use of public monies – key objectives of public financial management systems. It also provides donors with benchmarks for behaviour when providing budget support.

While this chapter does not prescribe good practice to partner countries, it does recognise that donors' readiness to provide budget support is influenced by the performance of partners' PFM systems. For example, a realistic medium-term fiscal framework may encourage donors to provide medium-term funding. Reaping the benefits of budget support will often require a collaborative effort between donors intending to follow best practices and recipients willing to reform their PFM systems. Key features of a strong PFM system are identified in the Annex.

The guiding principles and good practices identified below are meant to apply to general budget support provided to countries that have a poverty-reduction strategy or an equivalent national development plan in place. In the case of budget support to post-conflict countries and other fragile states, the guiding principles and good practices below should apply as appropriate in each case.

Guiding principles

The following principles guided the elaboration of this chapter's good practices:

1. **Budget support should reinforce partner countries' ownership** – When providing fungible resources in the form of budget support, donors should support a partner country's overall development policies and priorities. While this raises a justifiable need to discuss budgetary goals (and related funds-allocation decisions) with a partner government, sustained policy implementation ultimately depends upon the existence of strong political commitment. Budget support should therefore not attempt to leverage policy actions where such commitment does not exist.
2. **Budget support should help to enhance the performance and accountability of partner countries' PFM systems** – Budget support provides donors with a legitimate interest in strengthening the PFM systems through which their funds are spent. For both developmental and fiduciary reasons, donors should use the provision of budget support to foster the improvement of partners' PFM systems, including transparency and accountability to their legislature and civil society at large.
3. **Transaction costs incurred by budget support should be minimised** – Channelling budget support through national procedures is a way of decreasing transaction costs. Additional transaction costs associated with budget support, such as those incurred through multiple and large-scale PFM assessments, should be kept to a minimum.
4. **Budget support should be delivered in a way that enhances the predictability of resources and reduces their volatility** – When drafting their budgetary plans, partner countries' authorities should be able to count on reliable estimates of the amount of

budget support, the timing of its disbursement, and clear conditions for its release. Predictability is an important requirement for partner countries' budgetary authorities, particularly with respect to the short term disbursements of committed aid and the early commitment of future aid flows in the medium term. Higher predictability, and lower volatility, facilitates the implementation of policies geared towards macroeconomic stabilisation, the design (and implementation) of MTEFs, the strategic allocations of funds across policy priorities, and the rational choice of the most cost-effective financing strategies. However, experience shows that the actual timing and size of budget support commitments and disbursements are subject to a certain amount of variability. While this may be partly due to partner countries' behaviour, donors should seek to eliminate those sources of volatility under their control.

Good practices

Supporting ownership

- ***Refrain from targeting support*** – As a norm, there should be no restrictions on the use of funds once these are transferred to a partner country's treasury account following the fulfilment of agreed conditionality. Given resource fungibility, the earmarking of resources would have little or no positive impact on the effectiveness of aid, but it would increase transaction costs. Exceptions to the general rule should be limited to cases that are clearly justified, *e.g.* when significant risks of severe liquidity constraints raise the possibility of cuts in priority spending. Generally, however, the factors that seemingly justify the targeting of resources are better addressed through adopting an alternative aid modality, such as sector or project support.
- ***Reflect partner country priorities*** – Conditionality should draw as much as possible on the partner countries' policy agenda and objectives, as reflected, for example, in the programmes and targets set out in their national development strategy documents (particularly the poverty-reduction strategy paper [PRSP], and its annual review).
- ***Focus on results*** – Budget support should focus on results, that is to say, the outputs and outcomes that are linked to the policies pursued by the partner governments. Increased results focus gives governments an incentive to reflect on the progress achieved in designing their policies and formulating their budgets. It complements, rather than substitutes for, the dialogue between donors and partner countries on the underlying policies and the related provision of technical assistance. Increased focus on results can be achieved in several ways, including through the use of relevant indicators and/or conditionality, like evolution of service delivery. However, the move towards a greater focus on results is a difficult issue in practice, not least because of the need to identify clearly monitorable indicators linked to government policies.

Enhancing PFM performance and accountability

- ***Follow good practices in PFM diagnostic and assessment work*** – Donors should abide by the existing DAC good practice paper (OECD, 2003) when measuring performance in public financial management (see Box 2.1). Donors should also avoid burdensome and costly duplication of work by sharing the results of their own diagnostic and assessment work, and basing their decisions on the results of work conducted by others.
- ***Directly support the capacity development of partner PFM systems*** – Budget support should directly encourage improvements in partners' PFM systems, including transparency and

Box 2.1. **Performance measurement in PFM**

Donors have typically used a variety of different diagnostic tools to assess the strength of public financial management systems in partner countries. An effort is now underway by a working group composed of the World Bank, the International Monetary Fund (IMF) and the Public Expenditure and Financial Accountability (PEFA) Secretariat. The group is developing a common performance-measurement and reporting framework for monitoring PFM performance, working in consultation with the DAC Joint Venture on Public Financial Management. The aim is to streamline donor diagnostic work, and increase the focus of donor PFM capacity-building support by encouraging a common approach around a core set of PFM issues and by eradicating duplication of analysis.

The framework includes a PFM performance report, which is an integrated assessment based on a standard set of high-level PFM indicators (see Annex). Building upon the IMF/World Bank HIPC Public Expenditure Tracking Assessment and Action Plan (HIPC-AAP), the framework aims to offer a credible monitoring tool to inform donors' funding decisions, and feed into the policy dialogue between partner countries and donors. It also provides partner countries with objective feedback on the major areas of weakness and the impact of reforms. Following completion of technical testing, the PEFA partners expect to finalise the indicators and the performance report in early 2005.

accountability to partner countries' legislature and civil society at large. This can be done in alignment with countries' reform strategies through the inclusion of specific conditionality and the provision of targeted technical assistance. Increasing the involvement of a partner country's auditing institutions in PFM assessments and conducting *ex post* audits may also prove useful. More specific good practice on strengthening capacity in public financial management is provided in Chapter 4.

- ***Avoid undermining country systems*** – Given the varying standards of expenditure management among partner countries and the accountability requirements of donors, budget support providers cannot always fully rely on partner countries' systems for expenditure and control. *Ex ante* and *ex post* assessments, safeguards and additional reporting requirements can therefore be justified. They should, however, be carried out in a way that strengthens partner country systems rather than replacing them with temporary and/or donor-specific parallel arrangements.

Reducing transaction costs

- ***Streamline conditionality*** – Partners should have a single, comprehensive national budget and a single national strategy and budget support providers should link funding to a single framework of conditions and/or a reduced set of indicators. This does not mean that all donors should have identical conditions; rather that each donor's conditions should be derived from a common operational framework (see Box 2.2). Donors should seek, whenever possible, to draw conditions from a partner's poverty reduction strategy (PRS), its annual PRS review or equivalent national framework. Other conditions could be agreed when justified, and as long as they are the result of a transparent process involving other budget support providers and granting the partner government the time necessary to review and consider alternative policy options. In any case, conditions and indicators should be limited to those that facilitate the achievement of, or measure

Box 2.2. **Aligning processes in Mozambique**

Budget support donors in Mozambique have been collaborating since 1998. There are now 15 donors working together, including the World Bank and several observers, *e.g.* the United Nations Development Programme (UNDP). They commit to consulting government only through joint missions, organised around the *Plano Economico e Social* (PES), the annual implementation plan of the Action Plan for the Reduction of Absolute Poverty (*Plano De Acção Para A Redução Da Pobreza Absoluta* [PARPA]), Mozambique's PRSP. The PRSP is submitted to the National Assembly for approval prior to each financial year and the government reports on its outcomes (in a *Balanço do PES*) about three months into the following year. All donors have signed an agreement to derive their disbursement triggers from a single common performance assessment framework, negotiated annually, whose indicators are drawn from the PES. A common assessment is made of the progress made in implementing the PARPA, based on the *Balanço do PES*, and individual donors consequently make their own decisions on whether to disburse and, if so, how much. The Memorandum of Understanding in which this is formalised also sets out a number of underlying principles (including governance and human rights, macroeconomic stability, and poverty reduction) essential for the continued provision of budget support.

progress toward, the key elements of the PRS/national strategy. While in practice this has proved to be difficult to achieve, encouraging progress has been recorded in a number of cases.

- ***Rationalise fiduciary assessments*** – When providing budget support, donors have different accountability requirements and fiduciary concerns. In doing so, they should, however, reduce the burden on partner countries through fewer, better co-ordinated and, to the extent possible, common diagnostic reviews. These should provide a common pool of information from which donors could draw upon to make their individual fiduciary decisions (see Box 2.1).
- ***Align processes*** – Donors should individually and collectively align their dialogue and monitoring processes with the partner countries' national budgetary cycles of policy formulation and implementation, and rely as much as possible on the partners' reporting and monitoring systems for their own reporting purposes (OECD, 2003). For example, donor reviews should be designed as far as possible to use the data and information generated by the partner country's own monitoring and evaluation requirements.
- ***Tap the potential of joint donor frameworks*** – The drive towards increased harmonisation has led to the creation of donor groups on a country-by-country basis (see Box 2.3). These are often formalised through the drafting of "joint partnership frameworks" that outline the basic principles of donor collaboration and often contain a "common assessment framework" as the basis for reviews and disbursements. While these frameworks have the potential to reduce transaction costs, this objective cannot be taken for granted and donors should bear the burden of start-up costs. Frameworks should be streamlined and made as simple as possible. Particular attention should be paid to the risk of creating additional layers of institutional processes and of reaching agreement on common assessment frameworks simply by creating a single list of all partnership members' individual concerns.

Box 2.3. **Joint partnership framework in Tanzania**

In Tanzania, all 14 budget support development partners have agreed to the "Partnership Framework Memorandum", which outlines the principles of co-operation and harmonisation and aims to reduce transaction costs for the government. This has led to a joint process of appraisal, review and dialogue with the authorities on matters related to poverty reduction budget support (PRBS). The review of progress against the performance assessment framework is structured around working groups to share the burden among donors. In order to achieve closer alignment with the PRS, this framework is expected to evolve, in particular through the adoption of the PRS- monitoring-and-review process.

- ***Time disbursements to facilitate the smooth execution of budgetary payments*** – Donors should agree with a partner country's budgetary authorities on the most appropriate timing for the planned release of budget support resources, particularly if there are significant fluctuations in the country's budgetary cash flows during the year. If deemed relevant, seasonal macroeconomic patterns should also be taken into account. When more than one donor is providing budget support, donors and partners' budgetary authorities should co-ordinate to spread individual disbursements across the fiscal year in the most appropriate way. This information should be taken into account in the design of the macroeconomic and monetary programmes for the coming year.

Enhancing predictability and reducing volatility

- ***Programme budget support over several years*** – Donors should increase their efforts to programme and commit budget support (subject to performance) over a rolling multi-year framework in order to match the timeframe for partner countries' medium-term budgetary planning. Indications of the overall envelope of this medium-term support should be provided to the partner country budgetary authorities as early as possible. Box 2.4 presents examples of several existing multi-year arrangements.

Box 2.4. **Examples of existing multi-year arrangements**

Programming of *IMF concessional financial assistance* under the Poverty Reduction and Growth Facility covers a three-year period. The main macroeconomic objectives are agreed at the outset of the period and the policies for achieving these are set out in annual programmes, upon which programme conditions and disbursement triggers are based. There are two semi-annual disbursements, the first on approval of the annual programme, the second on the completion of its mid-term review, which can be delayed by slippages in programme implementation.

Programming of *World Bank support*, as reflected in the Country Assistance Strategy, now generally covers four years with some flexibility to accommodate countries' PRS cycle. Within the CAS framework, the World Bank sets annual amounts for poverty reduction support credits (PRSCs). PRSCs are then approved annually by the Executive Board and disbursed subject to progress made in implementing the PRS, as measured against a small set of disbursement triggers. In case of performance shortfalls, PRSC amounts can be adjusted but thus far all but one PRSC have been disbursed in full.

Programming of all *European Commission aid* is currently based on a five-year horizon with budget support generally granted on the basis of a three-year agreement.

Box 2.5. "Discounting" budget support projections in Uganda

Uncertainty over the volume of aid flows has led partner countries to "discount" donor aid projections when preparing their budgets. In the case of Uganda, the discount factor for budget support is set at the average level by which disbursements have fallen short of donor commitments over the last five years. Currently equal to 35%, the discount factor is revised periodically in order to reflect new developments. For any given deficit goal, the discounting of donors' projections adds realism to the government's financing plans and associated monetary programme, thus allowing a more robust assessment of the macroeconomic sustainability of the deficit target and its underlying expenditure ceilings.

- **Align support with partner country budget cycles** – Donors should align budget support commitments as closely as possible with partner countries' budget cycles. They should provide early indicative commitments to facilitate budget planning, and strive to complete negotiation in time to permit final commitment before the start of the new budget year. Box 2.5 provides an example of the "second-best" arrangements partners need to resort to when aid flows are less than certain.
- **Design conditionality to enhance the predictability of disbursements** – The availability of budget support funds can never be guaranteed up-front when disbursements are subject to the fulfilment of conditions. However, donors can, and should design conditionality in such a way as to make the disbursement of funds as predictable as possible in terms of timing and magnitude. This would allow the partner country's budgetary authorities to rely on sound estimates of the funds likely to be available.

To effectively design conditionality to enhance the predictability of disbursements, one should consider:

- *The timing of the review of performance* – The sooner the fulfilment of conditions can be verified, the sooner a partner country's budgetary authorities can be sure of the actual amount of budget support that will be disbursed, allowing the partner to adjust its spending plans in a more rational and controlled manner. When possible, zero in-year variability should be sought, *i.e.* by specifying in year n disbursements for year n+1. Other more innovative arrangements might also be envisaged, as described in Box 2.6.
- *The clarity of conditionality and its evaluation process* – The conditions attached to disbursements, and the process through which their fulfilment is assessed, should be clearly specified and leave little margin for interpretation, thus reducing the uncertainty surrounding disbursement decisions. This implies that specific conditions should be chosen over those that are vaguely defined, *e.g.* "… the successful conclusion of a joint-donors review of PRSP implementation". Similarly, while the evaluation of conditionality should not be reduced to a mechanical exercise, the criteria for disbursement decisions should be clearly established to ensure transparency and allow partner countries to fully understand the terms of the evaluation process.
- *Political conditionality* – While prohibited in the case of the international financial institutions, political conditionality can be legitimate for other donors. Political sensitivities are also likely to be more intense in the case of budget aid since some constituencies may see the provision of budget support as an endorsement of the partner country's overall policy stance. However, the very nature of political conditionality makes it difficult to formulate clearly defined conditions that leave very little margin for

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Box 2.6. The Enhanced HIPC Initiative and "threshold conditionality"

By granting irrevocable debt relief at the completion point, the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative in effect awards an irreversible stream of budget support flows over the medium term to those countries which have proved their willingness to implement sound macroeconomic and sectoral policies by successfully meeting a set of pre-defined criteria. These criteria include maintaining a stable macroeconomic framework, and satisfactorily implementing the PRSP and other policy actions which reflect the country's priorities. Combining what can be viewed as floating tranche conditionality with binding multi-year commitments, the HIPC Initiative is unique in providing fully predictable support over the medium term, regardless of any concern that may arise after completion point.

Given the need for stable financing flows for the achievement of the Millennium Development Goals, the importance partner countries attach to predictable aid flows and the difficulties encountered in providing them through more traditional arrangements, the donor community may wish to reflect on whether similar mechanisms could be applied outside the specific context of external debt cancellation, *i.e.* whether countries clearing a certain "performance threshold" defined in terms of set criteria could be awarded irrevocable multi-year support. The latter could complement, rather than substitute for, existing instruments.

interpretation. Accordingly, political conditionality should not be specifically linked to budget support or any individual aid instrument, but rather should be handled in the context of the overarching political dialogue between a partner country and its donors.

- ***Time disbursements in a predictable manner*** – Disbursements should be timely. Following the positive review of conditionality, disbursements should occur promptly or at least within a well-defined timeframe. Donors should re-examine their current disbursement and authorisation procedures to reduce the uncertainty surrounding the timing of disbursements following a positive assessment of conditionality.
- ***Avoid stop-and-go cycles and allow for graduated responses*** – Depending on the share of a country's public expenditures financed through budget support, the suspension of aid by donors can be particularly disruptive, leading to an unintended excessive response to the underlying policy slippage and introducing significant additional macroeconomic volatility. Various mechanisms can help mitigate these risks:
  - *Avoid the bunching of conditionality around a limited number of common criteria*. Measures to reduce this outcome could include a more co-ordinated *ex ante* approach to the distribution of key conditionality across budget support providers. In the case of the common requirement for a positive conclusion of an IMF review, donors should be prepared to maintain their flows of budget support – even in the event of minor slippages that may delay completion of the formal IMF review – provided that the macroeconomic framework remains satisfactory, and the slippages do not call into question the overall implementation of the PRS. In such cases, the IMF should produce and share a timely analysis of the macroeconomic situation with donors.
  - *Avoid institutionalising the principle of unanimous donors' agreement*. Harmonisation is different from unanimity. Whether formalised or not, joint processes should preserve the space for different donors to make different decisions on the basis of the same evidence. Donors participating in joint donor frameworks should reach agreement on the circumstances under which their support would be individually or collectively adjusted or reduced, as well as the modalities of such adjustments.

- *Identify potential underperformance early on*. Relying upon clearly defined conditionality, in-year dialogue can help identify and address problems as early as possible, before there are financial consequences.
- *Allow for partial disbursements in cases of partial fulfilment*. Such a mechanism can reduce the volatility of budget support by establishing an intermediate option between withholding all funds and releasing them. One method currently applied to provide for graduated response is the fixed and variable tranche mechanism utilised by some donors. Another possible arrangement would be to devise budget support as a set of multiple flows, each subject to its own specific array of conditions (see Box 2.7). In the simplest of cases, this would twin a macroeconomic and a sectoral tranche. While some funds could then, for example, be withheld in the case of a delay in an IMF programme review, the remaining funds could still be disbursed if sectoral conditionality was being met, thus allowing the continued financing of a sector despite the existence of some problems at the macroeconomic level.

Box 2.7. **European Commission and Switzerland: fixed and variable tranche mechanisms**

In most cases, the European Commission's budget support programmes envisage "*fixed tranche*" *and* "*variable tranche*" disbursements. The *fixed tranche* components are basic resources in terms of macroeconomic support and are disbursed in "all or nothing" form depending on the continued fulfilment of eligibility conditions pertaining to economic management and PFM conditions. The *variable tranche* components are additional resources that are released in a graduated form depending upon the extent to which targets and performance indicators, which have been agreed with the government within the framework of the country's PRS, are achieved.

Switzerland is currently adopting a "*multiple flows*" *arrangement*. In the case of Mozambique, for instance, half of the funds provided through budget support is disbursed as a fixed tranche, based on an assessment of macroeconomic developments, and more generally, performance against commitments in the performance assessment framework. The remaining funds are disbursed through thematic sub-tranches linked to PFM performance (20% of all funds), revenue mobilisation objectives (15%) and performance in private sector development (15%).

By adopting partial disbursement mechanisms, both the European Commission and Switzerland aim to increase predictability while maintaining incentives for progress in selected areas.

- ***Build public support*** – Donors should engage in an active communication strategy with their political constituencies and civil society in order to enhance the understanding of budget support, its opportunities and the related risks. An informed discussion on the benefits of budget support will help to create more awareness of the long-term commitment required by this form of direct support, mitigating the risk of disruption due to factors under the donor's control. A better understanding of budget support and of the related importance of partner countries' own systems and priorities will also provide an incentive for donors to move the policy dialogue away from narrowly defined individual agendas.

Reference

OECD (2003), *Harmonising Donor Practices for Effective Aid Delivery*, DAC Guidelines and Reference Series, OECD, Paris.

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Chapter 3

Sector-wide Approaches

This chapter focuses on sector approaches. It provides operational guidance on how to establish, at the sector level, partnerships between governments and donors that improve the effectiveness of development policies and broaden government ownership over public sector policy and allocation of resources. Where such partnerships have already been established, it suggests how they may be further developed and enhanced. Again, the implications for public financial management are a crucial consideration.

Key Issues

Chapter 1 noted the new emphasis on partnerships that permeates current thinking about effective aid. This chapter focuses on such partnerships at the sector level. Partnerships have common objectives, which are to:

- Broaden partner countries' ownership of decisions about sectoral policy, strategy and spending.
- Increase the coherence between sectoral policy, spending and results through greater transparency, wider dialogue and a comprehensive view of the sector.
- Strengthen national capacity at all stages of sector planning and management.
- Reduce the transaction costs associated with aid and increase its effectiveness.

Terminology in this area can be confusing: a variety of similar terms are often used in different ways by different organisations. Box 3.1 explains the two key terms used in this chapter: *a sector-wide approach* (*SWAp*) which focuses government and donor support on a comprehensive *sector development programme* (*SDP*).

Table 3.1 highlights the features that distinguish a SWAp from a conventional project approach. However, neither a sector-wide approach nor a sector development programme is itself an aid instrument: a SWAp is a way of working, and the SDP on which it focuses can be supported by a variety of aid instruments. Different aid instruments will be better in different contexts, for different purposes and at the different stages of development of a SWAp. A key challenge is to choose and design aid instruments to maximise their combined effectiveness. This chapter provides guidance that is relevant to all the donors involved in a sector and to all the instruments that may be deployed.

Table 3.1. **What distinguishes a sector-wide approach from a conventional project approach?**

Sector-wide approach	Conventional project approach
• Country holistic view on entire sector	• Focus on projects to support narrowly defined objectives
• Partnerships with mutual trust and shared accountability	• Recipient accountable to donor
• External partners' co-ordination and collective dialogue	• Bilateral negotiations and agreements
• Increased use of local procedures	• Parallel implementation arrangements
• Long-term capacity/system development in sector	• Short-term disbursement and success of projects
• Process-oriented approach through learning by doing	• Blueprint approach

Source: Adapted from World Bank (2004), "SWAps in Latin America: A World Bank Perspective", PowerPoint presentation, Tegucigalpa, 8-10 November.

A great deal of practical experience in SWAps has accumulated since the mid-1990s.[1] Albeit with differences in orientation, all significant aid agencies are engaged in them. It has become clear what is easier and what is more difficult. SWAps have made most progress in sectors where the partner country government is a major service provider and

Box 3.1. **Terminology related to sector partnerships**

The principal terms used in this chapter are *sector-wide approach* (SWAp) and *sector development programme* (SDP). They are linked to the broader concept of programme-based approaches (PBAs).

PBAs have been defined by the Learning Network on Programme Based Approaches (LENPA) as:

A way of engaging in development co-operation based on the principle of co-ordinated support for a locally owned programme of development, such as a national poverty reduction strategy, a sector programme, a thematic programme or a programme of a specific organisation.

PBAs share the following features:

- *Leadership by the host country or organisation.*
- *A single comprehensive programme and budget framework.*
- *A formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement.*
- *Efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation (Lavergne and Alba, 2003).*

A sector-wide approach is a programme-based approach operating at the level of an entire sector.

A sector development programme (SDP) is a specific, time-bound and costed set of actions and activities which support a sector strategy (*i.e.* the "single comprehensive programme and budget framework" of a PBA, which incorporates both government and donor resources).

Donors may have special terms for their own instruments that support a sector development programme (for example, the European Commission refers to its own instrument as a "sector support programme"). It is important to be clear, however, that neither a sector-wide approach nor a sector development programme is an aid instrument. A sector development programme may be (and usually is) supported by a variety of aid instruments, including aid-funded projects, technical assistance, sector budget support and general budget support.

government responsibilities are managed by a single sector ministry. On the other hand, the Strategic Partnership with Africa (SPA) has highlighted the challenges of reconciling SWAps with decentralisation, of inter-sectoral co-ordination when outcomes and impacts depend on the actions of multiple line ministries, of the "productive" sectors for which a strong role for a line ministry is less obvious than in the more typical service delivery sectors, and of securing substantive involvement of the private sector and civil society.

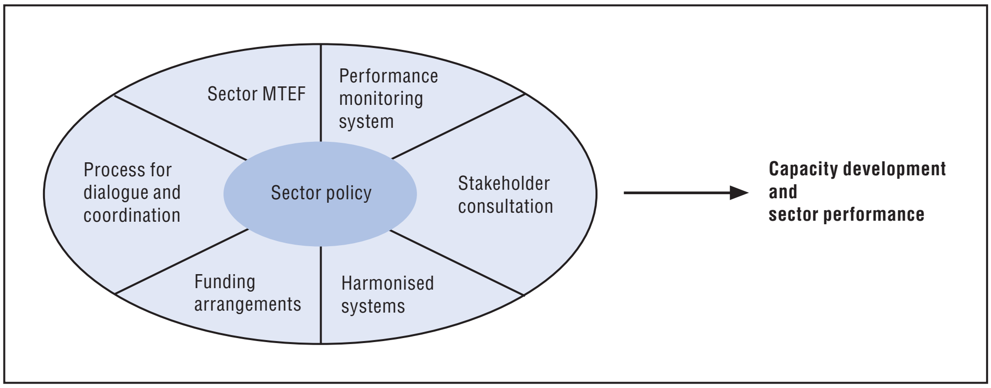
The context for SWAps has become more favourable, but also more complex, with the advance of poverty reduction strategies, and co-ordinated action on a national scale to address systemic issues (including PFM and national capacities) that have previously been addressed within sectors. SWAps and sector development programmes are often prominent in the areas that are stressed in PRSs: education, health, transport and agriculture. Ideally, a PRS should incorporate a co-ordinated and coherent set of sector development programmes. Governments and donors can draw on their experience at the sector level as they develop a collaborative framework for the PRS, while this may provide a helpful framework for addressing some of the "difficult" areas highlighted by the SPA.

The key components of an effective SWAp are:

- A clear nationally-owned sector policy and strategy.
- A medium-term expenditure programme that reflects the sector strategy.
- Systematic arrangements for programming the resources that support the sector.
- A performance monitoring system that measures progress and strengthens accountability.
- Broad consultation mechanisms that involve all significant stakeholders.
- A formalised government-led process for aid co-ordination and dialogue at the sector level.
- An agreed process for moving towards harmonised systems for reporting, budgeting, financial management and procurement.

As illustrated in Figure 3.1, all these critical components are oriented towards durable strengthening of *sector capacity and institutions* as well as improving *sector service delivery.*

Figure 3.1. **Components of a sector approach**



Purpose

This chapter seeks to provide operational guidance on how to establish partnerships between governments and donors at the sector level that improve the effectiveness of development policies and broaden government ownership over public sector policy and allocation of resources. Where such partnerships have already been established, it suggests how they may be further developed and enhanced with particular attention to the implications for public finance management by partner countries.

Guiding principles

The good practices presented in this chapter draw on the following guiding principles for donors:

1. **Support government ownership and leadership.** Donors must leave the initiative with the partner country government, while offering flexible support, information and guidance. Aid co-ordination at the national level is a government responsibility, while the government-donor partnership should be based on mutual accountability. Donors should be knowledgeable and sensitive about the country context and its institutions. They should seek areas of broad agreement and avoid micro-management.

2. **Work with government to strengthen institutional capacity and accountability.** Setting up parallel systems tends to undermine the regular systems of government and confuses accountabilities. Donors should therefore work as much as possible through partner systems and procedures while collaborating with partner country governments to address identified weaknesses. Both donors and partner governments should think in terms of national capacity, not just government capacity.
3. **Set the sector programme in context.** Donors need to be aware of the SWAp's implications for overall coherence across government, including the SDP's consistency with the PRS, and its effect on the role of the central co-ordinating ministries, and on the relationship between central and local governments. Address cross-cutting issues, including gender equality, the environment, HIV/AIDS, and public service reform.
4. **Take a long-term, strategic view.** Recognise the dynamic nature of SWAps and accept that it will take time to realise all the potential benefits of a sector partnership. Sector development programmes take a long time to mature and usually imply long-term institutional change and organisational development. They are typically implemented over at least a ten-year time frame, implemented in three- or five-year tranches. Donors must have similar time horizons, and must be prepared to commit long-term predictable resources. Address all stages of the planning and budgeting cycle for the programme, and build in a strong "results" orientation.
5. **Be pragmatic and flexible.** Design processes which economise on management, planning and policy skills within government, while progressively developing capacity. Assess the costs as well as the benefits of proposed innovations. Recognise that there are competing interests on both government and donor sides which need to be sensitively managed; undertake a proper institutional and incentive analysis. Recognise and manage risks. Look for some "quick wins" that can help to build support for the programme (amongst both government and donor constituencies) in its early stages. Be realistic and learn from experience (including comparative international experience).

Good practices

Establishing a SWAp

When and where should a SWAp be established?

The basic principles of taking a holistic view, working to a medium-term planning horizon and explicitly linking expenditures to policy are relevant to all sectors and are applied by effective governments everywhere. The effort of setting up a formal sector partnership is more likely to be worthwhile when *i)* donors are an important part of sector financing and *ii)* the sector is one in which public expenditure and service delivery play substantial roles.

Experience suggests the following factors are relevant for success:

- **Political and macroeconomic stability.** Without reasonable political stability, inconsistent policies and governance concerns can easily derail the partnership between government and donors. Macroeconomic stability is a pre-condition for predictable sector budgets.
- **Broad and effective government ownership.** This has three components: strong and effective leadership at sector ministry level, commitment to the process at senior political level, and the active involvement of the Ministry of Finance. Without all three, the process is likely to remain donor-led and/or to run in parallel to established government planning and budget systems.

- **Broad consensus between government and donors on sector policy and management issues.** The SWAp should provide a framework for continuing dialogue over areas of difference, but it is difficult to move the process forward if there are fundamental divergences between government and donor perspectives.

The definition of a *sector* is pragmatic: it may be, for example, the whole education system or just the primary education sub-sector. Experience shows that respecting the organisational mandate of the lead sector ministry simplifies management and co-ordination; working across ministerial boundaries is harder, at least at first. Whatever definition is adopted, it is important not to lose sight of general cross-sectoral issues (*e.g.* civil service reform) and the specific links between the sector and other parts of the system (*e.g.* from primary to higher education, from roads to agriculture).

Early SWAps were largely derived from sector-level initiatives in familiar, well-defined sectors, which were managed by a single line ministry. As sector development programmes mature, and as they become more integrated with national PRSs, there may be opportunities to broaden existing SWAps and to "fill in the gaps", as other sectors seek to emulate the early movers. Box 3.2 illustrates how effective SWAps can develop a momentum that influences other sectors. Many of the features of a SWAp may also apply to "thematic" programme-based approaches (*e.g.* numerous HIV/AIDS partnerships, and the developing partnerships for food security and for public sector capacity building in Ethiopia).

Sequencing

A SWAp is dynamic – a long-term partnership that continually develops, implements and improves the sector development programme. The sector policy and strategy is the

Box 3.2. **Uganda's Justice, Law and Order Sector Programme**

The Justice, Law and Order Sector (JLOS) programme in Uganda involves an unusually large number of government bodies, including the Ministries of Justice, Internal Affairs, and Local Government, the Judiciary, the Judicial Services Commission, the Law Reform Commission, the Directorate of Public Prosecutions, the Prison Service, the Police, and the Ministry of Gender, Labour and Social Development. The Ministry of Finance, Planning and Economic Development also plays a key role, including treating JLOS as a sector with a single ceiling within the MTEF.

Crucially, the JLOS programme was initiated by Ugandan government officials; this was both a reaction to, and an imitation of, SWAps in other sectors. Most of the components of the JLOS were not ring-fenced within the Poverty Action Fund (PAF), and so were subject to a diminishing share of expenditure as the headline poverty sectors grew; they also bore the brunt of in-year budget cuts from which the PAF budget was exempt. Preparing a sector development programme has helped to draw attention to the role of justice and security in equitable economic and social development. The holistic approach encourages a focus on cross-agency issues in the country system (*e.g.* many agencies are involved in reducing case backlogs).

A number of donors have joined in a basket fund mechanism that is a compromise between pure budget support and donor desires for tracking and audit of their funds. Some donors have chosen to continue project-focused support, but their projects are also part of the sector investment plan. The sector now receives some protection from in-year budget reallocations.

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hub of the SWAp (see Figure 3.1), and a disciplined expenditure framework is also vital, but *all* the elements are important, and all will develop iteratively as the programme evolves. Some corollaries:

- ***Avoid being too ambitious.*** Attempting to be too elaborate at the outset risks a loss of momentum and energy as unrealistic expectations are not realised. The essential components are a *statement of sector policy* that all partners can support, and an *agreed co-ordination and dialogue framework* through which the sector development programme can be developed and subsequently managed. The principle of a comprehensive, costed and prioritised programme needs to be established early, since this will discipline government and donors alike. Both these and other components can be progressively elaborated as the partnership develops.
- ***Support the partner government's efforts to design its sector policy and strategy.*** While the basic sector policy and strategy must be prepared by the government, donors can help by providing the resources for contributory studies (drawing where possible on in-country research and consulting capacity). Avoid rushing the process of strategic review; allow for – and facilitate – extensive consultation among national stakeholders. An important initial task is to take stock of the sector, including the full range of donor-supported activities, many of which may be off-budget or channelled through non-government partners. Donors should assist in making comprehensive information available (including the accumulated experiences of their projects and programmes in the sector).
- ***Implementation mechanisms matter.*** At the same time, avoid putting all the initial focus on the sector policy and strategy statements. Work on possible implementation mechanisms (with analysis of partner systems and procedures) in parallel, so as to avoid a hiatus when policy and strategy have been laboriously agreed but the implementation framework is still embryonic. It is vital to involve the Ministry of Finance[2] in this, along with finance and procurement specialists from both sides. Programme design needs to be informed by thorough capacity assessments, so as to serve capacity development as well as service delivery objectives from the outset.
- ***Common arrangements can be very tricky.*** Avoid putting too much initial stress on moving to unified aid instruments, such as a pooled funding mechanism. There is a danger of raising unrealistic expectations on the partner government side, since these are inherently difficult to agree upon, and can accentuate divisions between donors with different preferences or constraints over the choice of aid instruments. However, it is useful for government and all donors to sign up to an agreed intention and process for adopting a sector-wide approach in support of a sector development programme. This should include the outlines of the agreed consultative mechanisms for the sector, but should highlight the fact that all aspects of the partnership will be developed and elaborated over time.
- ***Collaborate with other donors.*** Donors should also establish or refine mechanisms for donor-donor liaison. The partner government may be wary of donors "ganging up" in the sector, but transparent mechanisms (*e.g.* donor sector working groups) help donors exchange information and develop a common perspective. The role of the lead donor (likely to be the chair of the donor group) should be agreed, and from the outset donors should seek ways to minimise their individual demands on government officials' time.

Sector policy and strategy

A coherent and consistently applied sector policy is at the heart of any successful SWAp and focuses the partner government, donors and other stakeholders on achieving collective results. It must be derived from, and consistent with, the partner government's overall strategic objectives and strategic framework (including the PRS). It must also be linked to a robust medium-term projection of resources and their planned use (see the next section, on the sector expenditure framework).

Strive for a good sector policy and strategy, rather than a perfect one. The sector policy document will not be a rigid blueprint. It will establish basic principles, objectives and strategies for the sector. It will acknowledge that detailed policies and resource allocations will continue to evolve. Accordingly, there should be a defined process and schedule for regularly updating the document and rolling it forward. A transparent process for review and revision helps to establish a cycle that strikes a balance between planning and implementation.

A good policy document will:

- **Be authored by the government** (not the donors) and fit clearly into the government's policy and planning system; it will be aligned with the national PRS and endorsed at a high political level.
- **Explicitly address the role of government in the sector** – distinguishing regulatory functions from service delivery and noting the complementary roles to be played by communities, non-governmental organisations (NGOs) and the private sector.
- **Define the allocation of responsibilities across government** (between *i)* the main sector ministry, other line ministries that may be involved, and the central planning and finance ministries; and *ii)* the different tiers of central and local government), focus on implementation capacity constraints, and identify the principal requirements for institutional reform and capacity development.
- **Focus on the whole sector's resource requirements**, including recurrent as well as capital expenditures, and demonstrating the sustainability of proposed public expenditures; it will address the effectiveness of existing policies and expenditures, and not simply submit a subset ("a shopping list") of additional activities for donor finance.
- **Have a strong results orientation**, providing the essential framework for subsequent monitoring, with a focus on poverty reduction and attention also to key cross-cutting issues (including gender equality, the environment, HIV/AIDS and the strengthening of public institutions and their accountability).
- **Set out clear mechanisms for monitoring, review and updating of the policy document**, and identify the principal areas where further research and analysis may be required.

Sector expenditure framework

The expenditure framework is what makes a sector development programme operational. It ensures that proposals in the sector action plan have been properly costed and prioritised against a realistic estimate of (government and external) resources available (see Box 3.3). It thus ensures financial sustainability and disciplines donors to focus on partner government priorities. Donors play a crucial role in supporting the development of the expenditure framework.

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Box 3.3. **Medium-term expenditure framework**

A medium-term expenditure framework (MTEF) is a system for planning actions and programming spending over a three to five-year period. It reconciles systematically the achievement of strategic objectives with respect for aggregate resource limits.

A sectoral MTEF must be:

- ***Comprehensive:*** all sources of financing to the sector and all proposed spending should be included.
- ***Realistic*** so that projections of finance are not over-estimated and projections of costs are not under-estimated.
- ***Clear about how resources will be used*** and what the desired results to be monitored will be; it must derive from a clear action plan.
- ***Endorsed at senior political level***.

In some countries the whole budget process is already managed through an MTEF system. In others it is limited to specific sectors and acts only as a broad guide for spending decisions. Improvements at the sector level play an important role in strengthening the national planning and budgeting system (see Box 3.4).

- ***Start from a comprehensive view of resource flows to the sector.*** An important task will be to get a comprehensive view of sector expenditures, taking into account donor expenditures that may be off-budget, and the contributions made by clients, NGOs and the private sector.
- ***Build up the sector expenditure framework systematically.*** It is not helpful to attempt a very elaborate expenditure framework from the outset. Only rarely will a new sector programme be able to draw on a strong context of medium-term public expenditure planning. More often, improved costing of existing public expenditures will be a starting point (public expenditure reviews [PERs] may play a useful role) together with costing of proposed targets, such as those implied by the MDGs – the affordability of desirable targets will have implications for the quality/cost structure to be adopted. The development and use of expenditure analysis and planning tools is an iterative process (see Box 3.4 for an example).
- ***Ensure that the sector expenditure framework is comprehensive.*** A comprehensive sector development programme will embrace all public sector funding (recurrent and capital financing by both government and donors). It will set public expenditures in the context of other resources going to the sector, *e.g.* through private sector activities and community contributions, but must demonstrate that agreed government responsibilities can be funded and implemented. These will be financed from a variety of sources: government itself will usually be the main financier, and will dominate the funding of recurrent expenditures. Government resources are supplemented by aid provided in a variety of ways – through general budget support or sector budget support; through pooled funds earmarked to the sector; and through individual projects. Technical assistance and other in-kind resources are also relevant.

Sector resource programming mechanisms

Even if adequate funds to meet the total costs of a SDP are available "in principle", this does not guarantee its smooth implementation. Funds have to be clearly allocated and

Box 3.4. **An emerging education sector MTEF in Vietnam**

Development of SWAps in Vietnam has been constrained by weaknesses in public expenditure planning (*e.g.* short time frames and lack of integration between recurrent and capital expenditures). Among other initiatives, the government of Vietnam is beginning to pilot "bottom up" MTEFs in four sectors and four provinces.

The education sector is the first of these. To date, work centres more on developing an analytical tool than a platform for policy dialogue between the Ministry of Education and Training, the Ministry of Finance and the Ministry of Planning and Investment. Nevertheless, powerful insights are emerging from analysis of the existing cost structure of the sector and the interaction between existing policies and demographic trends. This strongly vindicates the forward-looking integrated approach to recurrent and capital budget planning. It is expected that the education MTEF work will become increasingly integrated with investment planning, state budget formulation and political dialogue. It is expected that similar approaches will be taken in other sectors. The sector MTEF will provide an essential platform for sector budget support which is being considered by a number of donors.

budgeted to specific activities before any element of the sector development programme can be implemented. Therefore, a key concept is ***programming,*** that is: *linking projects and activities clearly to assured sources of funds, and to detailed work programmes based on agreed schedules for implementation*. In practice, even when the resource parameters of a sector development programme are broadly realistic, planned activities are always likely to exceed available budgets; hence, the allocation of funds requires a further prioritisation of planned activities. The whole process is made much more complex by the need to combine funding from many different sources.

A traditional public investment programme (PIP), focusing only on incremental capital expenditures, could be financed by donors "picking up the bill" one after the other for the different shopping list projects. SWAps attempt to overcome the typical lack of coherence and sustainability of a traditional PIP, but doing so requires a much more sophisticated programming of funds. A comprehensive SDP includes some one-off (capital) items, but also many recurrent costs that require continuing funding; its components are interdependent (*e.g.* there is no point in paying to construct schools unless the costs of training teachers to staff them are also met); the programme is implemented by many different agencies at different levels of government, each requiring appropriate budget authorisation. Moreover, funding decisions for different sectors are interdependent: this applies not only to governments' own funds but also to the deployment of increasing levels of general budget-support funding from donors. This means that planning and programming of funds for each sector has to be part of an overall system for allocating resources across sectors. Donors have a key role to play in supporting the efficiency and integrity of resource programming by partner governments.

- ***Support budget discipline.*** The effectiveness of a sector MTEF depends on the wider environment of public expenditure management. A sector ministry will not take the MTEF seriously unless there is both discipline and predictability in the formulation of government budgets and in the release of budgeted funds. It is crucial that donors do not undermine budgetary discipline by making funds available to sector ministries outside of the regular resource allocation procedures presided over by the Ministry of Finance.

- ***Support and use government expenditure management systems.*** Supporting government systems (see Box 3.5) is important at the programming stage, not only when funds are being disbursed. Donors should support the close involvement of the Ministry of Finance and the articulation of sector development programmes into a national MTEF system, ensuring a consistent medium-term approach to planning and budgeting across all sectors. Not least, they should themselves recognise the importance of making their own aid commitments more predictable and reliable, with specific allocations fully programmed before the start of the partner country's fiscal year. Ideally, all government-to-government aid funds should be fully incorporated in the partner government's budget. Even if it is not possible for some donors' funds to be disbursed through standard government procedures, they should be: *i)* "on-plan" – *i.e.* their availability should be notified in advance so that they can be fully taken into account when the government decides the overall pattern of resource allocation for the sector, and donors should not seek to apply them to activities that are not prioritised by the government; and *ii)* recorded in budget and expenditure documents both *ex ante* and *ex post*. Donors should also support the integrity of the sector MTEF by providing full information on their disbursements, using the same broad categories as in the budget classification.[3]

Box 3.5. **The Addis Ababa Principle**

As PEFA has noted:

The requirement that national authorities use different procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely, the use of national systems by donors can help to focus effort on strengthening, and complying with, the national procedures. The use of national procedures need not mean that donor funds cannot be kept separate from government funds, but that the banking, authorisation, accounting, disbursement and reporting arrangements are the same as those used for government funds (PEFA, 2004 [Annex]).

The SPA has accordingly adopted the so-called Addis Ababa principle:

… all donor assistance should be delivered through government systems unless there are compelling reasons to the contrary; where this is not possible, any alternative mechanisms or safeguards must be time-limited and develop and build, rather than undermine or bypass government systems. This applies to budget processes and procurement systems among others (SPA, 2001).

- ***Review the impact of all aid instruments on resource programming and on PFM in general.*** The main obligations on donors supporting the sector are to: *i)* ensure that their support is focused on the priorities identified by the sector development programme; and *ii)* deliver their aid efficiently and in ways that promote government ownership and capacity. Budget support, where funds are entirely allocated using the government's own budgeting and disbursement procedures, is the modality that is most fully integrated into government systems. There is nevertheless a challenge for budget support donors (see Chapter 2) to ensure predictability in their disbursements, and support government efforts to ensure predictability of funding to sectors. Moreover, all aid instruments should be reviewed in terms of their impact on government systems. Several different factors need to be considered:

- *Earmarking* of funds reduces budgetary discretion and may make it difficult for government to achieve the desired balance in actual funding of the sector. The underlying principle of a SWAp is to achieve consensus on an overall level and pattern of funding for the sector, as an alternative to ring-fencing the activities that each individual donor has financed. The costs of earmarking are magnified if they are linked to unrealistic programming procedures: for example, attempts to programme donor funds separately and within the annual budget period frequently result in under-spending because of the time lost while programming takes place and before expenditures can be incurred.
- The *disbursement channel* may follow standard government procedures, bypass government accounts altogether, or use a non-standard disbursement through government (*e.g.* when the sector ministry, rather than the finance ministry, is entrusted with donor funds). In general, donors should work with and through the finance ministry channels of government, even in cases where they require their funds to be segregated. Appropriate disbursement channels are crucial when service delivery is decentralised, and need to be adapted to match national systems – see Box 3.6.
- Ability to utilise aid efficiently is also affected by the imposition of special *procurement* procedures. Donors should work towards the maximum use and strengthening of government procurement.
- *Reporting and accounting requirements* are a further dimension in which donors frequently impose special requirements on governments. Again, the costs of such additional requirements, especially but not only when multiplied across a variety of donors, have frequently been underestimated, and sector programmes should give priority to streamlining reporting and accounting. Here too, donor requirements must take account of decentralisation (see Box 3.6).

Earmarked funding (both at project and sector – or sub-sector – level) will continue to be the modality used by a number of donors supporting many sector development programmes. The following rules of good practice should be observed:

All resources for the sector must demonstrably support the programmes and priorities of the sector development programme. The government should not seek and donors should not offer funds or projects that are outside the scope of the SDP or inconsistent with its priorities.

- Project/programme documentation should explain why earmarking is necessary or appropriate and how the project/programme is designed to support and integrate with the SDP.
- Costs should always be broken down according to the standard government classification (which should also be used in the main SDP documents).
- Government procurement procedures should be followed whenever this is feasible (if not, the project/programme document should explain why, and explain how the additional administrative costs of meeting donor requirements will be mitigated).
- A multi-year projection (or preferably a firm commitment) of funds should be provided.
- The project/programme documents should explain how budget and expenditure reports will promptly reach government.

Box 3.6. **Decentralisation – the importance of adapting to national systems**

Ethiopia and Uganda illustrate the importance of the local government dimension for sector programmes. Although both countries have embarked on serious decentralisation programmes, their very different institutional cultures and approaches also illustrate the importance of donors' adapting in detail, not just in principle, to the institutional circumstances of the country.

Uganda has funded local government services through a series of tightly-controlled specific purpose grants, which make it easy to identify sector budgets for health, education, etc. across all tiers of government, and allow donor funds to be tightly earmarked to sectors. Ethiopia, however, has a federal system with un-earmarked block grants which give regions and districts more discretion. Strictly speaking, this means that aggregate sector budgets are not known until the individual budgets of 11 regions and several hundred districts are consolidated with the federal budget.

Donors strongly support decentralisation in both countries, but need to adopt different mechanisms for channelling funds to support local services, so as to reflect and support the two countries' different approaches to decentralisation. There are implications both for the way funds are disbursed and for reporting requirements: donor earmarking of funds should not undermine local government discretion and accountability; and reporting requirements and schedules should be realistic about the time required for reporting from local levels to the centre. Where a policy role, and not just service delivery, is devolved – as in Ethiopia – regional governments are themselves key players in the SWAp.

- The agreed joint sector review mechanisms should be used as the chief means of monitoring and supervision.

The principle of pooling donor funds so as to minimise the direct and indirect costs imposed on the partner government is a valid one, but such arrangements need to be designed with exceptional care. There is a danger that interim "hybrid" systems – *e.g.* where finance ministry disbursement channels are used, but with special additional accounting, reporting and procurement conditions – may impose such demands on the government that they set back the more important task of strengthening underlying government systems.

A sector-performance monitoring and accountability system

An agreed approach to performance monitoring is an essential part of a SWAp. It provides the means for the partner government and donors to judge whether sector goals are being achieved and whether sector strategies are effective. It is also the basis for shared accountability. Donors often have a major influence on monitoring systems and should observe the following good practices.

Support links between planning and monitoring, avoid overload, and strengthen national data systems. Sector plans need to provide a clear structure of goals and objectives that can be monitored. The principal objectives and targets for a sector development programme will naturally be at a high level of aggregation (national averages for key indicators), and will be a small subset of what should be monitored at lower levels of the system. The starting point for sector monitoring should be the partner government's data systems, Sector performance monitoring system should therefore strike a balance between:

- Focus on a few high-level indicators vs. the need to support a coherent national monitoring system that is relevant to (and used by) implementers at all levels.
- Long-term targets vs. indicators that can be meaningfully measured (and therefore targeted at shorter [*e.g.* annual] intervals).
- Financial monitoring (for fiduciary reasons and to verify inputs) vs. non-financial indicators of outputs, processes and outcomes.

Emphasise dissemination and use of findings. An important part of any monitoring and evaluation (M&E) system is the process for disseminating and using its findings. The design of a sector monitoring system should go beyond specifying the data to be collected: it should also specify the timetable and forums for circulating and discussing its outputs at all levels of the sector. This will link, *inter alia*, to the agreed coordination and dialogue mechanisms of the SWAp.

Monitor so that domestic accountability is reinforced. Sector programmes should be monitored in a way that reinforces the accountability of a developing country government to its citizens. Donors reinforce, and to the extent possible, rely on the government's own systems of monitoring and accountability (see Figure 3.2). This is congruent with existing OECD-DAC good practices on reporting and monitoring:

- Donors should work with partners to rely and build on partner countries' reporting and monitoring systems.
- Where partner systems do not provide appropriate information, donors should work with partner countries to improve them according to a nationally led and clearly defined national strategy for developing and strengthening these systems.
- Donors should avoid creating parallel reporting and monitoring systems that undermine the sustainable capacity of partner countries to provide quality information that meets their own requirements.
- Donors co-financing a discrete set of activities – project, sector, or budget support – should work towards agreeing, in consultation with partner countries, common formats, content and frequency for a single periodic report that meets the needs of all partners. The reports should cover all of the activities in the defined area, and meet the information needs of key stakeholders in the country as well as individual donors.
- In addition to alignment with government systems, and co-ordinating among donors, it is important that donors also simplify, whenever possible, their own reporting requirements in order to help alleviate the burden on partner government systems.
- Donors should seek to reduce the number of donor missions and reviews by ensuring that such missions and reviews are rooted in a mutually understood need to facilitate learning and comply with accountability purposes (OECD, 2003).

Many sector programmes schedule joint review missions and/or annual review meetings where donors jointly review and discuss sector progress with government (see Box 3.7). Sector reviews should be timed to feed into the overall annual review of the implementation of the PRSP.

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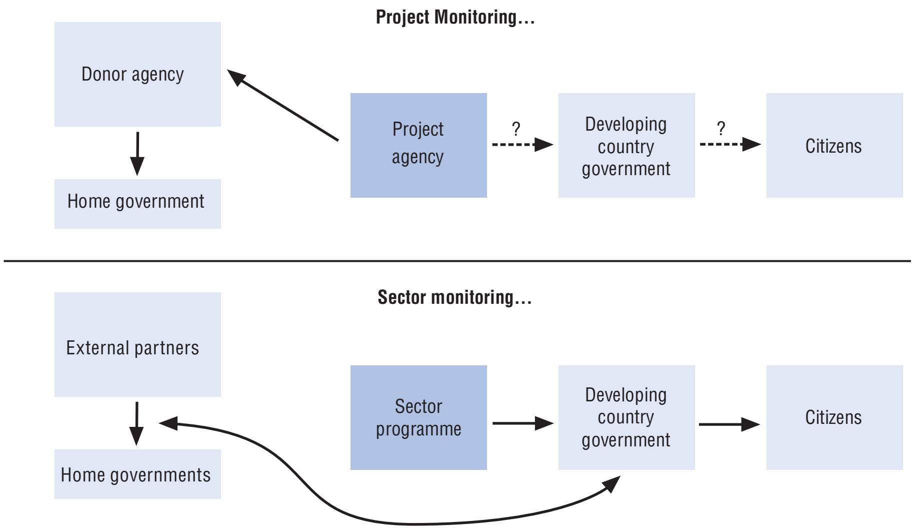
Figure 3.2. **Reconciling accountability requirements**



Source: Adapted from Schachter, Mark (2000), "Sector Wide Approaches, Accountability and CIDA: Issues and Recommendations", Institute on Governance, Ottawa Canada; prepared for Policy Branch, Canadian International Development Agency, October.

Box 3.7. **Joint donor missions and reviews**

Joint donor missions and reviews have proved very valuable in preparing and managing sector development programmes. They put donor collaboration into practice and can reduce the separate demands of individual donors on government time.

For example, in the health sector in Tanzania, many individual and separate reviews undertaken by development partners in the past have now been replaced by a "Joint Annual Review" which is led by the Ministries of Health and Regional Administration and Local Government, in close collaboration with other parts of government, development partners, other health sector stakeholders and civil society. The joint review is now recognised as the main forum for gathering all stakeholders in the health sector to review performance over the previous year, discuss critical areas of interest, address key constraints, reach conclusions and make commitments on selected issues for the coming year.

This follows a pattern successfully adopted by many other SWAps (*e.g.* in Uganda and Ethiopia). Uganda has gone further than many countries in inviting donors to be involved in sector working groups that have a direct input in the annual budget and planning cycle.

The engagement of government as well as donors in such reviews is crucial, and it can be useful to have a two-stage process, where an independent review of the sector is followed by formal dialogue on its findings between donors and the partner country government.

Among other benefits, involvement in such reviews helps keep donors in touch with local issues, even when they do not maintain separate projects.

Joint reviews can play a useful role internationally as well as within countries. In this connection, the SPA's Sector Support Working Group's (SSWG) Tracking Exercise has proved to be an effective tool for undertaking cross-section analyses and monitoring progress in implementing SWAps.

Mechanisms for sector dialogue and co-ordination

SWAps require formal, government-led mechanisms for co-ordination and dialogue at the sector level. It is generally possible to address weaknesses in any of the other components as long as the co-ordination system is strong and there is adequate government leadership of the sector. Conversely, where co-ordination is weak, problems in other areas tend to become intractable. However, a basic principle is that such mechanisms should not substitute for, or over-ride, the proper structures and responsibilities of the partner government. Thus the national budget should be the principal mechanism for allocating public resources (including aid) and the national parliament should be the source of authority for national policies, plans and budgets. Where weak governments and high levels of aid dependency have eroded this principle, a key objective for SWAps and for other aid co-ordination arrangements should be that they help to restore appropriate lines of national accountability.

Build sector co-ordination mechanisms in collaboration with partner governments. As well as being government-led, the sector co-ordination arrangements need to be consistent with the structure and responsibilities of the national government. This means, in particular, that: *i)* the Ministry of Finance (and the Ministry of Planning, where separate) must be involved and have a clear role; *ii)* the responsibility assignments and lines of accountability defined in the country's decentralisation system should be respected (see Box 3.6); and *iii)* when practical, the sector co-ordination mechanisms should be connected to the wider framework of co-ordination and dialogue around the PRS (see Box 3.8 for an example).

Address all components of a dynamic co-ordination system. It is important not to see things too narrowly in terms of a "steering committee" at the apex of the SWAp. The co-ordination system is defined more broadly by its documents, forums, and calendar:

- *Documents* that help to define the co-ordination system include the sector development strategy and expenditure programme, various agreements about the management of the

Box 3.8. Aligning sector and PRS co-ordination frameworks in Ethiopia

Ethiopia has a number of long-standing sector development programmes (education, health, roads). Each has a durable framework of strategy documents/expenditure programmes, joint consultative mechanisms, and a system for annual monitoring and review. Following the adoption of a poverty-reduction strategy – the Sustainable Development and Poverty Reduction Programme (SDPRP) – government and donors are working together to develop a consultative framework that will facilitate general budget support for the SDPRP. This will involve integrating the SDP institutions into the overall framework by *i)* ensuring that sector indicators and targets are consistent with, and as far as possible drawn from, the policy matrix of the SDPRP; *ii)* adjusting their annual timetables to feed into a timetable for budget-support consultations that is linked to the Ethiopian fiscal year and planning calendar; and *iii)* addressing systemic issues, such as financial management and procurement, at the national level rather than within individual sector programmes.

SWAp (*e.g.* any memorandums of understanding or codes of conduct, terms of reference for co-ordinating committees, any overall manual of procedures, etc.), and the agreed set of periodic and annual performance reports.

- Principal *forums* include, as well as the high-level government-donor liaison/steering committee: technical-level bodies to facilitate practical work; donor-co-ordination bodies; *ad hoc* working groups to tackle specific issues; periodic (probably annual) joint review missions; and a wider consultative forum (again probably annual) that allows participation by a range of stakeholders. These forums need effective secretariat support. The secretariat should not be a parallel structure outside the mainstream of government, but responsibilities for servicing the co-ordinating bodies need to be clearly allocated and adequately resourced.
- An agreed *calendar* links forums to periodic documents and provides rhythm and deadlines for the work of the partnership. The calendar should include: an annual programme, timed to fit with government's fiscal calendar, for meetings, reports, and reviews; a multi-year timetable for roll-over of the main sector programme document (linked to government's planning calendar); and a work programme for related thematic research and reviews.

Inclusive consultation mechanisms and involving all stakeholders

SWAps have at times been criticised for being too focused on government's role as a service provider and on the relationship between the central government and external donors, while taking insufficient account of the interests of other stakeholders. Other national stakeholders are important for a number of reasons. Most obviously, the interests of the clients for services should be central, as part of the general accountability relationship of government to its constituency. It is also important to take account of, and consult with, non-governmental service providers in the sector. These may include NGOs, community-based organisations and the private sector. In a number of countries with relatively successful SWAps (often in the health and education sectors), civil society organisations have been active partners in every stage of the sector development for many years. Often such organisations (*e.g.* mission hospitals and schools) have been financially supported by governments and donors for decades and are naturally part and parcel of the SWAp, active members of the steering committees, and involved in planning, implementation and M&E at various levels. Whether or not non-government service provision is already a major factor, the sector strategy should review the scope for contracting activities out to the most cost-effective partners, while maintaining adequate quality assurance, co-ordination, oversight, and policy development. Adequate involvement of local government stakeholders is also important.

Inclusive consultation should be a consideration at all stages of the SDP cycle: not only during its initial planning and policy stage, but also as part of subsequent monitoring, evaluation, and accountability. Even when seeking to involve other stakeholders, consultation may be thought of too narrowly in terms of participation in various formal sector/partnership bodies, *e.g.* annual reviews or technical committees. Such participatory mechanisms play an important role, but they can be onerous for the participants, and are not always the most effective way of engaging clients and other stakeholders, or of representing their interests. Complementary approaches may include using client surveys, tracking studies, focus groups and evidence from independent research. Civil society groups, research institutions, NGOs and the private sector may be involved in the provision of independent policy advice, supervisory monitoring or independent watchdog roles, as well as in national and local policy forums. Furthermore, there may be ways to encourage a higher level of participation locally, through such mechanisms as parent-teacher associations in the education sector, or consultations with community organisations. The key point is that the concerns of the recipients of government services and other alternative providers of services should be understood and factored into the design of sector policy and strategy (and hence also into performance monitoring). Careful attention to gender issues is essential if these systems are to work well.

An inclusive approach to consultation and the involvement of a wide range of national stakeholders has significant implications – both in promoting increased accountability to the ultimate beneficiaries of sector programmes and for the development of national, not just government, capacities. This will be facilitated by general transparency in the operation of the SWAp. Systematic follow-up is important in order to maintain the credibility of the consultation process.

Institutional development and capacity building

One of the principal reasons for adopting a sector-wide approach is to break out of a vicious cycle in which weak national capacity leads donors to make use of parallel systems for aid, which further undermines and debilitates government systems. SWAps are expected to make use of national systems of planning, management, implementation, monitoring and evaluation, and to contribute to the reinforcement of those systems over time. To some extent, this is expected to happen through "learning-by-doing", and by eliminating practices that weakened systems in the past. However, more proactive measures are also likely to be required. In order to ensure that such measures are included in sector development programmes, donors should encourage the preparation of a coherent, government-led capacity-development strategy for the sector, to help co-ordinate donor support for this critical activity. With this objective in mind, a thorough analysis of capacity issues and requirements should be built into the initial preparation of a sector development programme, and into its ongoing monitoring systems.

Outside partners can play a wide range of roles in support of institutional change and capacity development. SWAps offer opportunities for bringing external partners together in an integrated way. Under sector approaches, and programme-based approaches more generally, the emphasis tends to shift from knowledge-transfer-oriented approaches based on training and technical assistance towards learning-by-doing approaches and policy dialogue. In this context, the provision of incremental resources such as might be provided through sector budget support, as part of a process of policy dialogue, can itself be a powerful force for change; such additional resources may be easier to use than conventional government resources for innovative purposes, or in support of policy reforms.

This approach is most likely to be effective in the presence of effective policy dialogue, which may include: discussion of specific policy and institutional reforms; the introduction of results-based approaches; support for increased accountability to beneficiaries; or the encouragement of stakeholder participation and transparency. By helping to link SWAps with national reform processes, donors may also be able to help address cross-cutting issues such as public sector pay and incentives, or other aspects of public sector and governance reform.

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Policy dialogue usually occurs directly between donor representatives and the partner-country government. However, donors may also support capacity development processes in other ways – by facilitating access to knowledge, technology, ideas, or new management approaches – or by helping to facilitate change via networking, the brokering of new relationships, or the facilitation of consensus building. Such functions are often best supported through the provision of technical assistance, and may involve support for a range of national stakeholders.

In the past, technical assistance and capacity building efforts have often been supply-driven and based on fragmented, poorly co-ordinated donor initiatives. This is beginning to change: for example, more systematic and collaborative (government plus donors) diagnostic work related to PFM is providing a basis for more coherent PFM capacity development work (see Chapter 4). Donors should be prepared to rethink their traditional practices and to join in a learning process based on a systemic approach to change and capacity development, and focused on strengthening partner country ownership.

Good practices for capacity development and the use of technical assistance to support sector programmes include:

- *Make capacity development an explicit, cross-cutting focus* and ensure that all donor support is driven by the national strategy and priorities.
- Avoid overloading government capacity with too many simultaneous change initiatives – *prioritise and sequence.*
- *Strike a careful balance* between *i)* efforts to fill gaps and to accelerate progress in achieving results and *ii)* the need for longer-term efforts to strengthen government institutional capacity.
- *Distinguish between the different possible roles for technical assistance* and avoid overloading it with conflicting objectives (*e.g.* external expertise may be needed to fill short-term gaps, but expecting the same experts to train their successors rarely works).
- *Use nationally and regionally available expertise* whenever appropriate.
- *Use and strengthen local procedures for prioritising and managing technical assistance* and increase government's discretion over the use of technical assistance resources.
- *Increase collaboration* among donors in supporting capacity development (*e.g.* co-ordinate and pool resources).
- *Recognise that effective capacity development and the use of technical assistance is often problematic* and ensure that sector reviews and sector dialogue pay special attention to learning about (and increasing) effectiveness.

Processes for harmonisation and streamlining

A fundamental objective of SWAps is to improve harmonisation among donors as well as strengthening their alignment with national strategies. Relying on common arrangements for budgeting, disbursement, accounting, procurement and reporting is a key objective for any SWAp and in many cases the one on which partner governments place the most emphasis. In practice, harmonisation often proves problematic, demanding of government time, and expensive in terms of technical assistance and preparatory costs. Usually this is because "ideal solutions" have been sought from the outset, which bring together all aspects of harmonisation into one unified process, typically structured around the establishment of a single common pool fund for donors' financing of the programme.

Experience suggests that this is not the most effective way to achieve progress towards harmonisation. Rather it is important to ask:

- Which aspects of harmonisation are likely to bring the greatest benefits?
- How will the costs of introducing different aspects of harmonisation compare?
- In the light of costs and benefits, what is the most appropriate sequencing of harmonisation processes?

The following pointers on harmonisation are suggested by experience with SWAps to date (and echo many of the good practices already identified for each component of a SWAp):

- ***The formulation of an agreed, government-led sector strategy and programme is the foundation for harmonisation*** and a prerequisite for moving donor funds on budget and/or harmonising systems and procedures among donors.
- Similarly, the ***establishment of a formal co-ordination framework for the sector*** can create powerful, collective pressure towards harmonisation.
- ***Co-ordination amongst donors is key to an efficient SWAp.*** As already noted, transparent mechanisms (*e.g.* donor sector working groups), which help donors exchange information and develop a common perspective, are among the first building blocks of a SWAp. Donor-donor discussions of the issues and the preparation of joint responses to government drafts can be useful in developing consensus among donors, disciplining them to focus on the essentials and shielding government from having to react to a multiplicity of similar responses.
- A designated ***lead donor***, and the subset of donors represented on the high-level co-ordination committee, can play an important role in simplifying links between the partner government and donors. It is important that the lead donor is trusted both by the government and by the donor group and is not perceived to be taking advantage of its privileged access to government to further its own agency interests.
- ***Strengthening government PFM systems, by making use of them, remains the preferred approach.*** Most often it is broadly fiduciary aspects of budgeting, accounting, financial control and procurement systems that require attention, and these usually transcend sectors. The donor community has made substantial progress in developing standard criteria for fiduciary assessments (see Annex). SWAp donors should aim as far as possible to draw on common fiduciary analyses and work with partner governments to develop and support agreed strategies for strengthening of government systems (these themes are developed in Chapter 4 and Annex).
- ***Pooled funding of the whole sector or sub-components*** can also play a useful role in co-ordinating donors and reducing transaction costs for the government but, as noted earlier, careful design is required to ensure that benefits exceed the costs. More progress is made when the pooling group is similar in outlook and approach (a coalition of the flexible) than when it attempts to address the constraints of the full range of donors. From the government's point of view, even a modest element of more flexible funding may be especially valuable in mitigating the inflexibility and lack of discretion that is often implicit in project modalities.
- Donors can also ***work to limit the transaction costs imposed by the number of donor agencies as well as the variety of donor systems*** confronting government. Each donor should carefully consider the range of sectors and sub-sectors in which it seeks direct involvement. More use could be made of co-financing and silent partnerships.

- ***Reporting and monitoring is an area for "quick wins"*** in harmonisation: adoption of common formats, calendar and process for monitoring a SWAp can make early transaction costs savings for government while focusing the attention of the SWAp on agreed results. An agreed annual review process reinforces the conception of a sector development programme as a flexible approach that is continually rolled forward and adapted in light of experience.
- As regards ***substantive monitoring requirements*** donors should harmonise in ways that:
  - *Avoid multiplying the number of key indicators sought;* set performance targets and reporting requirements in ways that are sensitive to the country's institutional environment and capacity.
  - *Are realistic about timescales for reporting,* including financial reporting – especially when decentralisation lengthens the reporting chain.
  - *Minimise* their separate review and evaluation *missions* and routinely *share* M&E information.
  - *Rethink accountability:* support mechanisms that strengthen horizontal accountability and lessen the need for detailed upward accountability to higher levels of government and to donors themselves.
- Donors seeking to support the strengthening of different aspects of government management systems should *operate within the framework of an agreed overall capacity development strategy* which takes account of appropriate sequencing and the government's capacity to absorb and consolidate an agenda of reforms.
- Finally, in the spirit of mutual accountability, SWAp donors should transparently monitor their own progress in harmonisation and alignment.

Notes

1. The World Bank's 1995 paper on "Sector Investment Programmes" (Harrold, *et al.*) was seminal, but of course good governments have been thinking and acting on a sector scale for much longer.
2. And the Ministry of Planning, when agencies are separate.
3. Revision of the budget classification and chart of accounts is often an important PFM reform.

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Harmonising Donor Practices for Effective Aid Delivery

Chapter 4

Capacity Development in Public Financial Management

This chapter describes good practices donors can apply to support capacity development in the area of public financial management. Case studies illustrate how effective support of capacity development is beginning to take shape in a few countries and it provides guidance to donor organisations looking to improve the effectiveness of aid delivery aimed at capacity development in public financial management.

Key issues

Good governance in public financial management is critical to countries making progress in reducing poverty. Good financial governance encompasses competent and democratically legitimate policy formulation as well as an effective, efficient, transparent, and rules-based PFM system. The HIPC Debt Initiative underscored the connection between the quality of PFM systems and poverty reduction several years ago. Most of the poverty reduction strategy papers developed by partner countries today explicitly recognise that poverty reduction is not merely a question of spending more, but of maximising resources. If progress toward implementing the Millennium Agenda and the Millennium Development Goals is to be made, it is doubly urgent to improve PFM as an enabling condition for poverty reduction. Partner countries are beginning to recognise that problems in sectors such as health, education, and agriculture may have a common origin: weak PFM. Making aid flows more predictable, improving procurement systems and granting budget support also requires adequate capacities in PFM. While capacity development is central for all modes of delivery of development aid, the growing interest among donors granting loans to move to budget support as an alternative to project-based lending has fuelled increased concerns over capacity development in PFM.[1]

The United Nations Development Programme defines *capacities* as comprising "the ability of people, institutions and societies to perform functions, solve problems, and set and achieve objectives" (UNDP, 2002). *Capacity development* denotes the *process* by which partner countries are enabled to make better use of existing capacities and to further develop capacities at three levels: *i)* the individual level, *ii)* the level of organisations; and *iii)* the institutional and political level. The Norwegian Agency for Development Cooperation (NORAD) and the Swedish International Development Cooperation Agency (Sida) state that c*apacity development in PFM* aims at developing the rules and procedures in PFM, organising the work and providing resources (physical, human, financial) in a way that facilitates their efficient implementation; and equips people in the organisations with competencies to operate efficiently in accordance with them (NORAD/SIDA, 2002). The overall aim is to make PFM an efficient tool for implementing policies and producing services for the benefit of the people as well as providing an accountability mechanism for controlling government and the public service.

In this chapter, PFM is assumed to include: instruments and measures for budget formulation; revenue administration; commitment and payment of expenditures; internal control and audit; debt management; accounting and reporting; external audit; legislative oversight; and fiscal decentralisation.[2] PFM is also concerned with certain cross-cutting themes such as budget comprehensiveness, transparency, fiscal discipline, and efficient resource allocation to priority needs. The "PFM Performance Measurement Framework", proposed by the World Bank-IMF-PEFA Working Group, attempts to cut across national and cultural distinctions to provide a common reference guide as to what represents good practice in each area of PFM, for instance.[3] While most donors have focused in the past

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decade on "*what*" PFM reforms should look like, *e.g.* enhanced practices and procedures in organisations, only a few have reflected on "*how*" capacity development in PFM takes place. To move forward, much more attention must be given to the "*process*" of developing capacity in PFM. A new paradigm is needed – one that is less focused on imposing a particular PFM blueprint and one more focused on facilitating an environment in which PFM capacities build progressively.

In addition to its technical aspects, capacity development in PFM also has an inherently political dimension. Reforms of budgetary systems require high-level political support if they are to be realised. On the donor side, increasing emphasis is placed on the adequate mode of delivery for partner countries (including stand-alone bilateral technical co-operation, technical assistance within pooling arrangements, SWAps and budget support) and on its relationship with PFM reform activities, especially regarding the matter of sequencing. For instance, while some donors argue that budget support has beneficial effects as it initiates PFM reforms within partner countries, others stress that establishing a reliable PFM system in the framework of technical co-operation should be a pre-requisite for providing efficient budget support. Donors therefore need to focus on both developmental and fiduciary aspects.

The high technical complexity of capacity development in PFM, as well as its political dimension, stresses the need for more – and better – donor harmonisation.

Purpose

The purpose of this chapter is to highlight some of the good practices donors have been applying to effectively support capacity development in the realm of PFM. Based on country experiences, the good practice examples provided here are not intended to be exhaustive or prescriptive, but rather to illustrate how effective support of capacity development is beginning to take shape in a few countries. This chapter also seeks to provide guidance to donor organisations looking to improve the effectiveness of aid delivery aimed at capacity development in PFM.[4] It draws upon common principles that can/should be applied to PFM capacity development, though the application of them will vary across countries.

Guiding principles

An overarching principle that must guide our work in the future is that capacity development is not a donor activity, but a task for partner country governments. In other words, capacity development is primarily endogenous to a country, based on voluntary action and motivation. Exogenous aid initiatives can support capacity development, but they are not a substitute for it. Capacity development efforts should therefore be rooted in the partner country's goals and strategies. Furthermore, the motivation for capacity development should transcend the mode it is to be delivered by.

Though some efforts to support capacity development over the past decade have fallen short of expectations, important principles have emerged that can guide work going forward:

1. **Supporting country leadership and ownership should be central to donor approaches.** Capacity development is most likely to succeed when countries view it as serving their own self interests and are committed to taking the actions necessary to implement it. Donors have little ability to create incentive for capacity development where it does not

already exist, but for many countries elements of a PFM capacity development strategy already exist in some form. The role of donors therefore is to *facilitate* rather than direct the process of turning broad goals and strategies into an actionable plan.

Country ownership implies an engagement throughout the entire value chain of activity problem definition, diagnostic analysis, design of the action plan and proposed interventions, and implementation. Country leadership may mean that some donor-specific interests or requirements cannot be pursued immediately. However, donor facilitation of country leadership throughout each phase of capacity development is essential to achieving genuine impact.

2. **Capacity development design and sequencing should fit specific country circumstances, rather than reflect standard or imported solutions.** Effective capacity development starts with a premise of *building* upon what already exists, rather than transplanting entirely new systems. Capacity development in PFM should make use of local knowledge and build upon existing values where possible. The timing and scope of interventions are designed to be consistent with the country's capacity – be it political, social, or managerial – to implement change. All too often, well-meaning capacity-development programmes have led to over-stretching key government officials and dispersing effort, thus minimising results. Well-sequenced capacity development also takes into account the building blocks of a PFM system that must be in place for subsequent reforms to succeed. It balances the need to generate short-term "wins" with a longer-term view of how deep and lasting change occurs.
3. **The institutional, organisational and individual levels of capacity development, including managerial and technical aspects, should all be taken into account in programme design and implementation.** Capacity development must be viewed from a holistic or systemic perspective, and not merely as a transfer (*e.g.* of skills). Though new equipment, training programmes, and updated procedures all play a role, design of effective capacity development takes into account the political, institutional and organisational context in which change must occur. Technical solutions should be also supplemented by *reviewing* the broader social/political context, incentives for various stakeholders, the impact of human resource policies and practices, as well as the culture of the public service as a whole. In some cases, individuals may already have the necessary skills and experience, but the environment or organisation in which they work inhibits performance. In promoting change, and in order to achieve sustainable results instead of temporary islands of excellence, it is important to understand how these various system levels interact. Donors must increasingly consider change management issues, and how the process of developing capacity can be managed effectively by the organisation.
4. **Donor support should be provided in a coherent, co-ordinated, and programmatic manner.** One of donors' primary responsibilities should be to minimise the transaction costs (of working with multiple donors) to government. Therefore, wherever possible donors should strive to harmonise procedures and monitoring mechanisms. As to the content of capacity development, the government's own action plan should be the focal point for determining support. Though donors may come with different areas of expertise within the overall programme, their support should be complementary rather than competitive or duplicative. Support should be phased over a multi-year horizon in order to take into account the long-term nature of capacity development. Likewise, interventions should be programmed in a way that reflects how they fit with the country's development objectives.

Good practices

Facilitating country leadership and ownership

If capacity development is to succeed, partner country leadership and ownership are critical. Capacity development has often been supply-driven (by donor needs) rather than demand-led (by the partner government agenda). Regardless of the level of funding, commitment, or technical expertise of the donor agency, without national champions for reform, investments in capacity development have rarely proved significant or sustainable. Tying capacity development to loan conditionalities has also had questionable impact with regard to generating true country ownership. In contrast, donor agencies must move from leading capacity development to facilitating it. On the other hand, partner countries must be prepared to decide on the support donors provide. By encouraging the partner country to take a lead in the identification and design of capacity development efforts in PFM, the donor agency benefits from important insights into where critical entry points are and which recommendations are appropriate in the country's context. Because capacity development in PFM can entail major changes in organisational behaviour and incentive structures, those who understand these changes should be involved in the design of capacity development programmes.

Despite the benefits from encouraging country leadership and ownership, it has been difficult to achieve at times. Incentives within donor organisations themselves sometimes play against the slower, more facilitative role that is needed to encourage country leadership. Pressures, such as to conduct diagnostic analysis and/or show results on the ground, can lead donor agencies proceeding with activities, even while government may be questioning their utility or timing. Similarly, the objectives and goals of donors and partner countries sometimes diverge; they may not agree on priorities, or donor objectives may seem more ambitious than those of the partner country. There are other situations in which doubts prevail among donors about government's ability, for example, to diagnose the areas of weakness and to prescribe appropriate remedies.

Though views are mixed, some significant and telling examples regarding how to encourage country leadership and ownership have emerged in recent years:

- ***Take a long-term view of the engagement and building a common language for dialogue.*** The complexity of capacity development in PFM in a specific country context and implementing new structures and procedures, etc. require a long-term perspective in planning and executing activities (see Box 4.1). Possible backlash effects need to be taken into account.[5] Getting government to embark upon a capacity development programme may often need to start with simply building a common understanding of the current problems and challenges. In Andhra Pradesh, for example, financial control and financial accountability issues were appropriate concerns for donors, but they were not the initial priority for the government. As a result, donors adopted a flexible approach to priority setting and assisted the Andhra Pradesh government with improving the predictability of budget releases to spending ministries. After this was accomplished, the government opened the door to discussions about financial control issues. The donors' sustained dialogue and willingness to adapt to country circumstances helped the partner government develop home-grown reforms in financial accountability.
- ***Use joint diagnostics to facilitate ownership.*** The diagnostic phase should be used as an input to capacity development: reviewing existing capabilities and institutional arrangements; investigating and building linkages; exploring sequencing and priorities;

Box 4.1. **Supporting ownership in Vietnam**

The Japan International Cooperation Agency (JICA) has been providing technical support for Vietnam's tax reform since the mid-1990s. In this context, JICA took a number of steps to support ownership:

- At the request of the Vietnamese authorities, the area of co-operation between Japan and Vietnam was narrowed down – to focus on the introduction of a personal income tax.
- In order to help the government make an informed decision on appropriate choices for Vietnam, the Japanese experts, rather than proposing blueprints, presented the government with alternative personal income tax models of personal income tax based on viable examples drawn from other Asian countries.
- Building upon the Vietnamese government's practical expertise, the Japanese and Vietnamese ministries of finance have been twinned and are significantly strengthened.

Source: JICA (2004), "Workshop on Capacity Development in PFM", mimeo, Berlin, September.

and commencing preparation of training essential for reform, etc. Too often this comes late or even falls short in the process when the technical diagnostic is conducted. This may lead to overambitious plans and delayed implementation. In Tanzania, the government and donors have redefined the traditional public expenditure review work from a study that primarily fulfils fiduciary requirements to one that is part of the government's work plan and helps to feed into the annual budgetary decision-making cycle. Though the PER still provides key information to donors working in critical sectors, the process is primarily organised alongside the government's own budget process and feeds into it. Donors work in a supportive role under the government's leadership, even as it conducts further analytical work. In Senegal, a different approach was taken, but the process for conducting PFM diagnostics included an extensive government counterpart team. A joint government-donor workshop on the findings and recommendations was used by government to formulate its own action plan for capacity development.

- ***Build upon external incentives for reform.*** In some countries, external influences or political crises have helped make capacity development a priority for government. For example, in both Colombia and Guatemala – two countries which successfully implemented new information systems for financial management – public pressure to address corruption and improve transparency in public finances made reforms politically important. In Benin, however, the government's participation in regional bodies such as the West African Economic and Monetary Union provided an additional incentive for embarking upon PFM capacity development because of the desire to meet the new standards (*e.g.* in budget nomenclature) that were being established for member countries. At times, capacity development must be opportunistic.
- ***Step back to create space for government to lead.*** Where government does not appear to be leading the process, it presents particular challenges for donors. Where adequate information is available about the nature of the problems faced, donors may need to give government time to respond. In Madagascar a substantial body of analytical work had already been conducted by various donors on the problems in PFM, little of which had been incorporated into the government's strategy. When a new government that was committed to PFM reforms was elected in 2002, donors made the choice to step back and

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allow the government adequate time to develop its own reform agenda and action plan. Once the 2003 Action Plan was unveiled, donors accepted it as the focus for government-donor dialogue about capacity development and how donors could assist.

- ***Rely upon the leadership of the ministry of finance and beyond.*** Leadership by a partner country's ministry of finance is critical for implementing capacity development concerning PFM. In particular, the top management of the ministry of finance should actively participate in the reform process. Nevertheless, reforms can be easily derailed if the operational staff does not understand and/or support the change. This requires that middle management be involved in the design of actions aimed at promoting change in order to gain acceptance and active co-operation from the staff. This implies creating a "culture of ownership" regarding the reform process. Therefore, it is desirable at each stage of the process to communicate information on progress, and to encourage and respect feedback (see Box 4.2 for an example in Lebanon). The broader and more far-reaching the capacity development, the more likely it is that champions will be needed beyond a single ministry. For example, in Guatemala, leadership of the reform extended to the presidential level as it became clear that improvements in social outcomes would only be achieved by improving the underlying PFM system. The political context at the time – the end of a civil war and negotiations with guerrilla groups – made

Box 4.2. **Supporting "agents of change" in Lebanon**

Since 1993, the Lebanese Ministry of Finance (MoF) has embarked on a number of initiatives to implement the government strategy to modernise its economy and place it on a sustainable growth path. The development of training programmes to instil more professional working practices, and induct a new generation of highly skilled staff, is critical to the success of the reforms.

In 1996, the Lebanese MoF established the "Institute of Finance" (IoF) (supported *inter alia* by Adetef, a training and communication centre). As an "agent of change" the IoF is charged with carrying out the first ever in-house assessment of MoF staff: it has access to a database of all its employees.

One of the IoF's major tasks was to help improve internal communication at the MoF, thus ensuring that senior management had a good understanding of the aims and benefits of the new systems being introduced, and identified with them. By engaging current and new staff in the reform process and encouraging them (through dialogue, learning and exposure) to adopt modern work methods, procedures, and information tools, the IoF helped the MoF ensure ownership of the reform efforts. This has also led to creating, within the MoF's various directorates, an enabling environment for staff to continuously develop their knowledge, upgrade their skills, and provide orientation and coaching and clear career paths to the new generation of young staff.

In 2003-04, the IoF became a resource centre for other Lebanese public institutions, and has been instrumental in training staff in ministries of finance in various Middle East and Arab region countries. Today, it is one of the leading learning public sector institutions in Lebanon and the Arab region. The IoF has been successful in building partnership schemes with specialised local, regional and international institutions, as well. Consequently, the IoF has facilitated the participation of Lebanese MoF staff in training and learning events outside Lebanon.

Source: ADETEF (2004), "Workshop on Capacity Development in PFM", mimeo, Berlin, September.

progress imperative, and extensive analytical work had helped establish a link between the ineffectiveness of the health sector and weaknesses in the PFM system. The reforms included implementation of a new computerised information system and a significant decentralisation of financial responsibility to newly established accounting units in line ministries. Though seemingly limited in scope, it was clear that the new financial management system, accompanying regulations, and institutional structures would have wide-ranging ramifications. Significant downsizing occurred in the reorganisation of functions, and new posts were established.

More generally, capacity development in PFM should take into account the need to strengthen democratic transparency, accountability and control. Institutions and organisations that are outside the executive branch of government can also be important to building commitment and ownership of capacity development. In Bangladesh, for example, not only was the minister of finance firmly behind capacity development in PFM, but so was the comptroller and auditor general. The support of the comptroller and auditor general has been important because much of the capacity development efforts have focused on accounting practices and procedures (including a new chart of accounts), updated accounting manuals, and the creation of new management-accounting units within the largest spending ministries/divisions. Moreover, in situations where support from the executive branch may be weak, donors may need to reach out to the legislative body, the external audit organisation, or civil society in general. By informing the public and the legislature about PFM issues, an initial constituency for PFM can be nurtured which may eventually influence the executive.

Finally, it is helpful to clearly define responsibilities for managing the complex reform process. Thus, with the proper incentive structure in place, an "agent of change" can be created, and the progress of the reform process can become in the members' own interest. Identifying and supporting "agents of change" is all the more helpful in countries with a comparatively low demand of reforms in place on the partner-country side.

- ***Build awareness and ownership in line ministries.*** While support for capacity development tends to be cultivated at senior levels of government and within the ministry of finance, ownership of capacity development by line ministry staff has also been an important factor of success in some cases. For example, with the implementation of programme budgeting in Benin, support from key line ministries was vital to its acceptance. In Guatemala, development of the Financial Management Information System generated support within line ministries to see the changes implemented. Training and outreach extended to a wide range of users, which helped build interest in the new system – even down to the technical staff. In Bangladesh, likewise, the project team made it a priority to create a "bottom- up" interest in capacity development and the PFM reforms underway. Success stories were publicised and support broadened. Formal and informal teams, as well as functional and cross-functional teams, were promoted and nurtured to facilitate the exchange of ideas, share experience, and identify common ground for co-operation.

Generally speaking, one can expect that the stronger and more widespread the level of political commitment, the more complex capacity development can be sought. In environments where country ownership and political commitment is weak or narrowly focused, capacity development is more likely to focus on routine or technical issues, such as accounting procedures. In contrast, areas that would involve major shifts in institutional responsibility should be accompanied by strong political commitment, bureaucratic willingness, and some degree of capacity. In Bangladesh, a strategic decision was made to start off with the more technical types of issues (*e.g.* budget classification, accounting practices, etc.) before endeavouring to change areas that would create strong bureaucratic resistance.

Adapting strategies to country circumstances

Capacity development efforts must be tailored to country circumstances if they are to succeed. "One size fits all" solutions cannot be applied across countries: reforms in the field of fiscal decentralisation, for example, have to take into account a country's existing structures and inter-linkages (*i.e.* of the political and administrative layers – central, regional, local, etc.). Likewise, the sequencing of reforms in PFM has to take into account country-specific factors, including the political climate for reform, institutional incentives, and the managerial capacity to lead the process. In addition, some elements of the PFM system may be more critical to address as a foundation for moving forward in other areas.

- ***Be responsive to government's most pressing needs.*** The entry point for capacity development will vary country to country; there are no fixed parameters on what aspect of PFM should be addressed first. In some countries, such as Hungary, building a reliable treasury system was the first priority in its post-communist transition. In Sierra Leone, getting the payroll system working was a priority following the end of civil conflict. Other countries may start with revisions to the legal framework governing PFM. Though diagnostic work may indicate donors' views of the weakest areas of a PFM system, it provides little indication of the government's priorities. The areas that appear weakest may not necessarily be the most critical to PFM improvement or the most feasable given the current institutional climate.
- ***Support government in setting clear objectives and advancing incrementally.*** In a complex system like PFM, it is not possible to identify all the relevant reform variables *ex ante* (which may be subject to unpredictable changes). Hence, it is necessary to continually monitor the process to ensure that reform activities are on track and readjust them if necessary. This requires a clear set of objectives, priorities and clearly-delineated activities, outputs and success measures, which the donors should also bear in mind. A formulated action plan should be clear in its objectives, but flexible in its approach, to allow it to respond to unforeseen events. "Trial and error" is the underlying principle to achieve these objectives. This implies that the reform process should be shaped by small reform phases that allow for quick re-orientation when necessary. Furthermore, progress needs to be continually monitored and reviewed throughout the reform process: monitoring and evaluation should be impact-oriented and cost effective. It may be advantageous to focus on the improvement of routine processes as it requires less managerial capacity and is easy to monitor.
- **Focus on a specific PFM outcome, rather than a department or function.** Partner country officials also make judgments about what the institutional incentives are, and must balance long-term strategic objectives with the need to show short-term gains. In Sierra Leone, not being able to execute the payroll represented a substantial risk and one which government felt had to be addressed immediately. This became a way to develop other capacity-development elements that supported effective payroll management, including strengthening the internal audit of payroll. Thus, capacity development initiatives focused on specific outcomes guided the design of training and other capacity development.

- ***Reform fundamental procedures and structures first.*** The type of capacity development should be appropriate to the state of a country's PFM system. Procedures and practices that are used elsewhere may not necessarily be appropriate in the partner country, especially if certain preconditions do not exist. For example, in a system where annual budgets have little meaning because of large reallocations during the year, introducing a MTEF may be premature. In short, governments and donors need to assure that the basics are being addressed, particularly as they impact other parts of the PFM system (see Box 4.3). Though in its early stages, an approach is being tested in Cambodia in which donors dialogue with government around four progressive "platforms" of PFM performance. Only after the first PFM platform is achieved do donors and government consider the next platform. The first platform focuses on budget predictability and is planned with a two-year time horizon. Having agreed upon the goal, donors can be more receptive to various strategies government may propose and avoid pressing for other objectives.
- ***Extract key concepts in lieu of replicating whole systems.*** Effective capacity development attempts to build on what is already in place, rather than replace whole systems. Building on existing capacities, easy-to-handle instruments and procedures can be more easily implemented than sophisticated ones. Some advanced concepts can be introduced gradually, but only by extracting the elements that are most practical for the country. Programme budgeting, for example, may have some useful concepts that can be applied to a developing country PFM system. But the focus should be on slowly introducing the basic principles without trying to replicate a system found in more industrialised countries.

Integrating managerial and technical aspects

Donor experiences show that effective capacity development should also include the consideration of change-management themes. How government will manage the process of building capacity can be as important as the PFM proposals themselves. Managers are often busy and over-stretched with day-to-day responsibilities; many capacity

Box 4.3. **Getting the basics right**

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

Source: World Bank (1998), *Public Expenditure Management Handbook.*

developments efforts require thinking about activities that will have a longer-term impact. Use of external technical assistance may fill gaps, but this is not a solution in itself. In this respect, training of individual staff should not be ignored.

PFM capacity development must also be thought of systemically, or holistically (see Box 4.4). Changes in one area are likely to be influenced by changes, or the lack thereof, in other areas. No component of the PFM system stands in isolation; the technical aspects of PFM in individual, institutional and organisational terms cannot be separated from their managerial and even wider cultural context. At times, the legal framework, the institutional incentives, and the human resource policies in place can all have an impact on whether capacity development efforts succeed. Moreover, civil servants may already have the needed technical capacity, but are hampered by the institutional setting and incentive structure in which they work. Though these issues may not all be addressed at once, they should nevertheless be factored into the design of capacity-development programmes.

The functioning of a PFM system depends on all these elements and their interplay. Hence, effectively developing capacities in PFM calls for a broad understanding of PFM systems – including all relevant PFM-areas and capacity levels and their inter-linkages. Both managerial and technical aspects should work hand in hand. The picture grows more complex as PFM systems are also integral parts of the overall public sector. The quality of

Box 4.4. **Linking PFM sub-systems in partner countries**

A partner country's budgetary process should be unified and its ministry of finance should be sufficiently empowered. In particular, the budget department of the ministry of finance should be fully responsible for the preparation of the budget. This includes the capital investment budget and the review of sectoral budget submissions.

- A unit for macroeconomic and fiscal forecasting should be established in the ministry of finance.
- The distribution of responsibilities between the treasury department and the budget department should be clarified and their co-ordination should enhance the preparation of the budget implementation and cash plans.
- Debt management departments should be unified. Linkages between debt management, preparing budget implementation and cash plans are required.
- Co-ordination between tax administration and departments responsible for preparing tax forecasts, and continuously updating them, might be reinforced.
- Inter-ministerial co-operation needs strengthening at the political and operational level, *e.g.* Ministry of Finance – Ministry of Economy – National Statistics Office.
- Parallel reforms at the central and sector level are required, *e.g.* improving investment budgeting depends on the effectiveness of procedures to screen and select projects within the line ministries; dealing with the problem of generating arrears requires an efficient internal control within line ministries. Conflicts between the central and the sector level should be avoided.
- Attention should be given to the linkage between the central and sub-national layers. Devolution requires *e.g.* improved circulation of information and increased awareness of fiscal problems within sub-national authorities.

Source: OECD (2001), *Managing Public Expenditure*, OECD, Paris.

the PFM systems depends on the shape of the overall public sector. A general lack of transparency within the overall public sector, for instance, negatively impacts the PFM.

Furthermore, PFM systems are embedded in a society as a whole (see Box 4.5). In order to avoid creating islands of success in oceans of failure, an effective PFM system requires a society of constituents willing to bear their tax burden and to make use of their rights. Good financial governance is, therefore, closely related to overall existing key issues like respect for human and civil rights (and a denunciation of corruption, bribery, and tax evasion). Thus, as mentioned above, successfully supporting reform activities requires an understanding of the country context. On the one hand, normative rules defining constituency rights and obligations (*e.g.* on which incomes to report) need to be followed. On the other hand, rights granted have to be utilised (*e.g.* making use of tax allowances or complaining against improper tax assessment). Thus, the constituency has to be informed about changes. Marketing is especially important in terms of gaining the support of the public at large and in creating legitimacy. Besides increasing the efficacy of reforms, this will also create a greater sense of ownership.

- ***Integrate institutional and organisational issues.*** Some forms of PFM capacity development risk substantial institutional resistance. In the case of Turkey, the PER exercise was transformed into something that went beyond the typical examination of the PFM strengths and weaknesses. Instead, the process of carrying out the PER became one of capacity development. The PER was used as vehicle to bring together different institutional interests to discuss critical PFM issues. Consensus within government on a

Box 4.5. **Supporting the revenue authority in Rwanda**

When the UK Department for International Development (DfID) supported the establishment of the semi-autonomous Rwanda Revenue Authority (RRA) in 1997, it played a strategic role in the government's broader political vision. It contributed to developing a "culture of participation and citizenship" within the norms and practices of democratic governance.

At the beginning, there was a fair amount of scepticism about setting up the RRA: revenue collection was not taken seriously by the government or the public. DfID saw the need to transform the image of the revenue services and to establish a new relationship, based on trust and co-operation, with its stakeholders (Rwandan government, taxpayers, and organisational partners).

In addition to strengthening the RRA's internal organisational structures and processes, the DfID also worked to improve the RRA's relationship with its external partners. This involved a public relations campaign to build awareness; targeting consumer groups; and building in measures to increase transparency and accountability to end-users. Furthermore, by building co-operative relationships with its stakeholders, the RRA now has access to needed resources (*e.g.* technology, information, support, etc.), and has greater reach and increased effectiveness. The RRA has gone so far as to invest in the development of partner capacities, *e.g.* it helps to organise the nascent tax consultancy profession, and develop the revenue collection capability of local governments. Clearly, a key driver for success for the RRA was firmly rooted in its gaining legitimacy from its partners and citizenship as a whole.

Source: DfID (2004), "Workshop on Capacity Development in PFM", mimeo, Berlin, September.

plan of action came about through the PER exercise, and major legal reforms were subsequently implemented.

Implementation of financial management information systems (FMISs) is another area that is heavy on technical issues, but that will fail if broader institutional and managerial themes are not well integrated. FMIS projects potentially involve major shifts in responsibility from the ministry of finance to line ministries; substantial changes in the incentives and power relations within ministries; and implications for recruitment and retention. Guatemala is one of the success stories in FMIS implementation (and change management issues were squarely part of the project design). The team considered the implications for organisational structures, job descriptions, and how staffing needs should be aligned with the new informational outputs and decision-making procedures. The Ministry of Finance was reorganised to make it consistent with its new role, and new accounting units were created within line ministries that had a lesser stake in the old legacy systems that were being replaced. A wide range of users were also trained in financial management, which helped led to greater acceptance and understanding of the new system.

- ***Use training strategically to support institutional and organisational changes.*** Though the focus is often on improving organisational performance, training individuals remains an important component of capacity development. In other words, changes in procedures and policies need to be accompanied by extensive on-the-job training to ensure that the new concepts can be implemented (see Box 4.6). In Guatemala and Bangladesh thousands of individuals were trained in PFM to facilitate the implementation of the new procedures. In Benin, workshops on programme budgeting began well before a formal project was established so that key ministry officials could be acquainted with the concepts and make decisions on its implementation. During the project in Benin, there was extensive hands-on training, as donor experts reviewed draft programme budgets and provided specific guidance. In all of the country cases, training is not viewed as an

Box 4.6. **Aid and debt management in Ghana**

Development funds are critical for Ghana's solvency. The Japan Bank for International Cooperation (JBIC) decided to extend technical assistance for aid and debt management when the government of Ghana committed to its Comprehensive Financial Management Reform Programme 2002-07, which was based on the Ghana PRS. With a systemic approach in mind, JBIC's support includes individual, institutional, and organisational measures:

- Providing training for Aid and Debt Management Unit (ADMU) officers to create an understanding of a debt management system.
- Establishing administrative rules of procedure in order to enable the ADMU to collect the necessary aid- and debt-related information from relevant ministries in a timely fashion.
- Fostering systems for a better understanding of the relevant organisations.

JBIC organised three participatory workshops. In these workshops, the Ghana government personnel learned how to review the following on their own: *i)* what the problems in this area are; *ii)* why they occurred; *iii)* how they could be resolved; and *iv)* what actions should be taken. The results of a series of discussions on these issues were then reflected in the project design. Ownership was thereby strengthened, motivation was enhanced and the skills of the Ghana staff were improved.

Source: JBIC (2004), "Workshop on Capacity Development in PFM", mimeo, Berlin, September.

end in itself; it is used as a support to other organisational or institutional changes. Effective capacity development requires well functioning organisations consisting of trained, motivated and committed staff.

While it is necessary to build upon the capacities that exist, it is important to bear in mind that, in some cases, individual capacities exist that are detrimental to successful reform. These detrimental capacities are the skills individuals have accumulated (often over many years) on how to abuse the system in their own interest. As for the public sector in general, corruption, nepotism and embezzlement are major reform challenges and hindrances for a well-functioning PFM. Effective capacity development in PFM reduces these impediments. This requires not only organisational restructuring, but also changes in personnel (see Box 4.7). Well-performing staff should be retained by offering them competitive wages and other incentives; the hiring of new staff should follow merit-based principles. Experience shows that, in some cases, capacity development efforts in PFM have not led to improved administration – because civil servants who had been taking part in training programmes, but had perhaps been underpaid, left their positions to join the private sector for higher salaries. The incentive structure within public organisations has to be designed in a way that deters "brain drain" and allows for career development.

Box 4.7. **Reforming Peru's tax administration**

Peru's tax administration was riddled with corruption and on the verge of collapse. The tax agency neither recruited experienced professionals, nor provided training. As a result, tax collection declined. Thus, the government decided to pioneer the concept of the semi-autonomous revenue authority "National Tax Administration Superintendence" (*Superintendencia Nacional de Administración Tributaria* [SUNAT]), the first in Latin America. One key element was to implement radical personnel reform and to develop a plan for a comprehensive staff evaluation and replacement programme.

All staff members, who were inherited from the previous agency, were given the choice of either opting for voluntary retirement or applying for a position in the newly established SUNAT. Those who applied were subject to a three-phase exam. The first phase consisted of a psychological evaluation that focused on personality, intelligence, and moral judgement. The second phase evaluated knowledge, reasoning, and professionalism. The third phase consisted of personal interviews. Additional information from third-party sources, such as the public register and the general accounting office, was also used to evaluate the suitability of existing staff for employment in the new superintendence. Only those who satisfied all these requirements were rehired. Despite strong resistance from the union and staff, SUNAT managed to carry out the initiative, which sheared two-thirds of its staff. Bringing the number of employees to the needed 2 000, the final step was to recruit about 1 000 new staff members through a rigorous selection process at Peru's most elite private universities.

But the staff evaluation and replacement programme was just the beginning. As part of SUNAT's autonomy, it was allowed to operate under private sector labour laws, permitting the agency to design its own professional personnel system, which was seen as instrumental to the reform's success. To boost morale and efficiency, SUNAT decided to pay salaries based on comparable employment in the private sector. As a result, the average monthly salary jumped from USD 50 to USD 1 000. The new salary policy also included a provision to maintain the competitiveness of SUNAT's salary structure relative to the private sector.

Source: World Bank (2001), *PREMnote,* Number 60.

- ***Structure project management roles realistically.*** The form and quality of project management can also be an important consideration. The programme needs to have competent staff with the authority to guide and facilitate decision making at key junctures. In the Colombia FMIS case, it was concluded that it would be unrealistic to expect busy line managers to devote adequate attention to long-term capacity development efforts. Instead, they formed a group of individuals who could be devoted full time to the implementation of project activities, but would work closely with line staff. The project also benefited from a co-ordination committee of senior officials who met frequently enough to resolve inter-institutional issues.
- ***Balance local and international expertise in the implementation.*** The composition of the implementation team was an important success factor in the case of Bangladesh. The team was made up of government officials, international consultants, subcontracted national consultants, and retired senior officers. Experience in Latin America, however, suggests that use of long-term consultants should still be carefully managed. Some capacity development efforts have suffered from too many individual consultancies, which become difficult to co-ordinate and control, and costly to administer. As a result the Guatemala FMIS project was designed to keep the number of long-term consultants relatively low. And during Uganda's economic reforms in the early to mid-1990s, foreign advisors were assigned to specific departments of the Ministry of Finance and co-ordinated by one senior advisor.

Co-ordinated, programmatic support from donors

Donor support for capacity development is often fragmented and inconsistent. Rather than being complementary, the assistance is often duplicative or competitive. Though the desire may be to respond to the needs of the partner country, many donor practices are in fact intended to fulfil requirements of their own domestic stakeholders. This leads to separate funding mechanisms and pressure to show results within relatively short timeframes. Funding is often unpredictable over the medium term and technical support comes with significant restrictions. Shifting to a demand-driven (needs-driven) approach within a co-ordinated donor context, however, creates the flexibility government needs to decide how best to maximise donor support.[6]

- ***Co-ordinate donor activities to support the government's plan.*** It is critical to aligning all donors' support with a coherent national plan for capacity development in PFM. In several countries, including Tanzania and Mozambique, donors have formed a co-ordinating group that supports government activities through a jointly-funded programme. They have strived for common procedures and monitoring mechanisms. As they work together under the government's leadership, the donors reach compromises on the PFM issues that can be addressed according to the time frames agreed with government. There is still room left for donors to target specific areas of interest, but on the whole, support must fit within a common framework. Ideally, donor co-ordination goes beyond harmonising single donor activities and exchanging information. Donor co-ordination optimally includes establishing an institutionalised platform for both donors and partner countries, in order to also deal with the design and monitoring of the reform process. Donor co-ordination becomes even more important, but also more difficult, in countries with sophisticated PFM reform processes and a multitude of donors.

Making donor approaches more compatible

Capacity development binds existing capacities for reform in partner countries with donor capacities. Co-ordinating and aligning different donor' approaches allows for efficiency gains in this respect. General benefits from donor co-ordination are, *inter alia*: improved exchange of information and experiences; an acceleration of the reform process; decreased organisational costs; positive linkage effects and synergies; greater impact from donor recommendations; an improved co-operation on the partner side; and enhanced ownership and leadership. Coherent donor support allows donors to make more efficient use of their resources and increases the chances of successful capacity development.

A common understanding of technical co-operation (including similar objectives), complementing reform areas, compatible planning instruments, and methods is helpful for donor harmonisation. Ultimately, harmonising donor activities needs to be locally initiated and executed based on the local staff's willingness and ability to collaborate closely (see Box 4.8). Nevertheless, harmonisation itself generates costs: they need to be kept to a minimum. An optimal extent and form of harmonisation varies, depending on the country context (including reform objectives and specific circumstances).

Donors use different approaches when deciding how they should support partners' needs. Some donors, for example, will give more attention than others to partners' absorptive capacity. Agreeing on a common set of high-level performance indicators in

Box 4.8. **Joining forces in Nepal**

Along with the Danish International Development Agency (DANIDA), the German aid agency, *Gesellschaft für Technische Zusammenarbeit* (GTZ), has been assisting His Majesty's Government of Nepal (HMG/N) in supporting its revenue administration. As both DANIDA and GTZ supported independent activities in the areas of VAT and income tax, in 1999 the Nepalese Ministry of Finance requested that they enhance the capacities of the Inland Revenue Department (IRD), which had recently merged income tax and VAT administration responsibilities.

GTZ and DANIDA established the joint "Revenue Administration Support" (RAS) to help increase the effectiveness and transparency of the tax system through reforms in tax administration. The implementation of an information technology system by RAS has made considerable improvements to the system. During the existence of RAS, the rate of tax revenues has increased to a higher scale than GDP growth. Developing and implementing new Acts of Income Tax and VAT, combined with fitting administrative measures, have been key to this general trend. Furthermore, RAS contributes to the relation between the state and taxpayers through extensive public information campaigns to raise taxpayer awareness. The joint activity also develops long-term training plans on management functions and operations. Furthermore, RAS contributed to harmonising financial and technical co-operation. Both the IMF and the Asian Development Bank required changes in the tax system as conditions for financial support. RAS provided assistance to HMG/N in order to comply with these conditionalities.

The co-ordination between GTZ, DANIDA and multilateral donors, which was initiated and executed locally and founded on a common understanding of technical co-operation and the staff's willingness and ability to collaborate and respond, has been absolutely critical to RAS's success. Uniformly represented by both donors, RAS is considered a well-integrated and comprehensive resource centre within the Nepalese IRD.

Source: GTZ (2004), "Workshop on Capacity Development in PFM", mimeo, Berlin, September.

PFM (such as the ones presented in the Annex) is one way of achieving greater coherence of views between different stakeholders on priority areas for capacity development. It also helps focus monitoring on performance and impact of PFM reforms rather than on process based milestones.

Supporting team spirit as a key element

For donor harmonisation to work, a "spirit of co-operation" among donors should be created and nurtured. Among donors, competence as well as personal skills, *e.g.* communication skills and creativity, are key. Striving for synergies of co-operation, rather than competing in order to dominate, should characterise donors' common activities. This requires adequate capacities within donor organisations to be sensitive to other donors and respond to changing circumstances.

- ***Show flexibility in the timing of interventions.*** Experience shows that donors can be flexible in setting the focus and timing of capacity development activities. Obviously flexibility is easier when both sides can keep focused on a common long-term objective, and have a realistic view of the potential obstacles. In Benin, for example, when an external shock affected the country's primary export product, the World Bank team shifted its efforts to helping government obtain a supplemental credit to address the weather crisis. The donors also showed flexibility in their approach to working with Andhra Pradesh. First, they allowed the government time to delay addressing financial accountability issues until greater budget predictability was achieved. Then, once the government was ready to consider diagnostic work, it insisted on conducting the study itself through a local institute. The donors' flexibility in supporting this approach resulted in a quality report that had greater government ownership of the findings than would have been likely had it been a donor product.
- ***Maintain a medium-term perspective, with realistic expectations of short-term achievements.*** The platform approach in Cambodia (as mentioned above) builds upon the concept of capacity development being a multi-year and phased undertaking. Each phase or platform need not be elaborated to the same level of detail, however. Design and implementation should be centred around activities required to achieve the PFM performance objective that is set out as the first platform – *i.e.* improved budget credibility. This sets a boundary for what donors can consider and focuses both government and donors upon an agreed path. Achieving the first platform is a pre-condition for moving on to the next platform.

Notes

1. Project-based lending, including segregated project management units, has given some assurance that funds would be used properly, but the parallel systems have only undermined capacity development. Resources that could have gone directly into PFM enhancements instead went into setting up external structures. For budget support to gain wider usage, donors must still find ways to respond to the fiduciary concerns of their national stakeholders. Improvements in the capacity of PFM systems are one of the ways that partner countries are looking to address fiduciary concerns.
2. Though procurement issues are also part of PFM, they are not covered in detail within this chapter; another OECD initiative explicitly addresses this topic. See OECD/World Bank Round Table on Strengthening Procurement Capacities Development (2004), *Strengthening Procurement Capacities in Developing Countries*, forthcoming.

3. The "PFM Performance Measurement Framework" is currently structured around 28 dimensions of PFM and outlines four performance levels for each.
4. The "Strengthened Approach" to PFM that has been developed by the PEFA partners is also in line with this chapter. It is included in the Annex to this publication. The Strengthened Approach represents a greater reorientation of donor assistance from diagnostics to capacity building in support of a country's national strategy and action plan for PFM. The approach also proposes good practices that donors should incorporate to meet their fiduciary obligations while reducing the transaction costs to partner governments.
5. It can take decades rather years to achieve sustainability of PFM reforms, depending on the objectives and a country's specific circumstances. According to NORAD/SIDA a period of 15 to 25 years might be appropriate. See NORAD/SIDA (2002), p. 26.
6. Pooling arrangements, including the provision of technical assistance, involve harmonising donor procedures and practices. The level of the partner country's control for donor support can vary widely. Future experience will show which level of partner control can reduce fragmentation and increase the scope for national ownership.

References

NORAD/SIDA (2002), *Best Practice in Capacity Building in Public Finance Management in Africa*, p. 9.

UNDP (2002), *Developing Capacity through Technical Cooperation*, p. 2.

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ANNEX

Supporting Better Country Public Financial Management Systems: Towards a Strengthened Approach to Supporting PFM Reform

Joint World Bank/IMF/PEFA Public Expenditure Working Group – Consultative Paper

Introduction

Effective PFM systems are crucial to countries making progress in reducing poverty. This connection – between PFM systems and poverty reduction – was given added attention with the introduction several years ago of the HIPC debt relief initiative. Most of the Poverty Reduction Strategies (PRSs) that partner countries have developed recognize that sound PFM supports aggregate control, prioritization, accountability and efficiency in the management of public resources and delivery of services, which are critical to the achievement of public policy objectives, including achievement of the Millennium Development Goals (MDGs). In addition, sound public financial management systems are fundamental to the appropriate use and effectiveness of donor assistance since aid is increasingly provided through modalities that rely on well-functioning systems for budget development, execution and control.

A decade of intensive diagnostic and analytic work undertaken by IFIs, donors and countries[1] has generated an unparalleled body of information and knowledge on the operation of public financial management (PFM) systems throughout the world, but an increased focus on implementing reform is now required. The diagnostic work has been undertaken to support development of public financial management reform programmes that now exist in countries throughout the world and also meet the need of donors to collect information to assess fiduciary risks, inform decisions about aid modalities and design appropriate safeguard measures. While some progress has been made, assessments such as the EC's audits and the joint World Bank/IMF work in HIPC expenditure tracking demonstrate that major weaknesses remain in many countries. Efforts to improve public financial management systems are therefore entering a new phase of work. With reform programmes in place, the proposed approach reflects the need to shift country and donor focus from understanding organisational and systemic strengths and weaknesses to implementing reform and improving performance.

- **Innovations in assisting countries' establish effective public financial management systems are taking place in different countries.** These include greater government involvement in diagnostic processes, more integrated and co-ordinated assessments, support for integrated and sequences action plans, and recently to better understand the impact of governance and incentives on the performance and reform of the PFM systems. Approaches to assessing fiduciary risks are also evolving. While each donor continues to have their own criteria and thresholds when assessing fiduciary risks and taking decisions concerning the modality and quantity of its aid, increasing attention has recently been placed on partner countries' interest in strengthening their PFM systems and on the actual progress achieved rather than simply focusing on the level of PFM performance at any given time.

There is a need to capture the useful innovations that have arisen within a framework that enhances effective collaboration among the international community and governments. The modifications that have been made in supporting improvements in public financial management and addressing fiduciary needs have been important but remain partial. Progress has been made in improving country participation but diagnostic instruments are often still deployed to respond to donor and IFI timelines and schedules. The increasing use of budget support has given rise to an entirely new set of *ad hoc* fiduciary evaluations and analyses that burden country officials and threaten to create another source of conflicting policy recommendations and advice. As a result, problems now exist not in the absence of reform programmes but in their proliferation, with each plan supported by a web of different conditionalities demanded by different donors and IFIs, and related technical support, amidst a tangle of conflicting claims to legitimacy and country ownership. In many countries, it is not unusual to find five or more different action plans in various stages of implementation all designed to enhance financial management. While countries increasingly speak about achieving results, there existed no consistent framework for them or for donors to evaluate the workings of their systems or the progress that has been made to achieving better performance. In sum, there was a need for the creation of a platform that could serve as a common point of dialogue between government and donors, and among donors, that would assist in managing the developmental and fiduciary dimensions of public financial management reform.

- **This note sets out a proposed approach to supporting improved public financial management performance through aligning donor and IFI assistance to country-led programmes of work.** This approach has been developed by the World Bank and the IMF together with the Public Expenditure and Financial Accountability (PEFA) programme,[2] and in consultation with the OECD-DAC Joint Venture on Public Financial Management. It identifies a flexible approach to building constructive partnerships among countries, donors, and IFIs focused on delivering results on the ground.

Building upon lessons and good practices from existing work, the "strengthened approach" is designed around three central tenets:

1. Modernising and increasing the effectiveness of public financial management systems is an activity for governments. Donors can support these efforts but they are not a substitute for government leadership, and should not undermine domestic accountability arrangements.
2. Enhancing the capacity and performance of public financial management systems requires a government-led strategy that is sequenced in accordance with country circumstances, takes account of institutional, managerial, and technical issues, and is supported by donors in a coherent, co-ordinated, and programmatic manner.

3. Rigorous and consistent monitoring and evaluation of accomplishments is essential for managing reform, for the creation of effective accountability for reform success and to inform donors' evaluation of the evolution of fiduciary risks.

The strengthened approach

- **The strengthened approach reflects the principles that guide all international support for development.** The Monterrey Summit of 2002 proposed a new partnership based on mutual responsibility and accountability between developed and developing countries in support of sound policies, good governance and the rule of law.[3] The summit emphasised the principle that each country has primary responsibility for its own economic and social development.

The strengthened approach has three components:

- A country-led agenda – a country led PFM reform strategy and action plan.
- A co-ordinated programme of support – a co-ordinated IFI-donor integrated, multi-year programme of PFM work that supports and is aligned with the government's PFM strategy.
- A shared information pool – a framework for measuring results that provides consistent information on country PFM performance, including progress over time.
- **A country-led agenda – A country-led PFM reform strategy and action plan.** The starting point for public financial management reform is a country-owned programme of reform[4] and a country-owned structure for managing the reform process. Country ownership and leadership are critical to successful reform, and the strengthened approach involves development of effective partnership between government and donors to support country ownership. In developing a country-led reform programme, important considerations for all stakeholders are that the programme is prioritised and feasible, and builds from the country's current circumstances and capacities.
- **A co-ordinated programme of support – A co-ordinated, integrated IFI-donor multi-year programme of PFM work that supports and is aligned with the government's strategy and budget processes.** Country-led reform programme should form the basis for IFI-donor support. Donor support will include assistance for diagnosis, development of feasible, sequenced action plans, and support for implementation with a clear focus throughout on the goal of capacity development. The programme of support should be integrated across the PFM agenda. An effective donor co-ordination arrangement should streamline the dialogue between government and donors, facilitate donor support to the government budget and PFM reform processes, maximise the sharing of knowledge, and provide a collective framework for managing donor activities. Such an arrangement requires donors to recognise each other's expertise to allow assignment of specific and non-duplicative roles. Collaboration among IFIs-donors would recognise the distinct competences of different donor agencies, and seek to integrate work into a coherent programme delivered by a broad-based team. In countries such as Cambodia, Vietnam, and Indonesia, great strides are being made in achieving consensus on the roles of different donors.
- **Ideally, a yearly programme of support would be defined based upon a dialogue between the government and donors in a government-led forum** – a practice that currently exists in countries such as Mozambique and Tanzania. Support programmes would utilise all tools at IFI/donor disposal, including further diagnostic, analytical or advisory work, technical assistance, lending or grants, in-kind support, etc. Though

further analytical work might be part of a government's action plan, the focus would be on capacity building. The emphasis on long-term capacity development would also likely influence the methods of assistance, with greater use of techniques such as partnering, twinning, and other methods designed to ensure organisational change and increased institutional acceptance of a performance-oriented ethic.

- **Commitment to a co-ordinated programme of PFM work in support of a country strategy is complemented by making use of a country's financial systems to the greatest extent feasible in all forms of aid delivery.** Alignment of donor-IFI support with country strategies can also be advanced through the method of providing financial assistance, as well as the financial arrangements surrounding foreign assistance. Rationalising and co-ordinating donor practices, such as reducing the need for separate financial and accounting arrangements for donor funds, is important in order to free up scarce human resources needed to implement public financial management programmes.
- **A shared information pool – The final feature of the approach is a monitoring system that provides objective and consistent information on public financial management performance over time.** Until now, there has not been a framework for countries or IFIs donors to determine the degree to which reforms are yielding improved performance. The absence of reliable information using a consistent set of indicators has created problems for the management of reform and has retarded the ability to identify and learn from reform success. Moreover, the lack of objective information has led to a variety of invasive diagnostic efforts undertaken by donors and IFIs required to satisfy their own fiduciary requirements. To interrupt this costly practice, a system capable of providing such information in a credible manner was therefore needed.
- **Different arrangements may exist for PFM performance measurement and monitoring depending on country circumstances and accountability requirements of donors.** Some countries, including some middle-income countries, have reasonably robust systems for measuring and monitoring results which could be relied upon by donors. In many other countries such systems need to be progressively put in place, justifying the need for a credible, externally validated assessment of PFM performance. To facilitate this, IFIs and donors have jointly developed an integrated PFM performance monitoring framework that covers all aspects of the budget cycle including budget formulation and execution, procurement, accounting, auditing and internal and external controls. The framework includes a common set of indicators (see Appendix), and an accompanying analytic report, which could provide a common platform for dialogue between government and donors regarding the current performance, recent progress and development of a single action plan for reform and capacity development. This PFM performance report describes the country context and environment for reform, elaborates more fully on performance as measured by the indicators, comments on progress with the implementation of the reform programme, and judges its likely impact.[5] It would be informed as far as possible by available analytic work on the country's PFM systems. The cooperation of government would, of course, always be important, but the nature of the involvement may vary depending on country preferences and circumstances. The government may undertake an initial self assessment, the donors and government may undertake the process together, or the government may just provide information. The assessment would be externally validated by donors to ensure that a credible and objective assessment results. The assessment of the donors should be shared with government and any difference of view

clearly recorded. The report's high-level indicators could be supplemented as needed by detailed indicators on specific aspects of the PFM system. Procurement is one area in which detailed, drill-down indicators have also been developed (see Appendix). The indicators and the report would be modified and adapted as needed based on field testing and implementation experience. To recognize diverse country conditions, some customization may be appropriate (including for sub-national levels, where required), although it is important that the indicators remain constant over time to allow progress to be monitored.

Taking forward the strengthened approach

The proposed approach could represent a significant evolution of support to PFM systems that can be characterised as moving from diagnostics to implementation. The next step is implementation on the ground. This involves tailoring the approach to country circumstances in order to support country-led reform, changes in the nature of country-donor interactions, and internal changes within donor organisations to support improved donor practices on the ground. Further dialogue with partner countries and donors is taking place. In implementing the approach, critical challenges for countries and donors include the following:

- Aligning donor support to country priorities – an issue that requires consideration of how to increase the flexibility of donor interventions.
- Tailoring analytical work to meet country needs – an issue that entails reducing and streamlining analytical work to eliminate duplication and standardization.
- Streamlining the content and co-ordination of donor conditionalities and support – an issue that requires the establishment of effective structures for donor collaboration, as well as the creation of organisational incentives to promote better integration of technical or advisory assistance.
- Ensuring a credible assessment of PFM performance over time as an information pool for donors to draw upon for their fiduciary assessments.

Notes

1. Including through the World Bank's Country Financial Accountability Assessments (CFAAs), Country Procurement Assessment Reviews (CPARs), and Public Expenditure Reviews (PERs), the EC's audits, and the IMF's Fiscal ROSCs, some or all of which have been performed in a large number of developing countries.
2. PEFA is a partnership between the World Bank, European Commission, UK Department for International Development, Swiss State Secretariat for Economic Affairs, French Ministry of Foreign Affairs, Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa.
3. See *Report of the International Conference on Financing for Development*, Monterrey, Mexico (United Nations, A/CONF.198/11), 18-22 March, 2002.
4. This may not be captured in a single document, particularly at the outset of reforms when government may wish to commence in a specific area before considering a broader reform programme. The critical issue is not comprehensiveness since they may lead to over planning but that there is government ownership and commitment to the reforms, for coherence between different elements, and for donor alignment
5. Country-specific issues *e.g.* extractive industries, or aspects of the PFM system requiring special attention, could also be covered.

APPENDIX

Consultative draft – PFM performance indicators

A. PFM OUT-TURNS

1. Aggregate fiscal deficit compared to the original approved budget.
2. Composition of budget expenditure out-turn compared to the original approved budget.
3. Aggregate revenue out-turn compared to the original approved budget.
4. Stock of expenditure arrears; accumulation of new arrears over past year.

B. KEY CROSS-CUTTING FEATURES: COMPREHENSIVENESS AND TRANSPARENCY

5. Comprehensiveness of aggregate fiscal risk oversight.
6. Extent to which budget reports include all significant expenditures on central government activities, including those funded by donors.
7. Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation.
8. Administrative, economic, functional and programmatic classification of the budget.
9. Identification of poverty related expenditure in the budget.
10. Publication and public accessibility of key fiscal information, procurement information and audit reports.

C. BUDGET CYCLE

Medium-term planning and budget formulation

11. Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting, including procurement.
12. Orderliness and participation in the budget formulation process.
13. Co-ordination of the budgeting of recurrent and investment expenditures.
14. Legislative scrutiny of the annual budget law.

Budget execution including procurement

15. Effectiveness of cash flow and procurement planning, management and monitoring.
16. Procedures in operation for the management and recording of debt and guarantees.
17. Extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with original/revised budgets.
18. Evidence available that budgeted resources reach spending units in a timely and transparent manner.
19. Effectiveness of internal controls, including on procurement.
20. Effectiveness of internal audit, including on procurement.
21. Effectiveness of payroll controls.
22. The existence of a transparent procurement system as an integral part of the overall PFM system which is supported by a clear regulatory framework that provides for competition, value for money and effective controls.

Accounting and reporting

23. Timeliness and regularity of data reconciliation.
24. Timeliness, quality and dissemination of in-year budget execution reports.
25. Timeliness and quality of the audited financial statements submitted to the legislature.

External accountability, audit and scrutiny

26. The scope and nature of external audit.
27. Follow up of audit reports by the executive or audited entity.
28. Legislative scrutiny of external audit reports.

In addition to indicators of country PFM performance, this framework also includes two indicators of donor practices which impact country PFM systems. Through these indicators, donor performance and the extent of the negative impact of donor practices, are also measured.

Indicators of donor practices
Donor 1. Completeness of donor information provided on aid flows, and comparison of actual donor flows with donor forecasts.
Donor 2. Proportion of aid that is managed using national procedures.

For each of the high-level indicators listed above, detailed explanation and guidance on scoring (A-D) has been developed. The explanation and guidance for each of the indicators is contained in PFM Performance Measurement Framework, Revised Consultative Draft, 21 October 2004, which can be found at *www.pefa.org*.

This set of high-level PFM indicators could be supplemented as needed by detailed indicators on specific aspects of the PFM system. An example is the set of indicators that have developed and presented by the OECD-DAC and World Bank Round Table on procurement.

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DAC Guidelines and Reference Series

Harmonising Donor Practices for Effective Aid Delivery

Volume 2:

BUDGET SUPPORT, SECTOR WIDE APPROACHES AND CAPACITY DEVELOPMENT IN PUBLIC FINANCIAL MANAGEMENT

The international community is committed to helping partner countries meet the Millennium Development Goal of halving global poverty by 2015. Effective use of scarce official development assistance is one important contribution to this end. This is why the development community, under the auspices of the OECD Development Assistance Committee (DAC), is dedicated to implementing improvements in aid practices that deliver more effective and harmonised support to the efforts of partner countries. The good practices presented here have been designed to respond to this concern. They represent a set of practical steps that – if applied by development agencies – should significantly improve the effectiveness of development assistance.

Following the first volume of good practices published in 2003, this second volume focuses more specifically on good practice in providing budget support (Chapter 2) and support to sector-wide approaches (Chapter 3). In doing so, it acknowledges the special relevance of public financial management issues for both of these modalities of aid delivery. This is why the last chapter of this volume (Chapter 4) is devoted to setting out good practice in providing support to capacity development for public financial management. The chapters are complemented by a substantive annex that outlines a proposed approach to supporting improved public financial management performance.

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