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# Good financial governance: Towards modern budgeting

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## Acronyms and abbreviations

| | |
|---|---|
| AAA | Accra Agenda for Action |
| AfDB | African Development Bank |
| AFROSAI | African Organisation of Supreme Audit Institutions |
| AICD | Africa Infrastructure Country Diagnostic |
| ARA | semi-autonomous revenue authority |
| ATAF | African Tax Administration Forum |
| BSMD | Budget Strategy and Management Directorate |
| COA | chart of accounts |
| CREFIAF | Le Conseil Régional de Formation des Institutions Supérieures de Contrôle des Finances Publiques d'Afrique Francophone Subsaharienne |
| DIG | design and implementation group |
| FMIS | financial management information system |
| GFG | good financial governance |
| GSM | Global System for Mobile Communications |
| GTG | good tax governance |
| HIPC | heavily indebted poor country |
| IATI | International Aid Transparency Initiative |
| ICT | information communication technology |
| IFMIS | integrated financial management information system |
| IMF | International Monetary Fund |
| INTOSAI | International Organisation of Supreme Audit Institutions |
| JCCS | joint country case study |
| LIC | low-income country |
| MDG | millennium development goal |
| MIC | middle-income country |
| MOCSAR | Ministry of Civil Service and Administrative Reforms |
| MoFEE | Ministry of Finance and Economic Empowerment |
| MoFEP | Ministry of Finance and Economic Planning |
| MTEF | medium-term expenditure framework |
| NA | National Assembly |
| NAO | National Audit Office |
| ODA | official development assistance |
| PBB | programme-based budgeting |
| PEFA | Public Expenditure and Financial Accountability |
| PEMSRD | Public Expenditure Management Systems Review Directorate |

| | |
|---|---|
| PFM | public financial management |
| PMS | performance management system |
| PPP | public-private partnership |
| PSIP | Public Sector Investment Programme |
| RBM | results-based management |
| SAI | supreme audit institution |
| SMST | Sector Ministry Support Team |
| SOE | state-owned enterprise |
| TAS | treasury accounting system |
| TSA | treasury single account |
| UNDP | United Nations Development Programme |
| UNECA | United Nations Economic Commission for Africa |
| WP-EFF | Working Party on Aid Effectiveness |

# 1

# Good financial governance: Towards modern budgeting

Good public financial governance is a core objective of modern budgeting systems. It requires having in place sound institutions governing the allocation of funds, budget execution systems that operate within the rule of law, accounting systems that have integrity and audit systems that provide assurance on the quality of financial information and systems. Above all, it requires that public funds and financial assets and liabilities are managed transparently, accountably and with integrity in the interest of nations' welfare goals.

These principles of modern public financial management (PFM) underpinned the CABRI 6th Annual Seminar programme, held in Mauritius on 18 and 19 May 2010. The annual flagship event offers an opportunity to present to network members and participating countries the technical work undertaken by the network over the year, supplemented with presentations on relevant current issues.

In this spirit, the 2010 seminar dedicated time to discuss CABRI's research on progress in and blockages to achieving good public financial governance through budgeting and financial management. At the time of the seminar, the research was underway and the seminar offered the opportunity to present the key research questions and early results and to consult with senior budget officials. In addition to this discussion of the core PFM systems required to achieve good public financial governance, the seminar also reflected on ongoing CABRI work in the key financial governance performance areas of programme budgeting, public investment spending and the interface between donor and domestic resources in budgeting.

The chapters presented here are aligned with the Annual Seminar sessions, insofar as this publication provides a record of proceedings. It is also a resource book on which participants and others can draw to apply the discussions to their specific environments.

## Core PFM systems and good financial governance

CABRI, in collaboration with the African Organisation of Supreme Audit Institutions (AFROSAI) and the African Tax Administration Forum (ATAF), is undertaking a research project towards a status report on good public financial governance in Africa. The project, in association with the African Development Bank (AfDB) and the United Nations Economic Commission for Africa (UNECA), is aimed at the preparation of a declaration on good financial governance for consideration by African finance ministers in 2011.

Chapter 2 of this volume presents a summary by Alta Fölscher of the CABRI Secretariat of the paper prepared by a CABRI research team as an input to the status report on good public financial governance through PFM systems. The research team

comprised Kwabena Adjei-Mensah, Moses Bekabye, Alta Fölscher and Ato Ghartey. The summary includes the outcome of discussions held on the paper at the seminar.

This contribution is accompanied by summary versions of Eszter Rapanos' AFROSAI paper on good financial governance through external audit (by Nana Boateng of the CABRI Secretariat) and the ATAF paper on good tax governance (prepared by the ATAF research team, comprising Joseph Ayee, Odd-Helge Fjeldstat, Lincoln Marais and Aidan Keanly). The paper by Matt Andrews from the Kennedy School of Government in the United States, which was presented at the seminar as an input into the discussion on good financial governance in Africa, is also briefly summarised by the author.

Underpinning the CABRI research on good public financial governance is the understanding that it is achieved when core budget procedures result in responsive public services through public spending that is affordable, transparent and accountable, and which funds government priorities without wastage or corruption.

The research found that PFM systems in Africa face common challenges in achieving the objectives of good financial governance. In the decades since independence, many countries have battled with crippling debt burdens, low credibility of their enacted budgets, poor links between their policy priorities and the inputs that public resources actually fund, and the high costs of wastage and corruption.

At the same time, however, African governments have put in place various mechanisms to improve budget discipline and to link their budgets to the priorities identified in national and sector plans. There is hardly a country in Africa that has not embarked on some effort to improve or reform its PFM systems. The research findings show that good progress has been made towards sound PFM practices in respect of specific PFM functions and systems in many countries. As is argued in Chapter 2, progress is manifested through better legal frameworks, more credible fiscal frameworks, the modernisation of budget classifications, improved budget processes, the widespread efforts to make available non-financial performance information and, in some countries, better mechanisms for sector planning. These upstream budget system improvements have been supported by reform in downstream PFM processes, including increased use of risk-based internal audit, progress towards the use of standards in public accounting, improved in-year reporting and steps to reform procurement systems.

Yet, progress is hampered by system-wide challenges, such as the prevalence of informality in budget systems, poor transparency and weak accountability systems. The approach to reforms is often not optimal, with issues emerging around donor involvement in the choice of reform priorities, leadership of reforms, reform sequencing, the match between reforms and local capacity and frequently, therefore,

an implementation gap between reform plans and changes on the ground. For many countries, poor integration of aid with domestic resources takes a high toll on both budget systems and budget policy effectiveness.

Within specific sub-systems of the PFM system, there are also deep challenges. Despite improvements, budget planning processes continue to be plagued by systemic weaknesses, including in revenue forecasting, lack of institutions to ensure credible fiscal forecasts, the high use of off-budget measures, weak medium-term planning, the fragmentation of capital and recurrent planning and relatively weak systematic political engagement with the formal budget process. As set out in Chapter 2, the research has also shown that, on average, African countries have weak budget execution systems, with weak cash management, poor internal controls and irregular accounting practices. Although progress in internal audit and procurement system reforms was noted, the research highlighted that further work is required. The slow implementation of substantial accounting and financial management information system reforms often hampers progress in downstream systems overall.

In conclusion, chapter 2 sets out priorities for good financial governance in PFM, namely the need to address fiscal transparency shortfalls, to take ownership of and appropriately sequence reforms, to ensure that PFM capacity matches the technical choices made in reform design, to pay attention to key common weak linkages in the PFM chain and to integrate aid on budget. Overall, a key priority is political leadership and ownership of, commitment to and involvement in the budget system.

## Ensuring value for money through programme budgeting

Good financial governance should result in the optimal use of the state's financial resources to ensure improved quality of life for all its citizens. This requires institutions that enable linkages between social need, policy-making, budgeting, spending and the monitoring and evaluation of the effects of spending.

Over the last two decades, an increasing number of countries have turned to programme-based budgeting (PBB) – budget practices that have at their base the allocation of funds to budget programmes that are linked to public policy objectives. The shift to PBB can be a radical departure from the more traditional forms of budgeting that allocate funds, in the first place, to administrative structures (ministries, departments, agencies and institutions) and inputs like personnel, goods and services, and capital purchases without systematically understanding how these would translate into the achievement of public objectives. While, in principle, the shift is straightforward, in practice it can present many problems, particularly in respect of the sequencing of change, the degree to which non-financial performance information

features in budget decisions, the quality of non-financial performance information, the match between public service management structures and PBB for accountability purposes, and the capacity changes that are required when budgets are planned and executed in terms of programmes that take into account non-financial information.

In view of the number of CABRI countries that are undertaking PBB reforms and these common challenges, CABRI initiated in 2010 a multi-year programme of learning about PBB and what works in African contexts with a country-case study of Mauritius' PBB reforms. The study was undertaken as a joint country case study, in other words by a panel of senior budget officials from other CABRI countries, assisted by a researcher and the CABRI Secretariat.

Chapter 3 presents a summary of the case study, prepared by Helene Ba, based on the original paper by Adrienne Shall. The summary is supplemented with summaries of similar reforms in Kenya and Rwanda, prepared by Aarti Shah.

In Mauritius, the main aim of the reforms was to improve the effectiveness and efficiency of public spending. The country first embarked on PBB reforms in 2003, when it introduced PBB in six pilot ministries. However, in view of the lack of an explicit, general policy framework for the institution of PBB, ministry officials had little incentive to prioritise and control spending against objectives within hard constraints. In 2006, under the economic reform programme, the government reopened the reforms, this time within the context of a medium-term expenditure framework (MTEF) and as part of overall fiscal management. Thus, PBB was introduced into all ministries simultaneously, with changes to the legal framework for budgeting, the budget classifications and chart of accounts (COA), the main budget process and the performance management system.

An important start to the programme was to sensitise members of Cabinet, the legislature and heads of department and to convince them of the necessity of the reform. This has paid off, with a shift in attitude towards a performance-oriented budget system with buy-in from all levels of staff. In implementation, significant attention was paid to clearly defining the criteria for programmes, terminology and concepts and providing support to ensure that they are applied consistently. However, it was still challenging for ministries to develop PBB frameworks. Chapter 3 sets out the basic structure of the Mauritian PBB.

The PBB implementation also took cognisance of the need to underpin a PBB with strategic planning and costing exercises and changes to the budget process, budget documentation and budget monitoring frameworks.

Although the reforms are ongoing, key benefits are already emerging: the relationship between the finance ministry and line ministries has shifted, with line ministries taking more responsibility for their own budgets and spending. The case

study panel also concluded that there has been an improvement in the quality of budget submissions linked to improved resource allocation, a greater awareness of performance and the need to progress towards policy objectives, and in transparency and access to information. However, as in other countries that have embarked on PBB, challenges remain. These include the need to develop capacity, updating accounting and information systems to cope with the additional requirements, the introduction of meaningful mechanisms and systems to monitor and evaluate performance and the effective use of the new information in accountability and oversight processes.

The brief overviews of PBB reforms in Rwanda and Kenya in Chapter 3 highlight similar challenges. In Rwanda, for example, it is difficult to report on actual expenditure according to plan, as the budget execution data are not in the same PBB format as the budget formulation data. Non-financial performance information is captured in the budget system, but cannot be monitored automatically in the system. As yet, non-financial information is not used adequately to inform budget discussions, and a systematic process to monitor performance against set targets has not been developed.

Similarly to Mauritius, Kenya experiences great difficulty in developing robust programme budgets. The PFM Reform Programme targeted the establishment of results-based management as a tool throughout government in 2006/7. In 2007/8, ministerial finance officers prepared a first indicative programme budget alongside the tradition line-item budget. After a standing order that required all government ministries to present a budget to the legislature on a programmatic basis, most ministries adopted a 'one programme per ministry' approach, due to difficulties faced in designing good programme structures. At the time of writing, work was underway to address this, together with work on the COA, the financial management information systems and the quality of performance indicators.

Overall, the contributions in Chapter 3 illustrate the high importance of building the capacity to implement and use PBB reforms in tandem with the technical changes, echoing one key finding of the CABRI good public financial governance research.

## Managing public infrastructure investment

Capital investment budgets are an important lever for development in Africa. The quality of processes to manage public investment spending – particularly for big-ticket public infrastructure projects – is crucial for ensuring value for money. Africa is confronted with a significant infrastructure gap to grow out of aid and achieve sustainable growth. The CABRI Dialogue on Ensuring Value for Money in

Infrastructure Projects held in December 2009 made clear participating countries' interest in learning more about how to manage a constructive role for the private sector in public infrastructure. The 6th session at the CABRI Annual Seminar explored further the role and pitfalls of private sector involvement in public infrastructure development and management.

Chapter 4 comprises the two papers presented in that session. In the first paper, Mandla Gantsho, Chief Executive Officer of Nova Capital South Africa, argues that while there is great potential in harnessing private sector skills and money in public infrastructure development, there are also key risks that should be considered. The variety of options for the involvement of the private sector in public infrastructure development has expanded over the past 30 years, and ranges from management contracts to full-scale privatisation and divestiture. There are numerous hybrid models in-between, many of which bring private capital and/or skills into state infrastructure development, with potential gains in efficiency and quality of services. However, they may also have disadvantages, including the distortion of government priorities, an increased need for supervision, high development costs, some loss of control, potential loss of revenue streams and, when competition is lacking, risk that the promised value for money gains will not be realised.

The second paper in the chapter, a note based on the presentation by Tumisang Moleke from the Public-Private Partnership (PPP) Unit at the National Treasury in South Africa, sets out critical requirements for managing the spectrum of possible PPP arrangements to alleviate the risks. In order to manage private sector involvement through PPPs, governments need to ensure that they have appropriate institutional arrangements for project preparation, procurement, implementation and monitoring, and must develop capacity at the centre of government to ensure the appropriate management of PPP contracts.

## Integrating aid on budget

The final chapter in this volume picks up on CABRI's work in bringing aid on budget, a key priority for Africa, as confirmed in the good financial governance research. Since 2007, the integration of aid in budget processes and its reflection in budget documents has been a key concern of CABRI. This is important not only for ensuring that aid resources are used effectively in the interest of the sustainable development of partner countries, but also to ensure that their domestic resources are used with maximum effect, that the domestic budget process is strengthened and respected and that local accountability for development results is enhanced.

The 5th session at the annual seminar presented CABRI's work in the context of developments in this area, particularly country-level work by the Global Partnership on Country Systems. The paper in Chapter 5 was prepared jointly by Aarti Shah, senior advisor in the CABRI Secretariat, Sara Fyson, from the Global Partnership, and Alta Fölscher. The paper builds on discussions at the seminar to review progress in the use of country systems and the key factors and processes that hinder and assist change. It presents country examples, reviews ongoing work and emphasises the key role of regional and international institutions in overcoming the barriers to integrating aid in partner country budgets.

A key argument in the chapter is that despite global agreement on the importance of using country systems and the accompanying commitments, practices on the ground are still governed by donor attitudes towards risk, reluctance to let go of control over development choices, the need for attribution of results to specific donor inputs and slow progress in changing the formal rules on approaches to aid management within donor organisations.

The paper argues that too narrow a perspective on risk – often on fiduciary and reputational risk – means that the benefits of using country systems and integrating aid with domestic resources cannot be realised. To fully assess the benefits and costs of the use of country systems, donors have to shift from a focus on the individual short-term risks and benefits to a broader and longer-term perspective, and from a focus on fiduciary risks to a focus on developmental risks.

For the advantages to become evident, an overall change in donor practice and a significant amount of time is needed. It requires the alignment of donor staff incentives with the use of country systems, which would lead to a reduction in transaction cost, higher absorption capacity and increased sustainability. By using country systems, foreign aid can provide strong incentives and momentum to the government to strengthen and reform budgetary systems. Enhanced transparency and comprehensiveness, which enable greater accountability and oversight, are crucial channels through which the use of country systems would result in improvements in financial governance and, ultimately, in the effectiveness of public expenditure.

The use of country systems, however, requires adjustments not only in donor policies and systems, but also in how partner countries manage aid resources. In many cases, bringing aid on budget (or through country systems), notwithstanding the modality and type of flow, requires legislative/regulatory changes, institutional changes and changes to the budgeting instruments and documentation of the partner country.

The provision and in-country management of aid information is a key nexus of the donor and country system changes that are required to integrate aid with domestic

budgets. Unless donors provide comprehensive, timely and reliable information on the allocation and use of aid resources in accessible formats to countries, and unless countries set up systems to manage that information internally and publish it appropriately linked to domestic resources, many of the benefits in the use of country systems can be realised only partly or not at all. Chapter 5 offers a brief discussion on current aid transparency proposals.

The chapter also provides an account of the work of CABRI and the Global Partnership at country, regional and international level. It concludes by emphasising the key donor and partner country enabling institutions required to make significant progress in terms of the aid on budget agenda. These include a strong interface between the aid management unit and the budget office at country level, donor strategies to manage rather than avoid risk, changes in donor rules and procedures, building better understanding amongst donor staff of country systems in the field and radical improvements in aid transparency.

# 2

# Good public financial governance in Africa

# 2.1 Introduction

CABRI, in collaboration with the African Organisation of Supreme Audit Institutions (AFROSAI) and the African Tax Administration Forum (ATAF), is undertaking a research project towards a status report on good public financial governance in Africa. The project, in association with the African Development Bank (AfDB) and the United Nations Economic Commission for Africa (UNECA), is aimed at the preparation of a declaration on good public financial governance for consideration by African finance ministers in 2011.

Good financial governance is a necessary element in the capacity of African states for development, economic growth and poverty reduction. The responsive, prudent and effective management of the continent's financial resources is what ensures that Africa's citizens can access health, education and sanitation services, work and live in safe environments and conduct their business knowing that they are protected by the rule of law. Good financial governance has its roots in the quality of the institutions of the tax, public financial management (PFM), audit and oversight functions of government, the areas of research in the Good Financial Governance Project

This chapter presents a summary (by Alta Fölscher of the CABRI Secretariat) of the paper on good financial governance through public financial management systems

prepared by a CABRI research team as an input to the status report. The research team comprised Kwabena Adjei-Mensah, Moses Bekabye, Alta Fölscher and Ato Ghartey. The summary includes the outcome of discussions held on the paper at the 6th CABRI Annual Seminar. It is accompanied by summary versions of the AFROSAI paper on good financial governance through external audit and the ATAF paper on good tax governance. The full audit paper by Eszter Rapanos is summarised here by Nana Boateng. The summary version of the tax paper was prepared by the ATAF research team, comprising Joseph Ayee, Odd-Helge Fjeldstat, Lincoln Marais and Aidan Keanly.

The final contribution in this chapter is a short summary by Matt Andrews from the Harvard Kennedy School of Government of the paper he presented at the seminar on central themes in the recent history of public financial management reforms in Africa, drawing on analyses of Public Expenditure and Financial Accountability (PEFA) country assessments.

# 2.2 Good governance in budget preparation and execution

*Alta Fölscher*

## Introduction

The management of the budget, from preparation through to financial and performance reporting, is an important public financial management (PFM) objective. PFM refers to the procedures, established by law or regulation, for the management of public monies through the budget process, which includes formulation, execution, reporting and analysis (Potter & Diamond 1999 in Prakash & Cabezon 2008; Lienert & Fainboim 2010).

Good public financial governance is achieved when these procedures result in responsive public services through public spending that is affordable, transparent and accountable, and which funds government priorities without wastage or corruption. This paper is an extract from the technical research report on the status of PFM systems in Africa prepared for the CABRI Good Financial Governance Project, which systematically assessed PFM systems in this regard and identified common

priorities for consideration by African ministries of finance.[1] The research report incorporated the outcomes of the session on Good Financial Governance held at the 6th Annual Seminar (see box below).

**Key themes of the annual seminar discussion on good financial governance**

Consultation with members at the 6th Annual Seminar was an important mid-point in the research for the CABRI input on good financial governance through PFM. Participants emphasised that the research should look at what functionality is in place in PFM systems and, therefore, what Africa's achievements, challenges and priorities for reform are. The discussions highlighted several cross-cutting challenges, incorporated into the PFM paper, namely:

- the importance of finding the right balance between aligning reforms with capacity and building capacity for reforms;
- the lack of compliance with formal system changes;
- the challenge of implementing effective sanctions;
- the need for functioning monitoring systems;
- the sometimes debilitating effect of donor influence on reforms; and
- the need for political commitment to reforms that will bring about good financial governance at the operational level.

Area-specific issues also emerged from the break-away sessions, which were taken up in the research. In budget formulation, participants emphasised the need for resource predictability (of both domestic and external resources), a framework for allocating resources at the sector level, performance orientation and the clearer linking of budgets to priorities. In the budget execution phase, participants pointed out that the role of the finance ministry is weakened by the decentralisation of controls to spending agencies, which means that the budget reform focus should shift accordingly. The balance between predictability of cash resources and flexibility to maintain macro-fiscal balances is particularly difficult: pressure to ensure aggregate fiscal discipline impacts very negatively on the ability of the budget to fund programmes optimally. A key factor is improved budget formulation. In this regard, the discussion also highlighted the importance of getting cash planning and cash management right. The establishment of robust, effective internal audit was also emphasised. In the external audit and oversight area, seminar participants noted that weak legal

1 See the CABRI website (www.cabri-sbo.org) for a full set of papers related to the Good Financial Governance Project.

frameworks for external audit and parliamentary functions were one part of the problem. The important focus, however, was not only at an institutional level, but also in terms of assessing whether oversight as a function was working in African countries and what the endogenous and exogenous factors are that result in weak oversight systems.

## Good governance and PFM systems

PFM systems in Africa face common challenges in achieving the objectives of good financial governance. In the decades since independence, many countries have battled with crippling debt burdens, low credibility of their enacted budgets, poor links between their policy priorities and the inputs that public resources actually fund, and the high cost of wastage and corruption. The result has been the deterioration and even collapse of public services and infrastructure.

PFM systems in Africa function in the context of aid. Most countries in Africa receive official development assistance and other aid flows from various development partners. Some aid is delivered in cash and managed through country systems, while other aid is delivered off-budget and received as goods and services by African governments. Some aid takes the form of concessionary loans, while other aid is extended in the form of grants. Although aid traditionally flowed for investment projects, today aid pays for public goods and services of all kinds, from big public infrastructure items to everyday public health and education services.

In whichever form or type, the presence of aid flows in Africa creates complexities in budget management with which industrialised nations do not have to cope.

Firstly, the determination of available resources, their allocation and use cannot occur in isolation from aid flows and the conditions, however formulated, attached to them. This is challenging in most countries, where a systematic interface between aid and PFM systems is not yet well developed. Much aid falls outside of the loop of PFM, resulting in duplication, wastage and unsustainable aid-funded activities. Aid is also unpredictable.

Secondly, PFM systems have been affected directly by donor advice, conditions and required aid-delivery arrangements. Over the last few decades, African budgeting systems have had to accommodate public investment programmes (PIPs), poverty reduction strategy papers (PRSPs), arrangements for the flow of highly indebted poor country (HIPC) funds and the Millennium Development Goals (MDGs), as well as various ways of delivering aid resources, such as budget support, sector-

wide approaches and pooled-funding arrangements. Furthermore, it is difficult to determine whether governments themselves would have embarked on various budget reform approaches, such as medium-term expenditure frameworks (MTEFs), programme budgeting and the introduction of integrated financial management systems (IFMSs) in the absence of donor pressure to do so.

The primary concern of the Good Financial Governance Project, however, was not so much whether any one of these instruments or sets of arrangements succeeded or not in Africa; rather, the primary concern was with whether underlying budget preparation, execution and reporting systems were functional, delivered the objectives of good financial governance highlighted above and incorporated aid flows effectively. The assumption is that countries need sound technical procedures for budget formulation, execution, reporting and analysis, coupled with functional arrangements for political decision-making, transparency and accountability in budgeting, notwithstanding specific approaches they might follow to achieve such basic building blocks.

More specifically, the assessment was concerned with the status of and priorities for establishing the following budget preparation, execution and reporting functions in Africa:

- a comprehensive, clear and implemented legal framework for PFM, so that all spending has a basis in law;
- budget preparation functions, including
  - setting affordable, credible and comprehensive macro-fiscal frameworks using credible forecasts and realistic targets,
  - using transparent, integrated and specific budget structures and classifications, linked to COAs, for *ex post* reporting and accountability,
  - allocating available funds on the basis of accurate past spending information and credible sector expenditure plans,
  - deciding budget limits and allocating funds on the basis of a disciplined, predictable, legitimate and contestable budget process, and
  - providing comprehensive, clear, useful and timely information in the budget documentation to Parliament and the public on projected revenues, spending and debt, the allocation of available resources to objectives and the expected outcomes of spending;
- budget execution functions, including
  - predictable, transparent and accountable systems to plan for and manage cash,

  - functioning internal controls on payroll and non-payroll expenditure to ensure budget discipline and the rule of law,
  - functioning procurement systems, anchored in a clear legal framework, to ensure that goods and services are procured cost-effectively, competitively, fairly, on time and transparently, and
  - internal audit systems that assist executives in identifying weak areas in budget control systems;
- accounting and reporting systems that follow generally accepted accounting practices to produce reliable financial information in a timely manner;
- transparency to Parliament and the public during and after the spending year on the status of public finances and budget implementation; and
- robust arrangements for integrating aid in budget processes and reflecting it in budget documents and reports.

The systems and their required functionality set out above are viewed as the PFM basics for delivering on the requirements for good governance of financial flows. However, the research also acknowledged that countries that both achieve a functional medium-term budgeting perspective in their macro-fiscal framework, budget structure and budget process and constructively use non-financial performance information to inform their budget choices are better placed to deliver budgets that are affordable, stable and use resources effectively and efficiently. The research, therefore, also looked at what progress has been made in this regard and what the obstacles are to achieving this functionality in public budgeting in Africa.

This report does not presuppose a model PFM system that applies equally to all countries in Africa. It is based on the premise that PFM systems need to be suitable for each country's constitutional, legal, political, administrative and cultural context. At the same time, however, the report proceeds from the understanding that there are required PFM functions and established principles that all systems need to operationalise, notwithstanding their context, in order to achieve good governance of public finances. The research, thus, looks at the progress that has been achieved on average against these functions and principles, while noting specific outliers.

The research, nevertheless, shows that there may be enabling and disabling factors attached to different country contexts that are important to highlight up front. Andrews (2010) observes commonalities among the contextual variables for each distinct PFM performance league using Public Expenditure and Financial Accountability (PEFA) scores. His findings suggest that several factors, working in combination, are likely to facilitate PFM reform in a country and, consequently, to boost PFM performance. These factors are: a high economic growth rate; social and political stability; a 'fiscal

state' reliant on domestic tax revenues; sustained government policy commitments; and non-Francophone heritage. However, these alone do not explain the emergence of the PFM reform space necessary for performance-enhancing reforms. That may have more to do with the intrinsic features of the reform process and its management than the country context (Hedger & De Renzio 2010). The evidence on administrative heritage is also ambiguous, except that Francophone countries tend to score lower against the PEFA indicators for downstream external accountability dimensions (Andrews 2010). A comparative study by Lienert (2003) suggests that Francophone budget execution and government accounting systems have potential advantages, but these have not typically led to stronger PFM performance in practice.

The concern here is with factors that are internal to systems for preparing and executing budgets. However, achieving good financial governance in budget preparation and execution is also dependent on good tax governance, the sound management of debt and functioning audit and oversight institutions. These factors are discussed elsewhere in this volume.

## PFM reform achievements

African governments have put in place various mechanisms to improve budget discipline and to link their budgets to the priorities identified in national and sector plans over the last two decades. There is hardly a country in Africa that has not embarked on some effort to improve or reform its PFM systems. The research findings show that good progress has been made towards sound PFM practices in respect of specific PFM functions and systems in many countries.

### Better legal frameworks

The existence of a comprehensive legal framework for budget preparation is important in managing the budget process, in assigning responsibilities and in providing all fiscal decisions and activities with a base in law. Earlier assessments of both Francophone and Anglophone systems found legal frameworks to be lacking in terms of coverage and implementation. Over the last decade, however, several countries have introduced changes to the legal framework for budgeting and PFM, modernising systems, ensuring better coverage of fiscal institutions and reducing some of the distance between country groups (Lienert 2008; CABRI/OECD 2008). Modern PFM laws in Africa place emphasis on the performance of the budget and on stability, transparency and accountability.

## More credible fiscal frameworks

An important underlying objective of PFM systems is budget credibility. If the rules and institutions of the PFM system cannot succeed in delivering expenditure (and revenue) outcomes that are close to the planned outcomes approved by the legislature, the rule of law is undermined and the foundations of good financial governance are weakened. A credible fiscal framework is necessary for medium-term stability and debt sustainability, and underpins affordable policy commitments by the government. Fiscal frameworks are effective in the budget process if they are based on realistic forecasts and include all claims on public resources.

Fiscal framework development in African countries is supported strongly by the widespread use of fiscal rules. The existence of and adherence to fiscal rules means that the budget is defined by macroeconomic constraints, which enhances the budget as a tool for macroeconomic stability. Most African countries have fiscal rules covering expenditure, revenue, budget balance and debt.

In the face of weak revenue bases and limited options for borrowing, many African finance ministries have faced strong political pressure in the past to prepare optimistic fiscal frameworks in order to accommodate higher spending. However, the research shows that the provision of realistic forecasts of available resources has improved in some countries, overcoming these long-standing challenges. On average, though, African countries forecast aggregate expenditure better than revenue and expenditure composition. PEFA assessment scores show that aggregate expenditure forecasting performance in Africa is better than PEFA-assessed countries elsewhere in the world.

## Modernised budget classification systems

How the budget is classified is crucial in determining the quality of the budget process. In modern budgeting systems, good practice dictates that an integrated budget be presented in the most important classifications (usually administrative, combined with economic, functional and/or programmatic), that the classification be embedded in the COA to ensure that all transactions can be reported in accordance with any of the classifications used, and that classification adheres to established international standards (Jacobs et al. 2009; PEFA 2005). African countries have shown significant progress in classification reforms. Improvements in budget classifications and COA are fairly common across Africa, and many countries use classifications that are compatible with the international standards. In addition, many countries have made progress in integrating development and recurrent budgets, aiding functional budget planning.

## Improved budget processes

The political leadership, degree of centralisation and strength of the ministry of finance, discipline and timeliness, and degree of participation in and transparency of the budget process, are key determinants of the budget underpinning fiscal discipline and allocative and operational efficiency (Allen 2009; PEFA 2005; Holmes & Evans 2003; Wilhelm & Krause 2007; De Renzio 2007). In recent years, many African countries have reformed their budget processes successfully along these lines. Altogether, 75% of PEFA-assessed countries follow timetables (some with minor deviations). Budget processes are also functionally centralised in many countries, with clear assignment of responsibilities, the use of numerical fiscal rules and targets and top-down spending ceilings.

## Better mechanisms for sector planning in selected countries

Engaging sectors, line ministries and budget agencies in the strategic management of resources, and clearly distinguishing between resource allocations that belong at the centre (allocating envelopes to sectors, ministries and agencies) and resource allocations that rightly belong at lower levels (allocating funds within an envelope to Cabinet-approved strategies, programmes and projects) is crucial for allocative and operational efficiency. Selected countries in Africa have made significant progress in establishing mechanisms that get this balance right. Countries like Uganda, Kenya, Ghana, South Africa and Rwanda use sector working groups to make or inform trade-offs in more co-operative and participative budget processes. While there are still significant challenges in developing credible sector plans, African countries, on average, outscore their international counterparts in PEFA assessments, indicating that there has been quicker progress in Africa in developing sector-level capacity to link plans and budgets.

## Widespread efforts to make available non-financial performance information

Input-based budgeting can be enhanced significantly if it systematically links the inputs to information on results achieved. The most basic form of performance-based budgeting is when decision-makers consider information on results in the budget process. Many countries in Africa report the use of performance information. The CABRI/OECD budget survey found that 15 countries use performance targets, 12 use performance measures, 19 undertake evaluations of some kind, and 3 use benchmarking to manage performance. Only one country in the survey (Swaziland) does not generate performance information at all.

## Active reform of procurement systems

Functioning procurement systems mean that goods and services are procured cost-effectively, competitively, fairly and in a timely fashion, and that opportunities for corruption are minimised. Many African countries have made progress with reforming the public procurement system, implementing the reforms outlined in procurement assessment exercises and changing legal frameworks. For example, Benin, Cameroon, Senegal, Uganda, Mali, Kenya and Ghana have passed new procurement laws and have made spending agencies accountable for open, competitive and transparent procurement under the oversight of new public-procurement boards. Some have created appeals and complaints mechanisms, have promoted procurement planning and have initiated capacity-building at all levels in public procurement.

## Progress towards risk-based internal system audits

In recent years – in line with professional standards for internal auditing – countries have been under pressure to move closer to independent systems audits, which would comprise a critical review of internal control systems with recommendations for improvement of the systems. The International Standards for the Professional Practice of Internal Auditing (ISPPIA), issued in 1992 by the Institute for Internal Auditors, speak to the need for appropriate structures, sufficient breadth of mandate, access to information and power to report, and the use of professional audit methods, including risk-assessment techniques. African countries are making relatively fast progress in establishing risk-based internal audit functions.

## Progress towards the use of standards in public sector accounting

The use of consistent standards and/or international standards in public sector accounting is important for transparency. It ensures that stakeholders can interpret the government's financial statements correctly. Evidence suggests that most African countries have made some progress in the use of standards. Very few African countries scored at the lowest level in PEFA assessments on the use of standards in public sector accounting – only 5% compared to 21% of assessed countries in the rest of the world.

## Improved in-year reporting

The regular flow of information during the spending year on actual spending is crucial in addressing emerging problems in a timely manner, as a check on disciplined budget implementation and in ensuring functional internal accountability systems. Significant progress has been made in improving reporting practices in Africa. In respect of internal reports, the PEFA framework is aimed at measuring the ability: to

base planning on timely and regular information about actual budget performance, which is available to both the ministry of finance and the Cabinet; to monitor budget implementation performance in order to identify the need for remedial action early; and of spending agencies to manage their affairs. Of the countries assessed against these dimensions, only Lesotho, Mali and Côte d'Ivoire fall below a 50% mark. Morocco fared the best against this indicator, followed by Burkina Faso, South Africa, Mauritius, Uganda and Botswana.

## PFM challenges to achieving good financial governance

Despite the gains made, there are key PFM challenges facing African countries on the road to a sustained culture of good public financial governance. This is to be expected. Increasingly, it is understood that building effective, transparent and accountable PFM systems is a long-term undertaking. Even when gains can be demonstrated, countries need to be vigilant to leverage them and ensure that backsliding does not occur. In general, the reality is that progress against the objectives of reforms is slow to materialise and difficult to sustain (Allen 2009; Dorotinsky & Floyd 2004; Obidegwu 2005; Schiavo-Campo 2009; Le Houerou & Taliercio 2002).

The challenges identified by the research fall into two categories: specific, weak system points in the PFM value chain; and factors that weaken or threaten the whole PFM system.

### Specific challenges

**Weak links in upstream budget systems**

On average, African countries have made more progress in strengthening upstream than downstream budgeting systems. However, the following key areas require attention.

*A focus on improving revenue forecasting is required*. While African countries have made progress in budget credibility in respect of aggregate expenditure outturns, revenue forecasting performance lags. Having realistic revenue forecasts is a prerequisite for effective budget planning and execution. African governments should commit to improving revenue forecasting performance in countries where revenue outturn consistently deviates from budgeted revenue.

*The incentives for credible forecasts in African countries must be strengthened*. This can be done by ensuring the independence of the forecasts from the central budget authority and/or by putting in place independent country-based review mechanisms.

The budget documentation should make public the forecasts and underlying assumptions.

*The high use of non-transparent extra-budgetary mechanisms must be addressed*. In combination, the PEFA, Open Budget Index (OBI) and CABRI/OECD survey results point to a high use of extra-budgetary mechanisms combined with low legislative oversight and transparency in respect of them. Assessing the merits for the use of these mechanisms in the first place and ensuring their transparency should be a reform priority going forward. They undermine the key good financial governance principle of comprehensiveness in budgeting.

*Systematic political involvement in the budget process must be strengthened*. Political involvement is important to ensure legitimacy and discipline in the budget process. Yet, only approximately 50% of countries assessed using the PEFA framework had well-developed early political involvement in the budget process, and in less than half of the countries surveyed in the CABRI/OECD survey were budget disputes resolved by the Cabinet or a Cabinet committee. Almost two out of three African countries did not involve the Cabinet in early budget-ceiling decisions. A priority for good financial governance in Africa, therefore, is to enhance the timely and consistent involvement of the political leadership in budget preparation.

*Central rules for medium-term planning must be strengthened to be effective budgeting instruments*. Many African countries provide no information on forward expenditure projections in the budget presentation in Parliament, despite having introduced MTEF reforms. Mostly, MTEFs are used for internal purposes only and, even then, only at the ministry level. Only two countries, Mali and Lesotho, base their forward estimates on a combination of macroeconomic assumptions and the cost of current and new policies. In other words, resource-constrained medium-term expenditure planning in Africa is still weakly developed, opaque and unaccountable.

*Capital and recurrent budgets must be integrated better*. Despite some countries having made progress, the continuing separation between capital and recurrent budgets in many countries affects budget credibility and allocative and operational efficiency. Even if countries choose to have separate legal instruments for approving investment and recurrent spending, concrete steps towards institutional, managerial and documentation integration must be taken.

*The development of capacity at the sector and line ministry level for strategic planning and medium-term budgeting is crucial.* The quality of the budget process is as much dependent on good quality bottom-up processes as it is on macro-fiscal and top-down capacity. The development of costed, resource-constrained sector strategies is critical to quality bottom-up processes. Despite gains in this regard, sector capacity lags

behind the development of central budget mechanisms, compromising the quality of processes overall, in many African countries.

*Performance information should be used more effectively*. While many African countries report the collection of non-financial performance information associated with budgets, the effective use of this information for budgeting purposes is not strongly developed. The collection of information, without it being used effectively and consistently, often results in poor information quality. Countries should be more systematic about the use of performance information in the budget.

*Better use should be made of pre-budget statements to increase predictability, stability and transparency*. Pre-budget statements play an important role, in that they focus the debate on macro-fiscal issues and strategic trade-offs in the budget. They also serve to firm up the budget framework and high-level budget ceilings, thereby assisting in building disciplined budgeting processes. However, very few African countries make use of pre-budget statements on fiscal decisions.

**Downstream weaknesses**

The research showed that, on average, African countries have weak budget execution systems, with weak internal controls, weak cash management and slow implementation of accounting and financial management information system (FMIS) reforms. This is a crucial general finding in terms of our concern with good financial governance. It is discussed further below. Here, we focus on specific weak systems in the budget execution, accounting and reporting cycle.

*In general, African countries do not manage cash optimally*. The use of cash rationing to counter revenue shortfalls against the enacted budget is widespread in Africa, and is damaging to the rule of law in budgeting and the capacity of governments to achieve consistent service delivery. A first step is to improve revenue forecasting; on the budget execution side, the negative impact of cash budgeting can also be countered through better cash management in government, including adequate cash-flow forecasting and the effective and efficient use of cash balances. Many African governments have committed to using treasury single account (TSA) arrangements that will allow the efficient use of cash balances, but implementation lags significantly. The challenges of running effective banking arrangements that allow for regular consolidation of balances are many and diverse. Failure to implement such arrangements, however, carries a high cost; the proliferation of bank accounts and failure to consolidate bank balances regularly contributes to the accumulation of arrears, increased borrowing cost and poor oversight of spending. The implementation of TSA mechanisms, in order to manage cash transparently, should be a priority for governments in Africa.

*Cash planning and commitment practices must be improved*. Functional systems of cash forecasting, predictable funding of spending agencies and transparent adjustments of voted allocations are the backbone of efficient budget execution and a necessary precondition for sound budget preparation. Yet, many countries in Africa have not implemented robust and transparent systems to manage unpredictability and resource shortfalls without disrupting budget execution. Opaque, arbitrary and discretionary cash rationing is not conducive to good financial governance. A priority reform for African countries, therefore, should be the implementation of transparent, predictable and effective systems of cash planning and commitment.

*Commitment controls are weak*. Commitment controls are a key part of the internal controls that support budget credibility and efficient budget implementation. Many African countries do not control commitments effectively, with the result that arrears accumulate and/or budget credibility is lost. There are many reasons for this, not all of them technical: abandonment of planned activities for activities that are not authorised; lack of timely information on commitments already made; and poor incentives for commitment control on account of unpredictable cash flows. The institution of effective commitment controls in line with approved funds is a priority for reforms in Africa.

*Payroll controls are not sufficiently robust*. Payroll controls have a direct effect on a government's ability to account for the significant proportion of expenditure that is committed to personnel costs. In many countries, the integration of personnel records with payrolls and the updating of both records and payrolls are inadequate. On the other hand, a few countries have fully fledged and well-developed systems. The development of robust payroll systems is a priority for good financial governance in Africa.

*Procurement systems must be strengthened*. It is acknowledged above that some countries have brought significant improvements to their procurement systems. However, the research has also shown that many African countries remain at risk of poor financial governance in procurement and poor outcomes, with competitive processes not managed well. Overall attention to procurement reforms, in terms of transparency, institutions, management, accountability and control, is a crucial priority for good financial governance.

*Capacity for effective system-based internal audit is weak*. The correlation between expenditure composition outturn and the strength of internal audit systems in Africa is statistically significant. Yet, most countries have undeveloped systems of internal audit and, where progress has been made, executive agencies pay scant attention to the recommendations arising from internal audits. A priority for Africa is to implement improved systems of internal audit and to develop a professional cadre of internal

auditors, particularly as more countries are adopting reforms that deconcentrate expenditure management responsibilities. However, this will be effective only if underpinned by the political will to address the lack of responsiveness of government institutions to internal audit recommendations.

*Support and capacity for the adoption of generally accepted accounting standards is weak.* The initiative by the majority of African countries to adopt international accounting standards is noted above. This is important for financial control, transparency and accountability. Yet, the research has shown that weak support by senior management for these processes and weak professional capacity in the public sector constrain progress towards their implementation in practice. The training of accountants and IT specialists, and compliance with standards in place or the adoption of transparent standards, if not the international standards, should be priorities for reform.

*Reconciliations are not performed regularly enough*. Reconciling balances and bank reconciliations are important checks on the quality of financial management and on budget execution. The research has shown that bank reconciliations generally occur more regularly than the reconciliation and clearance of suspense accounts and advances, with many countries undertaking only an annual balances reconciliation, and then often late. Potentially, this can leave significant resources out of the reporting net, with a negative impact on budget management and governance. Improved practices in this regard should be a reform focus in many countries. Overall, African countries fare poorly in assessments. Strengthening accounting systems and oversight of accounting practices is a key priority for good financial governance in Africa.

*Integrated financial management information system (IFMIS) reforms need to be strengthened*. While the automation of FMISs offers important support for downstream reforms in budget execution, accounting and reporting, governments need to ensure that reforms are appropriate to their needs, cost-effective and sustainable. Political and bureaucratic commitment to implementing and sustaining IT solutions is crucial.

## Macro challenges

The budget preparation and budget execution arena in African public resource management systems faces core challenges that hinder progress towards systemic and sustained good financial governance. These challenges are not primarily about technical budget issues, even if they contain technical aspects. They are political and/or about the incentives for behaviour in public decision-making. The challenges noted here are interdependent and often mutually reinforcing.

**Budget transparency**

Overall, fiscal and budget transparency is weak and must be addressed as a top priority. Parliament and the public do not have the proactive access to the assumptions and models underlying fiscal frameworks, contingent liabilities and extra-budgetary flows that would support accountable budgeting. There is significant scope for countries to improve the availability, coverage and usefulness of *ex ante* budget information to the legislature and the public through the budget. This should be a reform priority.

Many countries in Africa provide very little or no information to legislatures and the public that explain budget allocations. Even fewer countries report against the information that is provided *ex ante*. Nevertheless, the CABRI/OECD survey indicated that most countries do use performance information, measures and targets in their budget process. The quality of this data and its use in the budget process would be strengthened if it were made public. Countries could sequence building their capacity to improve the budget documentation in this regard, starting with a narrative on strategic choices overall, by sector and by spending agency.

Despite many African countries having modernised their internal classification systems to provide multidimensional information on the budget process, relatively few carry this through to providing multidimensional information on the budget to Parliament and the public. This should be addressed as a priority.

Openness to the public and Parliament on progress with implementation of the budget and public accounts is a key requirement of good financial governance. Although many countries have made progress in the internal availability of in-year reports, few publish these. Long-term commitment to fiscal transparency, coupled with the identification of immediate means to improve transparency, should be a priority for African governments.

**The implementation gap**

The research has shown that PFM systems and, therefore, good financial governance face a gap between new formal system rules and whether or how well they are implemented in practice. This manifests at the higher level, where the finding is that often the modernisation of public finance legislation is not followed by the translation of the new laws into lower-order instruments, such as regulations, or by the necessary operational changes to structures, procedures and practices. This highlights an important issue for good financial governance in Africa: countries should not develop laws and rules for PFM that are unlikely to be followed. If new rules are introduced, they should come with a clear strategy for their implementation and a strong commitment to enforce them.

It also manifests at the lower level, where the creation of processes is not matched by changes in behaviour. Andrews (2010) identifies systematic differences in the way governments meet the different kinds of challenges in PFM systems, key amongst which is that practice lags behind the creation of processes and laws. This theme reflects the institutional differentiation between *de jure* and *de facto* institutions, which suggests that the former are less demanding to adopt and change than the latter. This is apparent in comparing the more *de jure* budget preparation dimension in PFM systems with the more *de facto* dimensions in the PEFA assessment framework. Whereas the mean score in Andrews' sample of 31 African countries for *de jure* reforms was 2.33, the mean for *de facto* reforms was 1.9, with almost double the number of countries at the lowest possible level (Ds) in the latter than in the former dimensions.

This differential with regard to progress against different PFM aspects is replicated along the upstream/downstream and centralised/decentralised axes. In other words, across countries on average, the data point to less progress in terms of downstream PFM systems, less progress in terms of *de facto* mechanisms and less progress for PFM processes that involve decentralised rather than centralised actors (Dabla-Norris et al. 2010; Andrews 2010). While each of these findings points to a good financial governance priority in its own right (the need to pay attention to implementation, to downstream processes and to processes in line ministries), a common factor underlies all three findings: informal systems in budget management and approaches to undertaking PFM reforms.

**Informality in budget execution systems**

That African countries, on average, do not translate new legal frameworks and processes into practice is symptomatic of the long-standing tolerance of informality (or the bypassing of formal rules) in budget management in Africa. It is not, for example, that commitment controls are not in place, it is that they are bypassed and that there are no consequences attached to bypassing them. Hyden (2005) sees the prevalence of informal practices, which have the effect of rendering formal institutional arrangements less effective, as the biggest governance challenge facing most African countries. These informal measures are often rational from an individual perspective, but they undermine objectives at the collective level. They also contradict reform efforts and often serve as the basis for resisting them. PFM reforms in African countries have not transcended these relationships successfully.

**Approaches to undertaking PFM reforms**

The progress differentials also reflect PFM reform practices. Finance ministries are usually the centre of PFM reform processes. It is understandable, therefore, that PFM performance is better in respect of aspects of the system that are more under the control of the ministry, such as upstream processes and *de jure* mechanisms. Downstream and *de facto* processes frequently involve decentralised actors, who may not buy into reforms and/or who may have been excluded from the processes that bring about the shift in mindset required to change practices. The findings of the research point towards the need to move the focus of reform from upstream to downstream processes and from *de jure* to *de facto* PFM mechanisms. Very significantly, however, they also point to the need to draw decentralised actors into reform debates and processes much more deliberately, in order to engender change across the full spectrum of budget preparation and execution institutions.

A second point in respect of PFM reforms concerns the important role finance ministers play in co-ordinating and driving PFM reforms: without their active leadership it is unlikely that formal systems changes (through new laws and processes) will become operational. The significant implementation gap in PFM systems that the research points to highlights that budget reforms are not sufficiently driven or owned by finance ministers.

Allen (2009) points out that frequently reform initiatives are funded significantly by donors, which can lead to a dependency on donors and their consultants to design and drive reforms, and which inhibits the development of local capacity and channels finance into projects that may not be appropriate or timely for the country, but that are rather what the donor knows or thinks is the right thing to do.

**Sequencing of reforms**

Overall, the sequencing of reforms is not being driven sufficiently by country context or need. It has been questioned, for example, whether focusing scarce resources and thin capacity for reform on the implementation of a programme performance budget in a country that does not have basic cash management and planning systems in place is the right choice. That progress in downstream processes so clearly trails progress in upstream processes is problematic for sustaining the upstream budget preparation systems and for achieving good financial governance in general.

It is important for good financial governance in Africa that countries are more resistant to donor-driven PFM system reforms, rely more on local commitment, knowledge and capacity and insist on realistic timelines for reform processes.

**Management of donor funds**

The integration of aid on budget and the transparency of aid flows are crucial for good financial governance in Africa. The 2007 CABRI study on aid on budget and the PEFA assessments point to significant challenges in bringing aid on budget, of which the frequency, quality and timeliness of information flows on aid are most important. The predictability of aid is also essential for sound macro-fiscal and budget management in African partner countries. A priority for good financial governance, therefore, is to increase international pressure on improved aid information practices and to bring together aid and PFM processes at the country level.

**Capacity to sustain quality PFM**

Skills shortages in terms of economists, accountants and auditors are well documented and affect the capacity of states to design, implement and maintain PFM reforms and to operate PFM processes. Across the budget cycle, processes require scarce technical skills. For example, establishing a professional systems-based internal audit process requires significant numbers of individuals with the requisite audit and financial qualifications, experience and skills; developing automated FMISs requires IT, accounting and process-engineering skills; building macroeconomic models and undertaking debt, macroeconomic and fiscal analysis and forecasting requires experienced economists. However, these skills are particularly scarce in African countries. A key priority for good financial governance going forward, therefore, has to be the development and implementation of strategies to train, recruit and retain the specialised skills required in the budget process.

## Priorities for good financial governance in PFM

### Fiscal transparency shortfalls

A first key priority for good financial governance in Africa is to make available useful, comprehensive, reliable, timely and accessible information on fiscal and budget decisions and the state of the public finances to legislatures and the public. An immediate commitment should be to improve the annual budget documentation and to publish the information that already exists. Where information is not available even internally, its reliable production should be prioritised.

### Ownership and sequencing of reforms

Finance ministries should take ownership of reform choices and processes. Key to this is ensuring that the basic building blocks of good financial governance set out above are in place, that their improvement is sequenced correctly and that

the specific reforms undertaken are country-appropriate. A second aspect is to close the implementation gap by developing clear, time-bound strategies for the operationalisation of legislative changes and new processes.

It is important for good financial governance in Africa that countries are more resistant to donor-driven PFM system reforms, rely more on local commitment, knowledge and capacity and insist on realistic timelines for reform processes.

## PFM choices and capacity

The implementation of robust budget and financial management systems is dependent on the professional capacity to operationalise systems being in place. Strategies to close the implementation gap should take account of capacity shortages and develop realistic timelines for implementing systems.

## Common weak linkages in the PFM chain

The paragraphs above highlight specific priorities for good financial governance in PFM. These include:

- improving revenue forecasting practices and capacity;
- strengthening incentives for credible forecasts;
- addressing high use of opaque extra-budgetary mechanisms;
- integrating capital and recurrent budgets;
- developing critical capacity at sector and line ministry level for strategic planning and medium-term budgeting;
- using performance information more effectively;
- using pre-budget statements to support discipline in the budget process;
- implementing TSA mechanisms;
- improving cash planning and commitment practices;
- strengthening commitment controls;
- developing more robust payroll controls;
- strengthening procurement systems;
- building capacity for effective systems-based internal audit;
- increasing support for the implementation of consistent accounting standards;
- performing more regular bank and other reconciliations; and
- strengthening the management of IFMIS reforms.

These priorities concern the improvement of specific systemic links in the PFM value chain. They may not apply to all countries, but it is crucial in many countries that they be addressed. It is vital that countries assess the technical robustness of their PFM systems and identify key shortcomings to be remedied.

## Political leadership and ownership of, commitment to and involvement in the budget system

Political leadership of PFM reforms and the political will to enforce formal rules and demand vertical accountability is crucial for good financial governance. However, the research has highlighted that the opposite generally occurs in Africa, where political engagement with the PFM system is precisely about bypassing formal systems, and this can be destructive. It is important, therefore, to strengthen transparent, systematic and accountable engagement by political actors with budgets and the PFM system. This should be supported by the political will and commitment of finance ministers to enforce formal system rules and demand accountability.

## The integration of aid on budget

A key priority for good financial governance in Africa is the full integration of aid in budget processes, the reflection of aid on budget and ensuring that country oversight institutions are engaged in aid options and choices. This is particularly relevant to high-aid-receiving countries.

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# 2.3 Progress towards autonomous, professional SAIs: Status and challenges of external audit practices in Africa

*Nana Boateng*[1]

Accountability in the use of public finances has been a key consideration for many African governments since independence. Accountability refers to the fact that actions and decisions taken by public officials need to be subject to oversight, which, in turn, is an essential ingredient in achieving the governmental objectives of providing services to citizens and reducing poverty. Accountability involves both the political justification of decisions and actions, and the managerial answerability for implementing the agreed tasks according to pre-selected performance criteria (Day & Klein, in ECA 2003: 8). Provisions for clear and transparent reporting practices, checks

1 This note is a summary of a paper prepared for the CABRI/AFROSAI/ATAF collaborative research on the status of good public financial governance in Africa (see Rapanos 2010). The full paper can be downloaded from www.cabri-sbo.org.

and balances and mechanisms for oversight should be promulgated in legislation and form part of an enforced practice.

Why should executive governments strive to have strong supreme audit institutions (SAIs), and how can this be achieved? What progress is being made in Africa in this regard, and what are the associated challenges? This paper aims to provide an overview of current external audit practices and the challenges faced by SAIs across Africa.[2] The roles of and interactions between SAIs, oversight mechanisms and government entities are also detailed, taking into account the differences between judicial (Francophone) and Westminster (Anglophone) models of accountability. The findings are based largely on various surveys performed by the African Organisation of Supreme Audit Institutions (AFROSAI).[3]

## The role of supreme audit institutions

Typically, SAIs are autonomous agencies charged with promoting oversight by evaluating and assessing the performance of government entities. They may also play the important role of assisting the legislature in overseeing the management of public money and holding government officials to account. SAIs evaluate the government's operations, including: financial and performance information; compliance with laws and regulations; and the efficiency and effectiveness of operational practices and present structures and systems. Due to their role of looking at internal control mechanisms and compliance with laws and regulations, they also contribute to the prevention of fraud and corruption in government. At the end of an audit, SAIs issue audit reports to highlight areas in need of attention from the legislature or other arm of the government. The reports contain recommendations to assist government organisations in improving their management and performance (ECA 2003: 27).

When looking at the main role of external audit in promoting accountability, the following potential effects of the work of SAIs have been deemed crucial:

- promoting increased transparency in public finances;

2 The paper and this note focus exclusively on external audit. Internal audit is included in the public financial management paper and note.

3 The surveys include: (a) AFROSAI Capacity Building Questionnaire (during 2009–2010), which was completed by 21 AFROSAI-F (CREFIAF) and 12 AFROSAI-E member countries, and 5 Arabic-speaking countries; (b) AFROSAI-E Activity Report Questionnaire for 2009, completed for 21 countries; and (c) Questionnaire on Good Financial Governance (during April 2010), completed by 8 AFROSAI-E and 10 AFROSAI-F (CREFIAF) member countries and 4 Arabic-speaking countries.

- minimising mismanagement and corruption, as ministries and sub-national levels of government know that their financial transactions could be audited at any time;
- contributing towards the more efficient use of funds in individual areas and, thereby, increasing the effectiveness of the public budget; and
- effecting change in the system, in the long term, by publicising cases of corruption and, thus, contributing to a change in the underlying culture. (Santiso 2007; GTZ 2007)

External auditors are responsible mainly for three types of audit: financial, compliance and performance. In the light of substantial reforms in the public sector, the auditing profession increasingly has to focus on risk-based audit, which requires greater emphasis on audit planning, fraud and internal controls. SAIs do not function in isolation from the government. Even a professionally functioning and adequately financed SAI can become ineffective where the government fails to implement mechanisms that utilise and follow up on audit reports. Legislative frameworks guaranteeing the SAI's independence need to be combined with a political will to enforce the accountability of government officials.

## The status and challenges of SAIs

The Westminster or parliamentary model (typically followed in Anglophone countries) and the judicial model (employed in Francophone, Lusophone and Arabophone countries) of accountability are the two major practices implemented in African countries. Most SAIs in Africa perform audits in line with the applicable International Organisation of Supreme Audit Institutions (INTOSAI) standards. However, the applicability of standards depends on the mandate and practices followed by SAIs and the different systems in which they operate. For instance, in most Anglophone countries external audit revolves around giving assurance on the financial statement provided by the government and/or each entity. Under a judicial system, audit work tends to concentrate more on the functions of public accountants, as far as the legality of expenditures or the compliance with laws and regulations are concerned (Lienert 2003). In other words, the audit most often looks at individual financial transactions from a compliance perspective, as financial statements are not always available or do not form part of such an audit.

What follows is a consideration of the current practices and challenges experienced by African countries in executing their audit functions.

## Independence of SAIs

SAIs should be able to operate independently and without interference from the executive branch of government. However, restricting the funds flowing to the SAI is a tool that can be used by executive governments or ministries of finance to influence the functioning of the SAI. The Open Budget Survey (OBI 2008) found that financial independence was lacking in 10 English-speaking (50%) and 11 AFROSAI-F (CREFIAF) member countries (52%), marking this as the most pressing challenge in the region. In most of these cases, it was found that the executive government was involved in the approval of the SAI's budgets with no effective oversight by Parliament. Almost all Arabic-speaking countries, however, indicated the required financial independence.

The influence of the executive in the appointment and removal of the head of an SAI is also an element that may diminish the institution's effectiveness. The fact that the head of an SAI can be appointed and removed without consent from the legislature or judiciary may influence the willingness and freedom of the SAI head to report publicly on pressing issues. Some countries, for example Uganda, have the safeguard that the president may remove the head of the SAI from office only after obtaining approval from a special body – a tribunal or a commission.

## Legal and policy frameworks

Constitutional/statutory/legal frameworks are very important in terms of spelling out SAIs' mandates, functions and independence. Countries with recently updated audit legislation include seven members of AFROSAI-E (Uganda, Kenya, Tanzania, South Africa, Lesotho, Sierra Leone and Ghana) and six members of AFROSAI-F (CREFIAF) (Burundi, Guinea (Conakry), Madagascar, Niger, Djibouti and Ivory Coast). In many countries, however, the legislation governing the functions of SAIs has not been updated recently. SAIs would benefit from laws that provide for wide financial and operational independence. Although some AFROSAI-F (CREFIAF) member countries have experienced difficulties in establishing a formal code of ethics, with 12 countries (57%) indicating the lack of such a code, most governments of AFROSAI-E and Arabic countries have a legislated code of ethics.

## Accountability of SAIs

Just like any other public sector entity involved in spending government funds, SAIs should be subject to the rules of accountability. That is, SAIs should be held accountable for their performance through regular, independent external audits and systematic monitoring and reporting of their performance. Twenty-two percent of AFROSAI-F (CREFIAF) SAIs issue reports on their own performance. In Anglophone

countries, 53% do so, and in Arabic-speaking countries the figure is 60%. Thus, the accountability of SAIs is an area that needs to be developed further in most African countries.

## Public reporting

Public dissemination of audit reports contributes towards more transparent government. Furthermore, it is about having an informed public and an informed decision-making process within government, which is essential to a well-functioning state. In terms of SAIs being able freely to disseminate their audit reports to the public, all Arabic-speaking and 86% of AFROSAI-F member countries have indicated such freedom in one form or another. The situation in AFROSAI-F (CREFIAF) countries, however, is less positive, with only 43% of these SAIs issuing public reports.

The formats of public reports, and the processes by which they are made public, vary substantially between countries. Some issue glossy reports that are publicly distributed, and/or the SAI's web site is used to display reports for public scrutiny. In many other countries, only an annual summary report is made public, while the detailed reports are not available to the public. In Tunisia, for example, the SAI prepares and displays an abstract of the annual report on its web site. Several other countries employ a similar practice. In the case of Algeria, on the other hand, the report of the SAI (*Cour des Comptes*) has not been published since the current president came to power in 1999.

With the introduction of electronic recording of transactions, most governments should be able to provide regular (at least annual) financial reports with relative ease. Nonetheless, auditing government entities only every 3–5 years is a common practice in AFROSAI-F (CREFIAF) and Arabic-speaking countries. As a result, audit reports in these countries generally are issued more than 24 months after the year-end. AFROSAI-E member countries have made substantial improvements in this regard recently. During 2009, 79% of SAIs managed to table audit reports in Parliament within 12 months of the financial year-end.

Frequently, SAIs do no more than send their reports to Parliament, and in some countries even this communication is missing completely (Van Zyl, Ramkumar & De Renzio 2009). Thus, formal communication channels should be established, the details of which should be included in the communications policy of the SAI. Provisions should be made for communicating with Parliament, public accounts/ oversight committees, civil society, the judiciary and other relevant entities. Civil society organisations, including the media, trade unions, community associations, religious leaders and non-government organisations, can play a very important

role in promoting good governance and accountability, and should be engaged adequately. Rwanda and Tanzania offer some best practices in this regard.

## Understandability and usefulness of reports

Audit reports should address the needs of specific stakeholders. Failing to provide a user-friendly, understandable and relevant report surely causes SAIs to lose their effectiveness. Stakeholders include members of Parliament, public accounts or oversight committees, ministers, accounting officers and the public at large.

When available, audit reports are found to be repetitive and to describe findings in too much detail. Despite improvements in some countries, there is still much to be done in order for reports to cater for the needs of users and to achieve the required impact.

## Follow-up on recommendations

Mechanisms should be put in place to ensure regular follow-up on audit findings and to provide assurance on the status of implementation of recommendations. Follow-up mechanisms should include the SAI and Parliament, public accounts committees or relevant oversight committees. This is an important area, which needs to be concentrated on in the region. Even countries with a parliamentary or Westminster administrative system do not always have a Parliament and public accounts committees that effectively discharge their oversight functions.

## Audit tools

Almost all SAIs have adopted INTOSAI standards as the basis for their audits. However, SAIs experience problems in the implementation of such standards for various reasons. Lack of technical capacity and inadequate knowledge of standards have been quoted as significant challenges faced by SAIs. Monitoring the quality of work and the extent of compliance with standards is important. It was found that only six (32%) AFROSAI-F (CREFIAF) member countries have quality assurance systems or mechanisms in place. In the Arabic region, this is 60%, while in the AFRSOAI-E region the results are also low with only 35% of SAIs having established functioning mechanisms. Moreover, the practice and system of external peer review is not widely encountered in the region.

## Performance audit

Challenges faced by SAIs begin with the specialised nature of performance auditing. The practice of performance auditing in different countries shows considerable variation in mandate, organisation and methods used. Guidelines on performance

auditing cannot comprehensively embrace all possible approaches, methods and techniques; consequently, no specific guidelines are available for the teams. Survey results have shown that some Arabic-speaking and AFROSAI-E member countries have dedicated performance audits. Performance auditing is routinely done in Tunisia, Senegal is in the process of establishing a dedicated unit, and the SAIs of Botswana, Kenya, Mauritius, Swaziland, Zimbabwe, Uganda and Sierra Leone have shown substantial progress towards implementing performance audits.

## Conclusion

In recent years, SAIs in Africa have made substantial progress towards becoming the autonomous, professional organisations envisaged by INTOSAI. Many good practices and examples have been identified, and these can be shared and used as a basis for learning. At the same time, there is a definite need to emphasise some of the essential prerequisites for effectively functioning SAIs identified in the Mexico Declaration on the Independence of SAIs. Although there may be differences between African countries in terms of their systems of accountability, the challenges faced by SAIs appear to be similar.

SAIs should be provided with adequate human resources and funding to discharge their functions effectively. It is recommended that the legislative frameworks and/or mandates of SAIs should include provisions to meet the following principles:

- SAIs should be financially and managerially independent, ensuring that they are free to plan and execute their activities without influence from the executive;
- clear reporting mechanisms should be set up for SAIs, in order hold them accountable for the effective discharge of their functions;
- public reporting and tabling in Parliament of audit findings should happen within 12 months of the financial year-end;
- effective communication and stakeholder management should be in place, whereby SAIs can communicate and co-ordinate efforts with relevant stakeholders, including oversight entities, civil society organisations, other relevant institutions and the public; and
- effective mechanisms should exist that enable the regular follow-up of recommendations by the SAI and by oversight agencies (the role of Parliament, public accounts committees and oversight committees in the process of accountability should be emphasised).

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# 2.4 Key efforts required to build on progress in tax governance

*Joseph Ayee, Odd-Helge Fjeldstad, Lincoln Marais and Aidan Keanly[1]*

Capable and responsible states are key actors in confronting and overcoming today's global developmental challenges. The building of institutions for a democratic state is a continuous, long-term goal. African governments recognise that revenue mobilisation is central to this goal and their ambitions to achieve the Millennium Development Goals (MDGs). Good tax governance (GTG) and more effective tax systems are central for sustainable development because they can: mobilise the domestic tax base as a key mechanism for developing countries to escape aid or single-resource dependency; reinforce government legitimacy through promoting accountability to tax-paying citizens, effective state administration and good public financial management; and achieve a fairer sharing of the costs and benefits of globalisation.

The African Tax Administration Forum (ATAF) has focused its research on good financial governance (GFG) in respect of revenue in Africa on taxation and not revenue or resource mobilisation. This is because it regards taxation as a very critical

1 This note is a summary of a paper prepared for the CABRI/AFROSAI/ATAF collaborative research on the status of good public financial governance in Africa.

part of the state-building agenda, apart from maximising revenue, economic efficiency and compliance. In other words, GTG is an essential ingredient of GFG. At the heart of both are not only the mobilisation and judicious use of resources to promote development and, thereby, achieve the MDGs, but also measures and strategies aimed at promoting accountability, transparency and trust. Indeed, it is a truism to say that there cannot be GFG without GTG.

This brief addresses the following key research questions:

- What are the inputs of GTG (history of taxation, governance framework, rules, incentives and practices) and what contribution have they made to accountability and transparency?
- What are the outputs of GTG (institutions, drivers of tax reform, mobilisation of revenues at local and national levels) and how do they promote efficiency, accountability and transparency?
- What are the outcomes of GTG (new ways of delivering services by tax administrations, new organisational cultures, increased revenue mobilisation, improved culture of compliance through public education)?
- What has been the impact of GTG (improved capacity of the state for revenue mobilisation, improved accountability, transparency and engagement of state and society around taxes)?
- What are the main challenges facing GTG?
- What are the key priority areas of GTG and what are the policy implications for GFG?
- What are the major issues that should be the focus for future research on tax governance in Africa?

## Key trends in tax governance in Africa

### Renewed interest in taxation

The proliferation of tax reforms and new legislation introduced by African governments has resulted in a general trend of renewed interest in tax issues. This engagement is not only the result of an increasing awareness of the nexus between taxation, state-building and accountability, but is also due to the drivers of tax reform. These include: the international tax family, made up of the International Monetary Fund (IMF), the World Bank, bilateral development agencies, international tax consultants and NGOs; the African tax family, consisting of, for instance, the ATAF and the African Development Bank (AfDB); international conventions, accords and declarations; and the World Taxpayers Association, which has branches in four African countries.

These drivers have been complemented by several pieces of tax legislation passed by African countries. This reawakened interest in tax issues is likely to be sustained because of the realisation by African governments that fiscal self-reliance requires improved tax systems, which entails a culture of trust between the state and citizens, and enhanced government accountability and transparency.

## Reform of tax administration

There is an increased appreciation of the importance of tax administrative reforms in general. A new focus for these reform efforts places relatively less emphasis on simply expanding revenue collection, while placing more emphasis on how taxes are collected, and how this can contribute to broader state-building goals and improved tax governance.

The following five aspects have characterised the reform of tax administration:

- General improvements in the capacity of the tax administration.
- Changing the tax agency from organisation by tax type to organisation by core functions, and, more recently, organisation by tax segments through the creation of Large Taxpayers' Units, which are organised functionally to deal with single tax segments. Notwithstanding this, reorganisation in other areas of administration, such as the motivation of tax officials through performance management agreements, has been much slower.
- Upgrading and expansion of information communication technology (ICT), with the objective of improving data management and analysis, lowering compliance costs, reducing the scope of corruption and collusion, and improving monitoring. Although there have been successes, most of the ICT projects have not achieved their objectives because of delays, poor integration with existing processes, weak implementation and taxpayer ICT illiteracy.
- Improving taxpayer services, with a focus on taxpayer education and awareness, reducing compliance costs and adopting a customer orientation. While a change in attitude has occurred in some countries, the lack of detailed assessments suggests that actual progress has been limited.
- Managerial autonomy of the tax administration from civil service regulations, with the aim of reducing political interference, increasing flexibility with respect to hiring and firing of staff, and improving wages and working conditions. This has led to the creation of semi-autonomous revenue authorities (ARAs) in 15 African countries. It is clear from the literature that even though ARAs often have achieved short-term improvements in

performance, those gains frequently have proved difficult to sustain once the initial urgency of reform has subsided.

While 15 African countries have established ARAs, the remaining 39 African countries have restructured their central tax administrations within the finance ministry with the aim of making them more effective and efficient. The comparison of the two institutional forms of tax administration in Africa undertaken for the research, exemplified by the Moroccan Central Government Tax Administration and the South African Revenue Service, shows no marked difference between the two in terms of effectiveness and capacity to collect taxes.

## Reform of the tax structure

Scholars have pointed out that historically the tax structure has been at the forefront of most tax debates. Since the 1980s, the focus has been on achieving economic neutrality (that is, minimising economic distortions caused by taxation) and increasing revenue collection. In practical terms, this has resulted in the following measures being adopted in all African countries:

- A shift away from trade taxes towards taxes on goods and services, in particular by introducing value-added taxes.
- Efforts to broaden the tax base. However, the already shallow tax base in Africa is eroded by high levels of informality, excessive granting of tax preferences and exemptions, inefficient taxation of extractive industries, and inability to fight illicit capital flows to tax havens and abuses of transfer pricing by multinational enterprises.
- General simplification of tax codes and decentralisation of revenue-raising functions.
- Promoting the welfare-enhancing benefits of extractive industries in African countries rich in natural resources through the signing of international good-governance and anti-corruption initiatives such as the Kimberley Process, the 'Publish What You Pay' campaign, and the Extractive Industries Transparency Initiative.

## Unstable tax revenues

In spite of the reforms, the trend of tax revenues on the African continent is far from positive. Even though tax revenue as a share of GDP in Africa increased on average in the early 1990s, this was driven mostly by natural resource-related revenues that typically distracted governments from generating revenue by way of more politically

demanding forms of taxation such as corporate taxes and personal income taxes. In other words, the tax mix of many African countries is unbalanced – they rely excessively on a narrow set of taxes to generate revenues.

As a result of these weaknesses, there is agreement that resource mobilisation can be increased by shifting towards more appropriate revenue sources. This calls for deepening and diversifying the tax base in a number of ways.

### The nexus between taxation and good governance

A growing trend in Africa is that taxation and good governance are being linked by the realisation that the tax system may contribute towards improved governance through three channels:

- Common-interest processes, which ensure that governments have stronger incentives to promote economic growth since they are dependent on taxes and, therefore, on the prosperity of taxpayers.
- State-capacity processes, which require states to develop a complex bureaucratic apparatus for tax collection because of their dependence on taxes, particularly direct ones. This is likely to lead to broader improvements in public administration.
- Taxation may engage taxpayer-citizens collectively in politics and lead them to make claims on the government for reciprocity and accountability, through either short-term conflicts or long-term increases in political engagement. Thus, governments are compelled to respond to these citizen demands in order to enhance tax compliance and sustain state revenues.

The linking of taxation to good governance in Africa has led to ongoing debate about: the appropriate linkage between taxes paid and services provided to citizens; the strengthening of partnerships between tax authorities and civil society; and the combating of fiscal corruption in tax administration (a phenomenon that is pervasive in many countries) to establish legitimacy.

## Recommendations

The study provides the following recommendations for achieving GTG, with serious implications for GFG.

## Addressing tax evasion

In many African countries where the informal sector is diverse, small and large taxpayers evade tax. This is a big challenge. Nevertheless, the informal sector can be brought into the tax net in practical ways. For example, Algeria uses a presumptive tax for the mainly informal entrepreneurs. Similarly, in Zambia a flat rate 'base tax' for rural areas has been introduced along with a 'presumptive taxation' of 3% on group income for urban areas; in addition, a 'peddlers license' has been instituted for street sellers. It is instructive to note that micro enterprises may be taxed by means of a 'synthetic fixed tax', in terms of which they would pay a fixed tax based on business activity and a few other easy-to-measure parameters (e.g. location and equipment). Micro enterprises would thus be subject to a simple tax scheme based on an assumed profit. Because the synthetic fixed tax scheme is simple and easy to implement, it makes it possible to involve local government authorities in collecting the tax, since it is conceived as a local resource.

## Stopping illicit capital flows

There should be a concerted effort by the international community and African governments to deal with illicit capital flows from Africa, mainly to tax havens and Western financial institutions. Companies engaged in commercial tax evasion, mainly through trade mis-pricing, should not only be blacklisted but also be prosecuted. Equally, citizens of African countries who collude with such companies, and sometimes act as fronts, should be sanctioned to serve as a deterrent. All opportunities that facilitate the phenomenon of illicit capital flows should be removed and stringent control mechanisms put in place through appropriate legislation and other incentives.

## Fighting transfer pricing

Fighting transfer-pricing abuse requires African countries to develop specific legislative measures that are adapted to their legal systems and economic contexts, and to build the administrative expertise needed to enforce them. African governments must carefully consider the extent of resources that should be devoted to addressing transfer pricing. With the existing administrative capacity constraints and considerable amounts of tax revenue at stake, a pragmatic approach, tailor-made to the administrative and institutional means available in the specific country, is needed.

## Efficient management of the tax system

Efficient management of the tax system enables the public sector to mobilise resources for economic development. It also engenders confidence and trust in public financial

management, which is an important component of good governance. Despite efforts to broaden the tax base and reduce tax evasion, many African governments need to take further steps to achieve satisfactory results.

The tax system in many African countries is largely inequitable. Often, it is perceived by citizens to be unfair, difficult to understand and not reflecting taxpayers' capacity to pay. In tax analysis, the equity of a tax system is divided usually into horizontal equity and vertical equity. Horizontal equity requires that people in similar circumstances be treated similarly, while vertical equity requires that people in different circumstances be treated differently. The inability of tax authorities to tax wealthy individuals and large firms is often due to the use of offshore financial centres (i.e. tax havens or 'secrecy jurisdictions'), which facilitates tax evasion and hides the illegal proceeds in non-traceable accounts. The existence of secrecy jurisdictions has serious consequences for both the revenue productivity and the equity of tax systems in Africa. Tax governance and, indeed, public financial governance will be enhanced if there is improved equity in tax enforcement and administration.

## Fighting fiscal corruption

Tackling fiscal corruption within tax administrations is a priority for establishing legitimacy. Corruption undermines tax morale and tax revenues. An appropriately paid tax official is less likely to take bribes. An additional challenge is that talented tax specialists are attracted to the private sector, which often is able to offer much better salaries and working conditions than the public sector. African governments must find solutions, which could include a pay scale for tax administrators that differs from that used for regular civil servants. It has been pointed out, however, that excessive use of bonuses and revenue targets can lead to decreased quality and can cause frustration amongst tax administrators, in particular between the management and the operational staff. Furthermore, reducing tax compliance costs helps with private sector development and lowers the amount of the bribe a taxpayer might be willing to pay to avoid declaring and paying tax. Similarly, opportunities for bribery can be lessened by reducing the number of times a taxpayer needs to interact with tax officers, and by introducing transparent tax codes.

## Ending tax preferences

Whether the use of tax incentives is a cost-effective way of overcoming investment impediments depends on the host country's investment conditions and characteristics. In general, it is better to focus on the actual impediments to investment and aim to address these directly. Addressing non-tax impediments may be a more effective policy for attracting investments than seeking to match the tax incentives

provided by other countries, especially if the latter option prompts a race towards widespread exemptions and a *de facto* zero-tax regime. In providing an attractive tax system for investors, African governments should aim for transparency, certainty and predictability of tax treatment, and take steps to limit compliance costs (for example, through taxpayer education and streamlined payments), before exempting international investors from all or part of their fiscal obligations.

Revenues foregone by tax incentives for investment, such as tax holidays, partial profit exemptions and free trade zones, tend to exceed by a wide margin the revenue costs expected before the concession is put in place. In particular, countries frequently underestimate the tax-planning opportunities and skills of multinational companies through which they can manage to extend the coverage of their initial tax relief to non-targeted activities and profits. Increased reliance on other taxes and the need for tax-base protection measures place additional strains on the tax system. At the same time, competition between countries to attract mobile investment creates pressure for the continued use of targeted tax incentives. Given this situation, some degree of co-operation among countries is required to prevent a counterproductive race to the bottom in effective tax rates on profit. This applies especially to countries linked by free-trade arrangements and which, thus, are likely to be in the most direct competition for mobile capital. Arguably, with some form of regional collaboration, the priority of policy-makers should be to limit the most damaging tax preferences, such as tax holidays and export incentives. A monitoring framework and computerised system to exchange information would be necessary to implement this type of agreement.

## Improving revenue mobilisation

Most African countries face difficulties with their tax policies and tax administration. At the same time, they need to improve revenue mobilisation to finance their ambitious economic development programmes and to meet the objectives of the MDGs. From a governance perspective, it is not only the revenue target that is an important issue, but also how taxes are enforced. If revenue targets are reached, but tax collection is implemented using harsh, illegitimate and coercive methods, this is not GTG. Some revenue authorities in Africa, such as the Uganda Revenue Authority, Tanzania Revenue Authority and Zambia Revenue Authority, have argued that the revenue targets they receive from the finance ministry often are unrealistically high given the current tax structure. Therefore, to reach the targets they 'go hunting in the zoo', which implies that the most easy accessible and less politically connected companies are exposed to harsh enforcement and quasi-legitimate tax audits.

Revenue shortfall is a major reason for budget deficits and lack of budgetary discipline. While countries like Benin, Malawi, Nigeria and South Africa have

succeeded in meeting or exceeding their targets, others like Burkina Faso, Ghana and Mauritius have failed to meet their targets for revenue mobilisation. Deficiencies in the tax collection system – evasion, corruption, abuse and misapplication of provisions for tax exemption, political interference and the low capacity of tax administrations – are at the root of these failures. In short, the predictability of resource mobilisation is a *sine qua non* for GTG as well as GFG.

## Measures to build a taxpaying culture

Measures, including the following, must be instituted to promote a taxpaying culture:

- Governments should remove the perception held by firms and individuals that paying taxes brings them little in return by providing quality services and infrastructure to the public and private sector.
- The cost of dodging taxes and the risk of getting caught must be perceived as high by taxpayers, and penalties must be applied when evasion is detected.
- Tax administrations should treat taxpayers as clients rather than as 'suspected criminals'.
- Well-defined and well-executed educational campaigns by tax administrations using the media and new technology can help in ensuring that taxpayers understand and accept the compliance requirements. In South Africa and Zambia, for example, taxpayer education campaigns have contributed towards greater public awareness and increased voluntary compliance.

## Taxing natural resources

Vast natural resources (in particular, oil, gas and minerals) are already an essential revenue source for many African countries. However, there is evidence that African countries receive less revenue from natural resources than do many other countries in the world. Several factors contribute to explain this situation, although it is difficult to obtain a clear picture. Contracts regularly impose strong confidentiality clauses on the multinational companies, governments, investors and banks involved. Generally, there is more than corruption to consider. Governments argue that they cannot make all details of the extractive industries public and that they have limited influence on the companies. Countries compete for the scarce managerial and technical skills needed for resource extraction. Yet, shortages of legal and negotiation skills play a major role in driving down tax revenues from natural resources. Given the challenges, the IMF and World Bank should assist African countries in building capacity to (re)negotiate contracts for the taxing of extractive industries.

### Understanding the political nature of taxation

While the technical aspects of tax reform are crucial, an understanding of the sustainability of reforms is not possible without comprehending how reforms become legitimate. Because taxation affects incentives and distribution simultaneously, tax reform requires a degree of social consensus that the policy is in the collective interest and/or a state with the ability to coerce those who challenge its allocations. While a technocratic approach to tax reforms and institutional development is required, it is incomplete if the political nature of taxation is ignored.

## Conclusion

The last decade has seen some progress in tax governance in Africa, in particular through the simplification of tax structures, laws and regulations, and by a strengthening of the capacity of the tax administration in some areas. However, there is still substantial room for further improvements. Governments and tax administrations are increasingly aware that the achievement of fiscal self-reliance in Africa requires:

- a broader engagement of citizens, civil society organisations, the business community and the media on tax issues, including improved dialogue between these stakeholders and the state;
- the establishment of clearer links between taxes paid and service delivery, thereby strengthening the social fiscal contract between the state and society;
- continued efforts to modernise and build the capacity of tax administrations; and
- a consolidation of Africa's engagement in international efforts to fight illicit capital flows that undermine African countries' tax bases.

# 2.5 A stocktake on African public financial management

*Matt Andrews*

How strong has African public financial management (PFM) become? How do the African PFM systems now in place facilitate effective PFM? Where are the next challenges and how can they be met? A recent paper addresses these questions using analyses of countries' performance in Public Expenditure and Financial Accountability (PEFA) assessments to identify central themes of the continent's recent PFM story (see Andrews 2010). The themes emerge from quantitative and qualitative data in 31 central government PEFAs completed prior to mid-2008 and tell a story in two parts: (a) across PFM processes; and (b) across countries.

## Themes across PFM process areas

The data analysis suggests that:

- African countries make budgets better than they execute them;
- practice lags behind the creation of processes and laws; and

- processes work best when actors are concentrated, but poorly when they are de-concentrated.

The first theme highlights that budget preparation processes are comparatively stronger than budget execution and oversight processes across all African countries. In PFM jargon, this is commonly referred to as 'upstream processes' being stronger than 'downstream processes', and may be called the *downstream problem* in African PFM.

The second theme is more nuanced, showing across all process areas that African PFM systems generally suffer from an implementation deficit – laws and processes may be in place, but seldom affect actual behaviour. The theme reflects a new institutional differentiation between *de jure* and *de facto* reform; legislation and procedures are improved, but implementation is not achieved. This may be called the *de facto problem*.

The third theme offers even more specificity, suggesting that processes are stronger when narrower, concentrated sets of actors are involved in implementation. Processes are weaker where they involve multiple players, especially outside of central PFM entities like the budget department or treasury. This may be called the *de-concentrated actor problem*.

## Themes across countries

The data show substantial variation in PFM strength across countries, and the variation is significant enough to suggest that different countries fall into different 'PFM performance leagues'. Countries in the different leagues look very dissimilar to each other, and face different challenges.

Lower-league countries have weak dimensions, no matter how these are categorised: their challenges lie in every area and it is difficult to see where to start. Countries that are one or two leagues higher are strengthening PFM dimensions that are upstream, *de jure* in nature, and centred on the engagement of concentrated actors. This seems to be the current challenge they are attempting to address. The highest-league countries already have stronger upstream, *de jure* and concentrated PFM areas and are now challenged to strengthen other dimensions – downstream, *de facto* and de-concentrated.

Five factors can be identified to explain why countries fall into different leagues:

- growing countries have stronger PFM;
- stability delivers PFM progress;

- states with larger domestic, non-mineral income sources have stronger PFM;
- longer periods of broad reform commitment foster PFM progress; and
- (possibly) colonial heritage matters.

Additional work is required to test the validity of these factors and to explain them more fully; they could all be reflective of more fundamental issues. The higher-league, stronger-PFM countries tend to have all or most of the 'positive' factors – high growth rates, stable politics, larger non-mineral domestic revenue sources, longer reform periods and an Anglophone heritage. The lower-league, weaker-PFM countries tend to have few or none of the factors – low growth, unstable politics, lower non-mineral domestic revenue sources, shorter reform periods and a Francophone heritage.

The message is simply that country characteristics influence PFM strength. Some countries are substantially ahead of others in a general sense because they manifest the positive, enabling factors. They are in Africa's top leagues, climbing rungs towards the top of the PFM performance ladder. Other countries find themselves struggling with contextual realities that undermine reform. Their PFM processes and outcomes are weak, and they are in the bottom leagues, struggling to get past the lower rungs of the PFM performance ladder. This raises the following question for reformers: Is context taken seriously in reform design, and how?

## Themes from past reforms, thoughts for the future

Context is not well considered in reforms, and there are strong similarities in reforms across the 31 countries. Reforms typically comprise sub-sets of the same international reform 'products', emphasise the engagement of central, concentrated entities like treasuries, budget departments and revenue and procurement agencies, and direct attention to amending laws and formal processes as the basis of reform.

Given this discussion, and drawing from new institutional theory about isomorphic change, it is suggested that the existing reform approach may have delivered strong laws and central agencies successfully but is less well suited to the looming challenges of other dimensions. It also 'works' in countries with favourable environments, but does not deliver stronger PFM in less welcoming contexts. To address the difficulties of context-challenged countries, and weak downstream, *de facto* and de-concentrated process dimensions, future reform approaches require:

- less focus on technicalities, more on 'reform space';
- less concentration, more reach and coverage; and
- less similarity, more context-appropriateness.

A critical focus of reform efforts should be on creating 'reform space', rather than pushing technical reforms. For reforms to be internalised, new ideas must be 'accepted', 'authorised' (by formal and informal mechanisms) and 'enabled'. This requires provoking endogenous change processes, instead of motivating and informing reform from the outside in. Ideas may come from the outside, but they will be implemented only if 'reform space' exists to allow for this.

PFM reform engagement should be extended beyond concentrated groups of actors at central-government level. A dialogue-based approach with multiple stakeholders should replace prescriptive and externally driven reform efforts as a means to garner reform commitment. Broad engagement stimulates support and demand for PFM reforms, enhancing 'reform space'.

PFM reforms need to be more contextualised, shaped to fit the peculiar political, social and economic realities of a country. Contextual weaknesses – as in the factors noted above – should not be seen merely as 'risks' that may scuttle attempts at 'best practice' reform. Rather, they should be seen as crucial factors around which reforms are designed, and that determine the scope, pace and ambition of reform. Ultimately, many contexts are too difficult for the simple importation of reforms, and require an approach that allows learning by doing (through experimental design) as a means to identify what reforms might work or fit.

The appearance of unorthodox reforms could indicate more appropriate design, especially in countries with challenging contexts. In conclusion, it may be asked what this would mean for countries and donor organisations that seem to have bought into orthodox one-best-way models of doing things. The PEFA diagnostic, relied upon for data in Andrews (2010), is a loose manifestation of such a model. However, key themes emerging from the study raise concerns about its general appropriateness: How relevant is the proposed model for Africa, if countries adopt PEFA-endorsed rules but routinely fail to execute them? How relevant is the model where it is adopted by agents in concentrated discussions with donors, but not by those whose day-to-day lives are informed by local politics, economics and social convention?

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# 3

# Budgets, programmes and performance

## 3.1 Introduction

Programme-based budgeting (PBB) reforms are common throughout Africa. They involve introducing a programme dimension to the budget classification system, usually in addition to existing administrative and economic or line item classification. This allows for the budget to be allocated to programmatic objectives and/or for stakeholders to view budget allocations against governments' overarching or sector- and institution-specific objectives. There are different options for using a programme classification. Programmes can span institutions or the classification can operate at a sector or institutional (in other words, sub-administrative) level. Governments can choose to change their budget administration laws so that the legislature allocates to programmes (as, for example, in South Africa and Mauritius) or just use the classification in the budget process and publish a version of the budget by programme classification, while the allocation still occurs by administrative and line item classification (as, for example, in Kenya). Alternatively, governments can choose to introduce performance information, linked to programme classifications, into the budget process. This is known as programme-performance budgeting. In a few countries internationally, the link between financial allocations and outputs and outcomes is firmly forged, with legislatures allocating to outcomes and outputs (as,

for example, in Australia and the United Kingdom). More commonly, however, the link is made by collecting and publishing performance information in conjunction with financial budgets and introducing rules in the budget process to allow the allocation process to be informed by programme performance.

CABRI is currently in the middle of a multi-year programme of learning about how African countries are introducing programme (performance) budgeting and what works. While the principles of this budget reform are clear, it is difficult to implement in practice. The following are ubiquitous questions: Should programmes span agencies or not, and, if they do, how can one manage accountability? If they are within institutions, should institutional structures coincide with programmes or not? Should programmes be permanent or change as strategies change? Who should develop programme structures and performance indicators, spending agencies or the centre? Should performance indicators operate at an achievement level or be about outputs? The main paper in this chapter represents CABRI's first step in this programme. It is the outcome of a joint country case study of Mauritius' programme budgeting reform. The full case study (summarised here by Helene Ba from the CABRI Secretariat) was prepared by Adrienne Shall, under guidance of the case study panel, which included representatives from Ethiopia, Kenya, Rwanda and South Africa. The case study is presented here together with summary notes on similar reforms in Rwanda and Kenya, prepared by Aarti Shah (also from the CABRI Secretariat).

# 3.2 Programme-based budgeting: Experiences and lessons from Mauritius

*Helene Ba*[1]

## Introduction

Mauritius has embarked on an ambitious reform programme, which includes the implementation of programme-based budgeting (PBB) within the context of a medium-term expenditure framework (MTEF). The main aim of introducing PBB is to improve the efficiency and effectiveness of public spending, so as to achieve better social and development outcomes.

1 This summary is based on the CABRI Joint Country Case Study of Programme Budgeting in Mauritius, prepared by Adrienne Shall, under guidance from the case study panel. The panel included representation from Ethiopia, Kenya, Rwanda and South Africa. The full version of the paper is available at www.cabri-sbo.org.

Mauritius has set up a sophisticated PBB system in a short space of time. Recognising that implementation is still in the early stages, there are areas that need further refinement and stabilisation. While the architecture of the PBB reforms is now largely in place, the focus is shifting to consolidating and deepening the reforms in order to reap the benefits of aligning resource allocation with policy priorities and improving service delivery.

The article examines the successes Mauritius has achieved and the challenges still faced in terms of implementation strategy, conceptual design and the impact of PBB. It also highlights general issues for other countries to consider before embarking on a PBB reform programme.

## Background to the reforms

In 2003, an attempt was made to introduce PBB and an MTEF in six pilot ministries. The methodology used was primarily a process of converting line-items to a programme classification, and incrementally forecasting the outer-year estimates. Within the pilot ministries, there was no change in the culture of budgeting, which remained incremental and adversarial (see SIPU 2007; World Bank 2007). With no explicit policy framework guiding the budget process, ministry officials had little incentive to prioritise and control spending within politically agreed, hard budget constraints. For the rest of the government, budget documents remained in the traditional format, there seemed to be no change in the budget formulation or implementation process, and budgeting was regarded as business as usual. The election in 2005 further hindered the implementation process during that year.

In 2006, the newly elected government launched an economic reform programme, part of which aimed to strengthen fiscal management.[2] Acknowledging that PBB in an MTEF context was an important area of fiscal management, there was a renewed impetus for the successful implementation of these reforms. The government of Mauritius was the initiator of the reform programme, with assistance from external partners such as the International Monetary Fund (IMF), the World Bank and the United Nations Development Programme (UNDP). Within the government, the Ministry of Finance and Economic Empowerment (MoFEE) is the engine driving the reforms, with strong support from the Prime Minister.

2 The aim of the economic reform programme was to address the economic challenges of a lower growth environment, persistently high fiscal deficits and escalating public debt. These reforms focused on increasing the competitiveness of the economy, attracting foreign direct investment, empowering the poor and strengthening fiscal management.

To overcome the perception that PBB and the MTEF were just add-ons with no real impact, a new implementation strategy was introduced in all ministries simultaneously, using a more integrated and inclusive approach. This meant focusing on using PBB to introduce performance orientation in the budget, and on employing it as a policy instrument to rationalise and prioritise resource allocation rather than just as an ad hoc addition to the budget process. Furthermore, the reforms were based on a sound policy framework to improve the link between policy decisions and budget allocations. The more recent initiative is now well supported by the whole government.

To implement PBB successfully, changes to the public finance system are necessary. Firstly, it is important that the organic budget law be updated to cater for all budgetary and accounting reforms. Secondly, it is important that the budget classification and the chart of accounts (COA) are aligned to ensure compliance and to facilitate reporting of payments by programme and responsible organisational unit. The most important enabling change for PBB was the enactment of the Finance and Audit (Amendment) Act.[3]

The Ministry of Civil Service and Administrative Reforms (MoCSAR) is in the process of implementing, along with the above reforms, a performance management system (PMS) to improve individual performance and the delivery of public services. The MoFEE plans to have an integrated individual PMS aligned to PBB by 2012.

Mauritius also recently introduced a Public Sector Investment Programme (PSIP). The PSIP draws from and feeds into programme budgets and covers the investment programme of the wider public sector. It is a rolling investment plan, which will be reviewed on a quarterly basis against the government's strategic objectives, taking into account, *inter alia*, resource availability, state of preparedness of investment projects and implementation capacity. The 2009–2013 PSIP was prepared by the MoFEE in collaboration with various ministries, departments and statutory bodies.

## Implementation strategy and conceptual design

The MoFEE employed a 'big bang' approach, introducing PBB to all ministries simultaneously, together with parallel reforms such as revising the COA and

3 It provided for: the introduction of PBB; the preparation of estimates of expenditure based on programmes and sub-programmes on a 3-fiscal-year rolling basis, specifying the resources to be allocated, the outcomes to be achieved and outputs to be delivered; the preparation of estimates of revenue on a 3-fiscal-year rolling basis; the abolition of the Capital Fund (as all expenditure in PBB is by programme, with no separate capital and recurrent budget for line ministries); the replacement of the Contingencies Fund by a new provision for contingencies; and performance audits to be carried out by the Director of Audit.

implementing a new financial management information system (FMIS). A concerted effort was made to ensure buy-in from all stakeholders, ranging from ministers through to line-ministry officials.

## Requirements

Country experience suggests that implementing PBB is an ambitious task that requires a well-developed and well-sequenced implementation strategy. In order to ensure successful implementation and design of the reform, it is important:

- that the appropriate preconditions (including issues such as the existence of sound macro-fiscal policy management, an ability to enforce the execution of budgets as planned, mechanisms for government-wide policy prioritisation, good governance, and adequate human and financial resources) are fulfilled before the reforms are initiated;
- to have an initial understanding of the shortcomings in the current budget process;
- to conduct a thorough analysis of how the functions, roles and responsibilities of different actors in the administration will be affected;
- to have a clear understanding of the concepts involved in PBB and to develop simple definitions that are easy to apply practically;
- that adequate preparations, including an agreed-upon budget format and methodology, are made within the finance ministry before introducing PBB to line ministries; and
- that a clear implementation path is developed for the reforms.

## Sensitisation and shifting attitudes

In Mauritius, an important start to introducing the PBB reform was to sensitise members of the Cabinet. Several ex-ministers of finance from other countries that had implemented PBB were brought in to meet with the Cabinet, and then with members of the National Assembly (NA) and heads of department, to convince them of the necessity for the reform. Initially, within both the MoFEE and line ministries there was resistance to change. Line ministries felt that the MoFEE was imposing the new system on them, and they did not take ownership of their budgets and performance information.

Despite the initial resistance, the MoFEE has managed to instil a performance consciousness throughout the government. There has been a clear shift in attitude

towards a performance-oriented budgeting system, and there is buy-in from all levels of staff, which is crucial to successful PBB implementation. Nevertheless, challenges remain in some of the line ministries, with respect to the knowledge and capacity necessary for the full implementation of PBB, especially in terms of how the functions, roles and responsibilities of different officials need to change.

## Sequencing and timing of reforms

Starting in 2007, Mauritius developed a reform strategy and action plan to provide a clear vision of the future and to lay out a path for getting there. A budget reform matrix was worked out, which described the various tasks that needed to be performed, the deadline for each task, the responsible individuals, external technical assistance required and general observations. An important factor in the sequencing of reforms was the timely amendment of the Finance and Audit Act, which allowed the 2008/09 budget to be appropriated in Parliament in the PBB format. The decision to first implement 'indicative PBB', in parallel with the line-item budget, was a key element in changing the line ministries' understanding of the shift towards a programme and performance orientation. It allowed time for a change in mindset, particularly in awareness of the importance of interaction between the finance section and programme implementers in formulating the budget.

## Terminology, concepts and programme structure

### Definitions of terminology and concepts

Definitions of terminology and concepts generated much debate and discussion within the MoFEE. Since the 'indicative PBB', frequent changes were made to definitions, with the aim of making them simpler and easier to apply. However, this was challenging for Sector Ministry Support Teams (SMSTs) and officials from the line ministries, as misunderstandings arose as to what was required in terms of defining outcomes, outputs and performance indicators. Consequently, confidence in PBB was undermined.

**Definitions**[4]

The Finance and Audit (Amendment) Act of 2008 provides the following definitions:

*Programme:* group of activities or interventions intended to contribute to a common set of outcomes, specific objectives and outputs that are verifiable, consisting of a defined target and a given budget including staffing and other necessary resources.

*Sub-programme:* the programme hierarchy which breaks programmes into sub-programmes, which in turn break into activities or interventions, and is designed to achieve at least one specific objective.

*Outcome:* the likely or achieved short-term and medium-term effects of an activity's or intervention's outputs.

O*utput:* the products, goods and services resulting from the carrying out of an activity, including changes resulting from activities relevant to the achievement of outcomes.

According to the *PBB Manual*:

'For the purposes of performance specification, services are often grouped together in service groups which are called *programmes* or *sub-programmes* in Mauritius. A service group is a stable aggregation of services that are similar in nature and for which the costs can, for accountability purposes, be attributed to a delivery unit.'

## Programme structure

The PBB framework in Mauritius consists of programmes, which are then broken down into sub-programmes and activities. Each programme has to achieve at least one outcome, and each sub-programme has to meet at least one priority objective.[5] Each sub-programme is required to provide specified services (outputs), and each service is measured by service standards (performance indicators) with targets for the three years of the MTEF. Generally, a ministry may request changes to the programme structure either through the budget analyst assigned to it by the MoFEE, or through the Cabinet.

4 In addition to the definitions given here, the MoFEE has issued a *PBB Glossary*, which further clarifies the definitions and provides examples for each.

5 The *PBB Manual* defines an outcome as a change in the economic, physical, social and cultural environment, which the government is trying to influence through its provision of services. A priority objective is defined as a sub-programme goal, which is a priority, affordable and measurable.

While there are no formal guidelines for developing programme structures, the *PBB Manual* states that the ministry should identify strategic outcomes for current and future years on the basis of the strategic plan, and then develop programmes and sub-programmes relating to the achievement of the expected outcomes. The MoFEE has recommended that all ministries/departments have an initial programme called 'Policy and Management'.

**Criteria for defining a programme structure**

- Each programme should have a clearly articulated objective, which is aligned with the strategic policy objectives of the government;
- the design of programme budget structures must be linked to a ministry's strategic plan and output indicators relevant to the programme;
- programmes should be broken down into sub-programmes and activities in successively greater detail, in order for line ministries to transform the programmes into concrete actions that can be implemented;
- the number and scope of programmes and sub-programmes should be limited, in order to facilitate in-depth, policy-oriented analysis;
- the programme structure should not change every year (changes to programme structure should be allowed only if there are major policy changes in the ministry);
- programmes should relate clearly to the core functions of the ministry, and programme names should reflect this; and
- a management position within the organisation should be assigned responsibility for management and financial control at the programme or sub-programme level.

## Audit of performance information

The National Audit Office (NAO) is responsible for the auditing of performance information. The auditing of performance information differs from conducting a performance audit in that it is concerned more narrowly with the integrity of the reported performance information. This type of audit should focus on the systems and processes used to generate performance indicators, as well as assuring that the performance information is reliable, consistent and comparable over time. Currently, this is the intended focus in Mauritius. Full performance audits, which investigate a ministry's logic of intervention and, thus, its policies, are conducted annually by the NAO on selected sectors.

## Issues in budget preparation

### Strategic planning

Strategic planning in line ministries is the starting point for developing programme information, and should be the foundation on which PBB is formulated. A strategic plan should set out the direction the ministry intends to take in order to reach its goals and objectives, and should define the programmes, sub-programmes and outputs necessary to achieve this. It should be mandatory for all line ministries to develop strategic and operational plans that are updated on an annual basis.

It is important that the programme structure in the strategic plan is aligned to the programme structure used in the budget, that the plans are forward-looking and that they are costed. The plans should contain information on the vision, mission, and goals and objectives of the ministry, as well as linkages to programme outcomes, sub-programme outputs and the inputs required to achieve them. Performance information in the strategic plans should be linked directly to performance information in the PBB, so as to provide a mechanism for reporting measurable progress at the end of the year.

In Mauritius, instead of delaying the PBB implementation by waiting for line ministries to develop strategic plans, the MoFEE saw the implementation of PBB as an impetus to strengthen the strategic planning process. The development of 15 sector strategies has been commissioned by the MoFEE. In 2010, four have been completed.

### Costing

The *PBB Manual* states that the first step in building a programme budget is to establish a baseline by calculating the costs of programmes and sub-programmes. This involves:

- identifying the sub-programmes or programmes (when there are no sub-programmes) to be costed;
- identifying and assigning the direct costs incurred in undertaking the sub-programme activities;[6]
- identifying the indirect costs of sub-programmes or programmes, and assigning them to Programme 1 'Policy and Management';[7] and

6 Direct costs are those costs that can be identified specifically and exclusively with a particular cost object. Examples of direct costs are labour, consumables, equipment and maintenance.

7 Indirect costs cannot be identified specifically with a single cost object. Examples of indirect costs are rental, salaries of senior management, legal costs and other overheads.

- adding sub-programme costs for each programme, to achieve the full programme cost.

MoFEE officials recognise that further work is required on the costing of programmes and sub-programmes. As a starting point, a full interrogation of baseline costs should be conducted. Currently, costing is based on the status quo prior to the implementation of PBB. Inaccurate costing of the baseline not only has implications for the delivery of services but also may result in increased virement, which could affect the credibility of the budget. Thereafter, a methodological approach for the allocation of indirect costs should be communicated to all ministries, as there appears to have been some disagreement on how indirect costs should be allocated to programmes and sub-programmes.

In-house costing skills need to be expanded, as administrators are doing the costing with insufficient input from sector specialists. Currently, costing is done at a programme level and not at a service level. For more accurate costing, MoFEE officials have indicated that an output-costing module is due to be implemented on a pilot basis in 2011.

**Budget submissions and hearings**

The budget circular, containing detailed requirements for budget submissions, is issued in May. An officer from the SMST in the MoFEE is assigned to each ministry to assist in the budget preparation process. If a ministry's budget proposal is within the given ceiling, the budget submission is accepted as is. Budget hearings are held only for those ministries that require a budget over and above the ceilings allocated to them.

Ideally, budget hearings should be held for all ministries, whether they are within the ceiling or not. The purpose of a budget hearing is to scrutinise spending plans (ensuring that resource allocation is efficient and effective) and to promote agreement on priorities. It is during the budget hearing that information is shared to facilitate appropriate trade-offs and prioritisation among programmes and sub-programmes, so that the budget is aligned with government policies and priorities.

**Budget documentation**

Once the budget has been finalised, the MoFEE submits the budget documentation to the NA for approval. The format of the budget document is the same as that of the budget submission, and includes:

- an overview of the ministry/department;

- the services to be delivered, and performance information for all programmes and sub-programmes for a four-year period (the current-year baseline, plus targets for the three-year MTEF period);
- the financial resources allocated to each programme and sub-programme for the four-year period; and
- the human resources (funded positions) for each programme.

## Capacity-building

The 'indicative PBB' led to the recognition that capacity-building is an important issue. A training programme, consisting of 12 modules, was tailor-made for the Mauritian context. External consultants trained approximately 65 people from the MoFEE, line ministries and universities; the best 15 were chosen to become trainers, and they then trained 400 officers from a range of line ministries. This first round of training was fairly broad, and was followed by the mentoring and support of IMF experts. More specific, specialised training (sometimes taking the form of extensive consultation with a ministry) was developed at the request of individual ministries.

## Issues in budget execution

At the same time as the PBB formats were being designed, revisions were being made to the COA and accounting system to facilitate budget execution in a PBB format. Budget execution is managed through the Treasury Accounting System (TAS). The reclassification of the budget according to the new COA (together with the introduction of the new FMIS) has been a successful part of the PBB implementation. In particular, the creation of the working group to co-ordinate the implementation aided the smooth transition. Before the migration to the new system, there was a process to clean the data and remove duplications and outdated data. Line ministries were involved in this process and were asked to review their items in detail.

## Reporting and monitoring

In Mauritius, reporting and monitoring are the responsibility of each line ministry/ department, with the MoFEE playing a co-ordinating and supervisory role. The reports on financial and performance information are not integrated, complicating the analysis and review of these in relation to each other at the programme and sub-programme level. Furthermore, the responsibility for monitoring and reporting on progress with investment projects is separate from monitoring and reporting on performance information in the PBB, which also makes it difficult to get a complete overview of programme performance. Reports should be integrated in such a way that all financial and performance information is presented together by programme

and sub-programme, thus allowing for meaningful monitoring and evaluation of overall performance.

| Department | Responsibility | Timing |
|---|---|---|
| Treasury Department | Preparation of financial reports | Monthly, quarterly and annually |
| Budget Strategy and Management Directorate (BSMD) | Management of PBB database of non-financial performance data | Quarterly |
| | Supervision of monitoring reviews on investment projects and/or acquisition of assets listed in the PSIP | |
| Public Expenditure Management Systems Review Directorate (PEMSRD) | Co-ordination of the preparation of performance monitoring reports | Half-yearly |
| | Supervision of budget monitoring reviews on performance data | Monthly |

No empirical analysis of the link between resources and performance achievement is being conducted by ministries or the MoFEE. Only when ministries start empirically analysing their underlying data and its relation to published indicators, can it test its logic of intervention (i.e. whether inputs intended to yield the stated outputs achieve their purpose) and then make relevant policy choices based on that analysis.

### Accountability

A clear and unique relationship between the budget programme structure and the organisational structure is critical in terms of holding the appropriate organisational unit accountable for programme implementation and service delivery. In Mauritius, organisational structure is not always aligned with programme structure. Recognising that it is difficult to change organisational structure, this is an objective to be achieved over the medium to long term.

## The impact of programme-based budgeting

### Flexibility and ownership

The introduction of PBB has resulted in a more collaborative relationship between the Budget Strategy and Management Department (BSMD) in the MoFEE and the line ministries, with more interaction between the line ministries and the SMSTs during budget preparation. The role of the BSMD has changed from that of preparing budgets for the line ministries to that of commenting, refining, assessing quality and co-ordinating. For the most part, line ministries feel that they have greater flexibility in determining and managing their own budgets. Changes in virement rules and the relaxation of procurement rules have led to additional in-year budget flexibility.

### Better resource allocation

There has also been an improvement in the quality of budget submissions, and budget hearings have shifted from focusing only on line-items to including a focus on the determination of priorities and services to be delivered. There is, however, room for improvement, particularly in the areas of policy analysis and the use of performance information therein. Since the introduction of PBB, the number of ad hoc projects introduced in-year during budget implementation has decreased, and ministries are better disciplined in this regard.

### Performance orientation

The implementation of PBB has increased awareness of performance and the need to monitor the achievement of targets. The presentation of performance information in the budget documentation has improved over time, and some ministries have enhanced the quality of the information provided.

### Transparency and access to information

Transparency and access to information have been enhanced since the implementation of PBB. The Cabinet is in a better position to set targets and priorities based on the information contained in the PBB, and line ministries feel that financial administration is facilitated by more readily available information. Debates in the NA are now focused on targets and achievements rather than just on line-items. However, the NA has yet to make full use of the information, as members do not have the required capacity and external support.

## Conclusion

In the three years since the ‘indicative PBB’ was presented to the NA, the government of Mauritius has made great progress in the implementation of PBB. The MoFEE ensured an enabling environment for PBB with the requisite amendments to the legal and institutional framework, and has managed to instil a sense of performance orientation throughout the government. The budget has been restructured using a programmatic approach, and the budget documentation now includes performance information. A new COA has been implemented, and the FMIS upgraded, enabling budget execution according to PBB requirements. Now that the system is stabilising, Mauritius must focus on ensuring consistency in the use of concepts and terminology. Line ministries should review their programme structures, outputs and indicators to make sure that they are relevant and appropriate.

One of the main aims of PBB in Mauritius is to make the budget process more policy oriented, using PBB as a tool for allocating limited resources to services that provide the greatest social benefit. Recognising that strategic policy analysis aligned to budgeting is a process that takes time to institutionalise, this remains a challenge. Specific areas requiring further attention include: using strategic planning to ensure linkages between policy priorities and resource allocation; performing in-depth budget analysis to inform resource allocation aligned to targeted outputs; and developing mechanisms to monitor and evaluate service delivery in relation to spending.

The challenges faced by Mauritius are fairly common to most countries. Some of the major issues for countries to consider when implementing PBB are:

- the necessity of a well-thought-out implementation strategy and plan, identifying what needs to be done and in what sequence;
- agreement on terminology, concepts and formats early in the process, and ensuring appropriate capacity-building for all implementers;
- a strategic plan for each ministry, to be used as the basis for developing a programme structure and informing resource allocations to programmes and sub-programmes;
- the definition by ministries of appropriate outputs and performance indicators that are realistic and measurable;
- the importance of developing capacity to analyse whether ministry budgets reflect policy priorities, whether programmes are efficiently costed relative to intended performance, and whether the projected performance is achievable;
- the updating of accounting and information systems to cope with additional classification requirements;
- mechanisms and systems to monitor and evaluate programme performance from both a financial and a non-financial perspective; and
- improved accountability and oversight, for which it is crucial that performance information be included in budget documentation and that members of Parliament and civil society are able to use the information presented to them.

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# 3.3 The experience of implementing programme-based budgeting in Rwanda

*Aarti Shah*

## The impetus for programme-based budgeting in Rwanda

The Public Expenditure Review of 1997/98, undertaken jointly by the Rwandan government and the World Bank, recognised the potential advantages of introducing a medium-term framework for expenditure management. The existing budget was of an incremental nature, focusing on inputs and budget line-items, relying on centralised controls, and had a sharp separation in the planning of the recurrent and development budgets. The legal framework was archaic and required a complete overhaul to match the strategic vision of the country. In particular, the review recognised that converting strategic objectives into concrete expenditure targets inevitably would require large shifts in the allocation of sectoral expenditures, which

would be impossible to achieve over the course of one annual budget and would be difficult to manage in the absence of a medium-term expenditure framework (MTEF).

A design and implementation group (DIG) was established in March 1999 to manage the design and implementation of the MTEF reform. The DIG comprised staff from the Ministry of Finance and Economic Planning (MoFEP) and the Ministry of Public Service, supported by advisers and consultants. With the assistance of the UK Department for International Development, a full-time MTEF project co-ordinator was hired to manage the project.

The introduction of the MTEF encompassed the whole of the government (central, provincial and district) through the development of a strategic planning model, which was the basis for training and project development. All cadres of government participated in training provided by the DIG in the use of the model and its application to budgeting.

Throughout 2000, the DIG concentrated on the development of sector profiles and worked closely with line ministries, provinces and districts to develop programmes and subprogrammes, as well as outputs for their budgets. The government decided to introduce the MTEF system during 2000 so that it might apply for the three-year period 2001–2003.

## Implementation challenges

As in Mauritius, there are parallel systems capturing information on budget formulation and budget execution. In Rwanda, it is difficult to report on actual expenditure according to plan, as the budget-formulation data are not in the same format as the budget-execution data.

The non-financial performance information is captured in the budget system, but cannot be monitored automatically within the system. Consequently, it is entered in the system simply for documentation and information purposes. Furthermore, the non-financial performance information that is included in budget documentation is not used adequately to inform budget discussions and allocations for subsequent financial years.

There is no systematic process of actual monitoring of performance against the set targets within line ministries, and this raises questions about the reliability of line ministries' reported achievements. The system of evaluation and monitoring relies heavily on trust. Annual reports and joint sector reviews are only post-mortem assessments. There is also no mechanism in place to ensure that the baseline data of performance measures are reliable and accurate.

The methodology for costing programmes and sub-programmes over the medium term is weak. There is insufficient linkage between the cost of programmes and sub-programmes and their corresponding outputs. Employee costs and overhead costs are grouped together in one 'Management Support' programme across all line ministries.

Despite the fact that training workshops on strengthening the MTEF are conducted every year for different cadres in line ministries, there is no well-structured training programme intended to build sustainable capacity. Thus, capacity is often inadequate in line ministries, and there are numerous requests for support from them during budget preparation.

Throughout the period of implementing the MTEF and PBB, however, the MoFEP has gained greater understanding of the challenges involved, and has developed improved working relationships with line ministries. The quality of discussions around budget issues has improved substantially, and the focus has changed completely from negotiating resources for the purchase of inputs to achieving output objectives.

# 3.4 The early stages of programme-based budgeting in Kenya

*Aarti Shah*

Kenya has undergone a series of reforms in public financial management over the last ten years, the first phase of which involved the introduction of a medium-term expenditure framework (MTEF) in the 2000/01 financial year.

In 2002/03, the government adopted a new policy framework aimed at reviving the ailing economy. The strategy, which was popularly known as the Economic Recovery Strategy for Employment and Wealth Creation, presented the policy direction for expenditure prioritisation and provided the impetus for several legal, institutional and public financial management reforms.

The next set of reforms was packaged as the Public Financial Management Reform Programme between 2006/07 and 2010/11. One objective of the reforms was to establish results-based management (RBM) as a performance management tool throughout the government. A key element of RBM in Kenya was the introduction of performance contracting (a performance management system) and programme-performance-based budgeting. This began with an initial programme classification in tandem with the GFS 2001 economic and administrative classification of the budget.

Since then, the government has adopted a guarded approach to introducing programme budgeting. In 2006/07, finance officers involved in the budget process underwent a basic capacity-building exercise on programme budgeting while preparing the first indicative programme budget for 2007/08 alongside the line-item budget.[1] Between 2008/09 and 2010/11, ministries first submitted line-item budgets, and then prepared indicative programme structures with indicative budgets for each activity. The indicative programme budgets presented programmes, sub-programmes, outputs and key performance indicators for all ministries.

During this preparatory stage, a Standing Order was issued requiring all government line ministries to present the budget to Parliament during the budget preparation phase on a programmatic basis. In preparation for the 2010/11 fiscal year, most ministries adopted a 'one programme per ministry' approach, due to the difficulties faced in designing good programme structures. The Ministry of Finance soon realised that this approach was counterintuitive to the objectives of programme budgeting and, consequently, instructed ministries to streamline the programme structures in line with their mandates and to generate more meaningful performance indicators

## Challenges and next steps

The Ministry of Finance has taken important steps in designing a process that has allowed line ministries to become familiar with drawing up programme budgets over a period of three years before tabling the first programme budget in Parliament. While the current legal framework still requires the government to present the budget document in line-item format, the Fiscal Management Act of 2009 and the Standing Order require the presentation of the budget in a programmatic form, as a document parallel to the line-item budget that underpins parliamentary appropriations.

To make the transition from line-item budgeting to programme budgeting, besides effecting further legal changes, the government is in the process of modifying the COA to enable accounting and reporting against programmes. Alongside changes to the COA, the financial management information systems (FMIS) are being developed to facilitate the capture of financial information on a programmatic basis.

The indicative budgets over three years have demonstrated that many performance indicators focus on input and workload, consequently making it difficult to evaluate the success of a programme. However, programme budget guidelines are being developed by the Ministry of Finance for the collection, monitoring and evaluation

1 An intensive capacity-building programme was mounted in April and September 2010.

of the output data produced through the programme budget. Ministries and agencies need to be fully trained or guided with regard to the implications of the change.

Accompanying the process of equipping officials to undertake the necessary reforms in a systematic and standardised manner is the need to gain buy-in, and to inform and manage expectations, at a political level. Making the Cabinet, Parliament and the public aware of the purpose of the initiative and the impact it will have on how they engage within the budget process is an important next step.

The current institutional arrangements for driving the design and implementation of programme budgeting have placed considerable pressure on the Budget Supplies Department. The government has established a working group comprising representatives from line ministries and various Treasury departments to guide and oversee the reform process, and is considering setting up a body of dedicated programme budget expertise. Co-ordination of the actors, processes and outputs within the broader budget process will be vital in ensuring that programme budgeting is successfully implemented.

Programme budgeting is one aspect of introducing a performance management perspective in Kenya. Permanent secretaries are required to agree to and sign performance contracts on an annual basis. The next step is to link the performance contracting process to the outputs presented in the programme budget.

Important lessons on sequencing have emerged from Kenya. The implementation of programme budgeting should be designed to ensure that line ministries are part of the process from its inception. In achieving an effective programme budget structure it is of paramount importance to arrive at an early agreement on the necessary modifications to the COA, FMIS and budget reporting structures. This requires that senior managers are brought on board and are up to speed early in the process. Kenya’s experiences indicate that a common standard usage of terminology and concepts must be tested, developed and agreed upon from the outset.

# 4

# Managing private sector participation in public infrastructure development

# 4.1 Introduction

Africa is confronted with a significant infrastructure gap in advancing out of aid and achieving sustainable growth. While African governments already finance a large proportion of their infrastructure needs, their resources to extend this and fill the gap – of approximately USD90 billion per year for the next decade – are limited. At the same time, the continent experiences a loss of value from the resources it does invest, on account of inefficiencies arising out of public sector infrastructure project implementation and management. One option for resolving these infrastructure challenges is to turn to private skills and financing.

The CABRI Dialogue on Ensuring Value for Money in Infrastructure, held in December 2009, made clear participating countries' interest in learning more about how to manage a constructive role for the private sector in public infrastructure. The 6th session at the CABRI Annual Seminar, on private sector involvement in public infrastructure, therefore, explored further the role and pitfalls of private sector involvement in public infrastructure development and management. Two papers are provided here arising from the session. In the first, Mandla Gantsho, Chief Executive Officer of Nova Capital South Africa argues that while there is great potential in harnessing private sector skills and money in public infrastructure development,

there are also key risks that should be considered. The second paper, a note by Alta Fölscher based on the presentation by Tumisang Moleke from the Public Private Partnership (PPP) Unit at the National Treasury in South Africa, sets out critical requirements for managing the spectrum of possible public-private partnership arrangements to alleviate the risks. This paper echoes the discussions held at and the lessons arising from the six case studies prepared for the CABRI Dialogue. Interested readers can find the Dialogue keynote papers and case studies at www.cabri-sbo.org.

# 4.2 Private sector involvement in bridging the infrastructure gap in Africa

*Mandla Gantsho*[1]

## Introduction

Infrastructure spending is critical to the achievement of Africa's growth, but the continent is hampered by low service levels and the high costs of providing infrastructure services. While Africa's growth performance improved markedly between the 1990s and 2000s, a recent study by Calderón (2008), which aimed to isolate the factors responsible for this increased growth, found that infrastructure improvements contributed almost 1% to the per capita growth rate. This was comparable in magnitude to the growth effect of improved macroeconomic policies.

1 This paper and the data presented draw on the Africa Infrastructure Country Diagnostic study (Foster & Briceño-Garmendia 2009) and is co-authored by RH Thomas, Nova Capital Africa, May 2010.

The infrastructure improvements that generated this growth effect were those associated with the information communication technology (ICT) revolution taking place during this period. The percentage of Africa's population living within range of a Global System for Mobile Communications (GSM) signal soared from less than 5% in 1999 to more than 50% in 2006. Over the same period, 100 million new cellular telephone subscribers were added. Other dimensions of infrastructure, however, have been holding Africa back. Deficient power shaved 0.1 percentage points off the per capita growth rate in the period 1999 to 2006 (and this was before the current power crisis had really taken hold).

Illustrative simulations suggest that if all African countries were to improve their infrastructure to the level enjoyed by the best performer in the region (Mauritius), the impact on future growth rates would be substantial. Africa lags behind the rest of the developing world (let alone the OECD countries) in infrastructure provision. What is particularly striking is that both low-income countries (LICs) and middle-income countries (MICs) in Africa trail their respective LIC and MIC peer groups in the rest of the world.

The gap between Africa and the rest of the developing world is most striking with respect to power (see Table 1). The installed generation capacity per million people in Africa's LICs is about one-tenth of that found in other LICs around the world, and electricity coverage is less than half.

Table 1: Comparative infrastructure statistics

| Normalised units | Sub-Saharan Africa LICs | Other LICs | Sub-Saharan Africa MICs | Other MICs |
|---|---|---|---|---|
| Paved road density | 31 | 134 | 94 | 141 |
| Total road density | 137 | 211 | 215 | 343 |
| Mainline density | 10 | 78 | 106 | 131 |
| Mobile density | 55 | 76 | 201 | 298 |
| Internet density | 2 | 3 | 5 | 8 |
| Generation capacity | 37 | 326 | 256 | 434 |
| Electricity coverage | 16 | 41 | 35 | 80 |
| Improved water | 60 | 72 | 75 | 86 |
| Improved sanitation | 34 | 51 | 48 | 74 |

Not only does Africa have very limited infrastructure, but the associated services are very expensive by global standards (see Table 2). In many cases, the cost of using infrastructure in Africa is more than twice that in other developing regions, and for some countries and sectors the differential can be much larger. For example, road freight tariffs in Central Africa, at $0.14 per ton-kilometre, are about ten times higher than best-practice levels in Asia, while power tariffs in small diesel-based systems in

West Africa can easily top $0.20 per kilowatt-hour, which is four times higher than those found in some other parts of the world.

Table 2: Comparative tariffs for infrastructure services

| High end costs for Sub-Saharan Africa & other regions | Sub-Saharan Africa LICs | Other LICs |
|---|---|---|
| Power tariffs ($/kWh) | 0.46 | 0.10 |
| Water tariffs ($/m$^3$) | 6.56 | 0.60 |
| Road freight ($/ton-km) | 0.14 | 0.04 |
| Mobile telephony ($/month) | 21.0 | 9.9 |
| International telephony ($/min.) | 12.5 | 2.0 |
| Internet dial-up service ($/month) | 148.0 | 11.0 |

The reasons for these high tariffs are wide-ranging. In some cases, the cost of production is genuinely higher in Africa, particularly due to the very small scale of production and reliance on inefficient technologies. For example, many countries rely on oil-based generation technologies, or use satellites for international connectivity. In other cases, the problem is a lack of competition, leading to very high profit margins. This explains, in particular, Africa's high road freight tariffs. It also explains why the charges for international connectivity remain so high in many countries even after they break free from dependence on satellites, because of monopolistic control of international gateways.

Table 3: Diagnosis of infrastructure spending need

| US$ bn per annum over 10 years | Capital expenditure | Operating expenditure | Total |
|---|---|---|---|
| ICT | 7.0 | 2.0 | 9.0 |
| Irrigation | 2.9 | 0.6 | 3.5 |
| Power | 26.7 | 14.1 | 40.8 |
| Transport | 8.8 | 9.4 | 18.2 |
| WSS | 14.9 | 7.0 | 21.9 |
| Total | 60.4 | 33.0 | 93.3 |

The Africa Infrastructure Country Diagnostic (AICD) has estimated that the continent will need $93 billion annually for the next 10 years to meet the following extremely modest targets: to rehabilitate existing infrastructure; to build new assets needed to keep pace with economic growth over the next decade; to meet minimum social targets such as the millennium development goals (MDGs) for water and other sectors; and to operate and maintain all new and existing assets (see Tables 3 and 4).

Table 4: Infrastructure-related goals

| Sector | Economic target | Social target |
|---|---|---|
| ICT | Complete networks of submarine cables and fibre-optic backbone linking capitals | Extend GSM voice signal and public access broadband to 100% of the rural population |
| Irrigation | Develop all financially viable opportunities for large- and small-scale irrigation | |
| Power | Attain demand-supply balance in power production within a regional framework | Raise household electrification rate by 1% annually |
| Transport | Attain good quality road networks supporting regional and national connectivity goals | Provide 100% rural road access on high-value agricultural land; place entire urban population within 500 metres of a road supporting motorised access |
| Water & sanitation | | Meet the MDGs for water and sanitation |

These goals are not ambitious, but they would allow Africa to catch up with other developing regions. It is important to emphasise that while the bulk of the $93 billion relates to investment, there is also an important share relating to operations and maintenance – an area of spending too often overlooked by policy-makers.

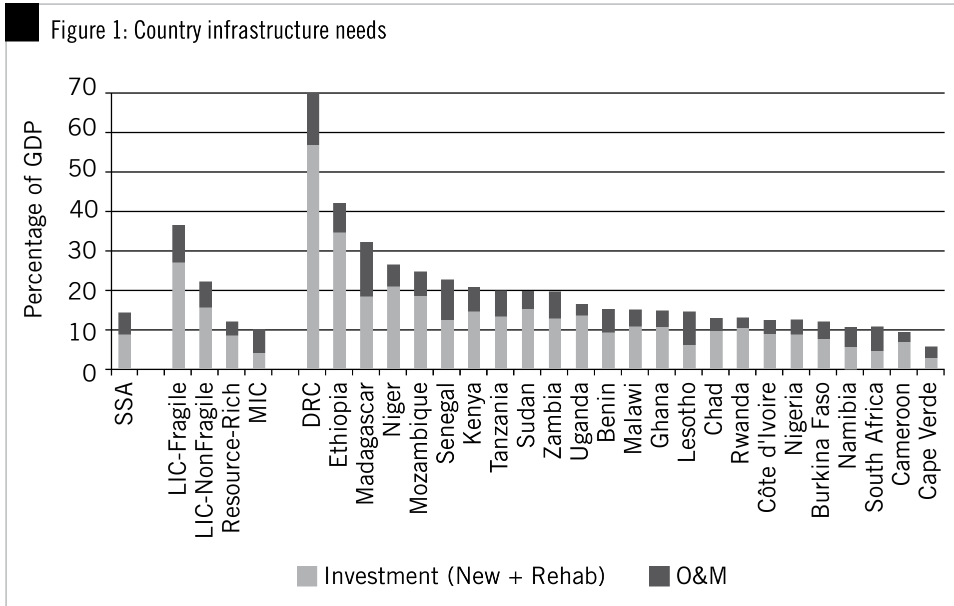
Power stands out as having by far the largest spending needs at $40 billion per annum; water and transport lie a distant second with around $20 billion per annum for each. The reason that power spending needs weigh so heavily is that the continent is in the midst of a power crisis affecting more than 30 countries. The causes of that crisis differ across countries, but the effects are similar – regular blackouts leading to significant production losses and a drag on economic growth.

To restore equilibrium in the power sector, Africa will need to build some 7 000 MW of new capacity each year over the next decade, compared with the meagre 1 000 MW of new capacity each year for the last decade. Outside of South Africa, African power consumption is little more than 100 kilowatt-hours per person per year and falling. Even if all this power were allocated to residential use, it would be barely enough to power one light bulb per person for three hours a day. The entire installed capacity of sub-Saharan Africa with its 48 countries and population of 1 billion is no more than that of Spain with a population of around 40 million.

Expressing annual infrastructure spending needs as a percentage of GDP, sub-Saharan Africa would need to spend 15% of GDP on infrastructure, 10% on investment and 5% on operations and maintenance (see Figure 1). If these numbers look high, note that China invested 14% of GDP in infrastructure during the mid-2000s. However, the burden of funding infrastructure assets varies hugely across country groups. Whereas MICs and resource-rich countries need spend only around 10% of GDP, non-fragile LICs need to spend more than 20% and fragile LICs more than 35% of GDP. Some countries face a particularly difficult situation. For example,

the Democratic Republic of the Congo needs to spend 70% of GDP to meet the above targets; of course, this is manifestly impossible, but it illustrates how hard it will be for some African countries to catch up.

Figure 1: Country infrastructure needs




These numbers are based on detailed analysis of public expenditure at the country level, including central government budgets, as well as parastatals and special funds. The results show that already $45 billion a year is being spent to cover the kind of infrastructure needs mentioned. What is most striking is that the bulk of this – some $30 billion – is financed domestically by the African taxpayer and African service users. The balance comes from a variety of external funding sources. Of these, by far the largest is the private sector, with more than $9 billion per annum. OECD countries and non-OECD funders (such as China Ex-Im Bank, India Ex-Im Bank and Arab Funds) each contribute official development assistance (ODA) of around $3 billion per annum.

MICs account for a third of total spending, while fragile LICs account for less than 5% of the total. For MICs and resource-rich countries, the private sector is the key source of external finance, whereas for non-fragile LICs, ODA is the main source of finance. Non-OECD finance is almost on a par with ODA for fragile LICs (see Table 5).

Table 5: Source of infrastructure financing in sub-Saharan Africa

| US$ bn per annum | Public sector O&M | Capital expenditures | | | | | Grand total |
|---|---|---|---|---|---|---|---|
| | | Public sector | ODA | Non-OECD financiers | Private sector | Total | |
| MICs | 10.3 | 3.1 | 0.2 | 0.0 | 2.3 | 5.7 | 16.0 |
| Resource-rich | 2.5 | 3.9 | 0.6 | 1.7 | 3.8 | 10.0 | 12.5 |
| LICs (typical) | 4.4 | 1.7 | 2.6 | 0.6 | 2.1 | 7.0 | 11.4 |
| LICs (fragile) | 0.7 | 0.3 | 0.4 | 0.3 | 0.5 | 1.4 | 2.2 |
| Total sub-Saharan Africa | 20.4 | 9.4 | 3.6 | 2.5 | 9.4 | 24.9 | 45.3 |

The existing spending envelope of $45 billion captures expenditure that is allocated effectively to meet the infrastructure needs identified. However, due to widespread inefficiencies, the financial cost of spending this $45 billion is very high, and represents an efficiency gap estimated at $17 billion per annum. Inefficiencies arise in a variety of ways:

- when budgetary resources allocated to public investment in infrastructure go unspent due to delays in project appraisal, procurement and other administrative bottlenecks;
- when infrastructure service providers fail to recover the revenues associated with the services billed to their customers, due to non-payment and deficiencies in revenue-collection practices;
- when utilities lose significant volumes of power and water on their distribution networks, due to either technical (e.g. leaking pipes) or non-technical losses (e.g. clandestine connections);
- when utilities employ a larger workforce than needed to provide their services, due to either patronage or political pressure to create jobs;
- when governments fail to carry out adequate preventive road maintenance, allowing assets to deteriorate and necessitating more costly reconstruction at a later date (every $1 that goes unspent on road maintenance creates a $4 liability for rehabilitation, in present value terms);
- when user charges for services fail to fully recover costs, be they power or water tariffs or fuel levies (although the typical excuse is one of affordability, in practice only relatively well-off Africans have access to these services in the first place); and
- when public funds are not allocated to their highest value uses, there is some evidence to suggest that there is overspending in some areas of infrastructure relative to what appears to be necessary (a salient example is ICT, where

many governments devote public resources to services that could easily be provided by the private sector).

Although much less quantifiable, inefficiency also takes place when governments pay inflated unit costs for infrastructure construction and maintenance, due to corruption.

Almost half of the $17 billion efficiency gap comes from operational inefficiencies such as distribution losses, collection losses, over-manning and under-maintenance. A further $4 billion comes from improving cost recovery, $3 billion from improving allocation of resources across sectors, and $2 billion from enhancing capital budget execution. The largest potential efficiency gains are in the power sector ($6 billion), followed by transport ($4 billion) and water supply ($3 billion).

Putting aside the fact that since the global financial crisis hit in 2008 private capital flows to infrastructure investments have slowed down tremendously, closing the financing gap of $48 billion ($17 billion through efficiency gains plus $31 billion through new finance) presents a number of challenges for African governments. These include the following: addressing the huge backlog in infrastructure services via financing for new assets; rehabilitating existing infrastructure assets; conducting operations and maintenance (O&M) on all existing assets; and redressing the inefficiencies of public services providers. The burden of meeting the proposed set of infrastructure targets is considered insurmountable, especially for fragile LICs, and, thus, the possibility of raising external finance on the required scale appears to be remote. Finding a way to close the circle between infrastructure targets and finances is, therefore, a critical objective. In this regard, it is recognised that, in addition to the usual measures required, African countries need to attract more private sector investment in infrastructure.

However, in following this route, governments must understand first that while their orientation is towards providing efficient and affordable services to their citizens, the private sector's motivations are totally different and driven primarily by the maximisation of profits. Second, governments need to be clear about both the role and the pitfalls of involving the private sector in infrastructure provision. The challenge is to harness their profit motivation for efficient and affordable services delivery, and this requires certain measures to be taken by the public sector.

## Increasing private sector involvement in infrastructure

The private sector can be involved in infrastructure development to bridge government capacity gaps in the development and management of infrastructure or as financiers, or in some combination. While building or strengthening the financial management

and operational effectiveness of utilities and state-owned enterprises (SOEs) is a key strategy, it takes time and additional public resources, neither of which may be available to governments in the short-term, to fix the problem.

An option is to engage the private sector in improving operational efficiency and service quality via management or affermage/concession contracts, as found in West Africa, particularly in the water and sanitation sector. This type of public-private partnership (PPP) has grown in use in many developing countries and does not involve any privatisation or divestiture by the government. No investment is expected of the private sector; rather, the latter is covered by government or donor funding, or by annual cash flows (as in projects in Côte d'Ivoire and Mali).

The private sector is remunerated via fees paid by the government (adjusted for performance) rather than from tariff revenues collected from customers. These low-risk contracts have been on the increase since 1990, although, according to the public-private infrastructure (PPI) database, they have never accounted for more than 10% of all PPI contracts.[2] They occur mostly in the water and sanitation and the transport sectors, with less than 20% in the electricity sector. During the 1990s, these contracts were viewed as first steps towards deeper forms of PPI, such as long-term concessions. The frequency with which this happened, however, has been low, and has occurred only in Mali and Gabon. Since the end of the 1990s, such contracts have been seen as ends in themselves (i.e. as a way to make short-term improvements in operating efficiency and to transfer skills to local staff). Of the 17 management contracts concluded for electricity services in 15 countries in sub-Saharan Africa, only three remain in operation. Four were terminated prematurely, and others were simply not renewed. Problems included unrealistic expectations and limited ability to address broader sector challenges. Many were undertaken with donor support, with the view that they were initial steps towards more extensive reform, while many governments saw them as costly reform measures needed to secure donor funds, and had no intention of taking the process further. In addition, while financial and efficiency gains can be achieved through these contracts, they cannot overcome broader policy and institutional weaknesses. Finally, the efficiency gains did not always produce tangible results for customers (Foster & Briceño-Garmendia 2009).

The Kenyan Power and Lighting Company (KPLC) project – under a two-year contract signed with Manitoba Hydro in 2006 to manage distribution services on behalf of the Kenyan government – is one of those that were not renewed. It ended in April 2008 with the government complaining about high costs and poor performance. While both the government and the contractor agreed that at least three-quarters of

2 The database is managed by the Public-Private Infrastructure Advisory Facility (PPIAF) and the World Bank.

the long list of performance targets had been met, they disputed the exact percentages and the size of the performance bonus. Compensation paid to the contractor was much higher than that ever received by Kenyan managers, but the company had had to weather labour disputes. The first two years had been paid for by the World Bank, and the costs of any extension would have had to be met by the Kenyan government. In the wake of the post-election civil unrest in 2008, the government had to consider other spending priorities.

In Uganda and South Africa, a series of short-term expatriate contracts in the water sector demonstrated to governments that improved training, greater independence and better compensation can lead to more efficient commercial operations directed by local managers. Management contracts of this nature encounter certain issues not commonly found in the more usual type of PPP project. Project companies will be bound by general obligations to improve service delivery and labour productivity (whether in terms of addressing levels of leakage of water or increasing the roll-out of services distribution). More needs to be done to improve the performance targets and incentives incorporated into such contracts. Customer-service issues must be better addressed, and cost-effective generation planning and procurement must be recognised as foundations for the successful implementation of such contracts in the electricity sector.

Usually, the public sector transfers the use of existing assets to the company for the purpose of performance of its obligations. The condition of these assets and the need for refurbishment or replacement may not be clear until well into the management arrangement, which represents a serious risk for the project company. The public sector may need to allow the company sufficient flexibility to manage these conditions. Additionally, the personnel of the existing utility are transferred to the project company so as to facilitate training and continuity, and to satisfy the requirements of public sector labour unions. The latter would generally be hostile to any form of privatisation that might threaten their members' employment benefits. This needs to be managed carefully by the project company. To some extent, these risks can be dealt with more efficiently by the public sector prior to bringing in the project company, rather than during the contract period. Some residual risks, however, will remain with the private sector (Delmon 2009).

In these contracts, by way of example, tariff levels for water services can be a very political issue, and historically have been used to subsidise certain elements of society, specific industries or public sector entities. Often, tariffs are not charged, are charged at very low levels or are not collected at all. Private sector involvement may require formal arrangements with the project company for government subsidies or financing, especially where the government is not willing to raise tariffs to profitable levels or

where substantial investment in capital works is needed. Though challenging, this can provide a healthy transition for the utility, formalising the subsidy and rendering transparent the burden on the public purse as demonstrated by the artificially low tariffs (Delmon 2009).

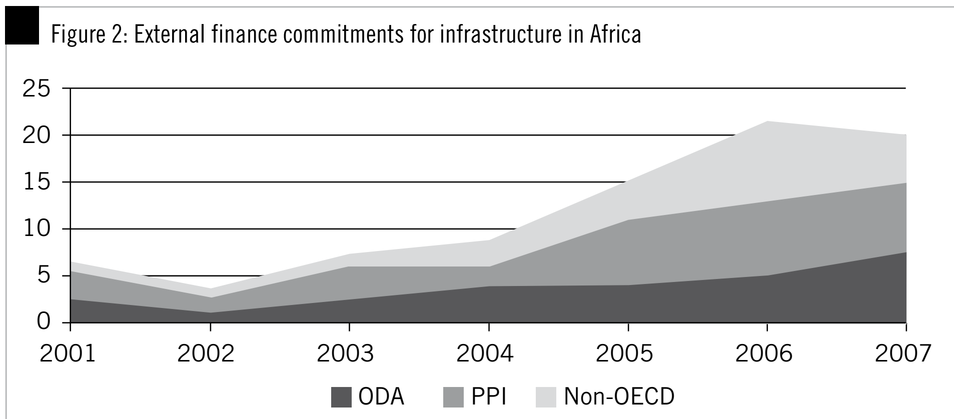
The range of PPP options has expanded over the past 30 years, with agreements between public and private entities assuming many shapes and sizes for both new and existing services. At one end of the spectrum are management contracts. At the other end is full privatisation or divestiture, where the government sells assets to a private company. Outsourcing is another popular option, in terms of which a private company handles an aspect of service, such as billing, metering, transport or even cleaning. There are hybrid models in between, which have grown exponentially in recent years, especially with the development of a more diversified pool of emerging market investors and operators with local expertise. These models rely on simpler contractual arrangements and blend public and private money to diversify risks (see www.ppiaf.org).

Among the usual PPPs, and for purposes of raising new money, build-operate-transfer (BOT) projects that mobilise limited-recourse (or project) financing stand out. BOTs are large and complex undertakings, usually involving major infrastructure such as roadways and power generation plants. They place the responsibility for financing, constructing and operating the project on the private sector. The host government grants a 15–30-year concession to the project company to build and operate the facility. The private company uses the revenues from the operation of the facility to service the debt and to provide a return to investors.

Where the host government is also the off-taker or purchaser of the service, the project is treated as a payment for a service rather than the financing of infrastructure. This can keep the project off the host government's books, and, therefore, will not burden the country's debt ratios or public sector borrowing requirements. With PPPs, therefore, African governments have a range of options to consider when contemplating how to engage the private sector in infrastructure provision, and particularly in the financing of such infrastructure.

To meet the private sector part of the above-stated challenge, the AICD suggests that Africa needs to double private sector investment in infrastructure, scaling-up investments from the current $9 billion recorded, to $18 billion over the next ten years. Up until the financial crisis, there was a large increase in external finance for infrastructure across all major sources. Political commitments at Gleneagles drove the ODA scale up, while the surge in private finance was buoyed by favourable economic conditions during this period. The increase in non-OECD investments reflected increased Asian interest (especially from China) in Africa, as a natural resource trading partner (see Figure 2).

Figure 2: External finance commitments for infrastructure in Africa




Additionally, there has clearly been strong specialisation across different sources of external finance, both sectoral and geographical. From a sectoral perspective, private capital has been particularly important for the ICT sector, non-OECD finance for energy- and mining-supportive transport networks, and ODA for water and sanitation and transport. From a geographical perspective, private capital has also been a key source of investment in MICs (ICT and transport) and resource-rich countries (ICT, transport and electricity), ODA for non-fragile LICs, and non-OECD finance for resource-rich countries and fragile LICs. Figure 3 shows the key sectors in which PPI has developed in the African countries listed.

Between the 1990s and 2006, Africa attracted private investments into only ICT-related and power projects, with almost no investment in socially challenging sectors such as water and sanitation, or in longer-term and higher-risk projects. Since 2004, greenfield and small projects accounted for 70% of PPI in Africa, with concessions and divestiture accounting for only about 10% of the total. There has been increasing interest in transport concessions (e.g. Uganda's Rift Valley Railway and Sudan's Juba Port), and larger greenfield power projects are now beginning to emerge. Table 6 sums up the PPP projects undertaken in Africa, the experience by sector and what the future prospects are.

Figure 3: What is PPI spent on by country?

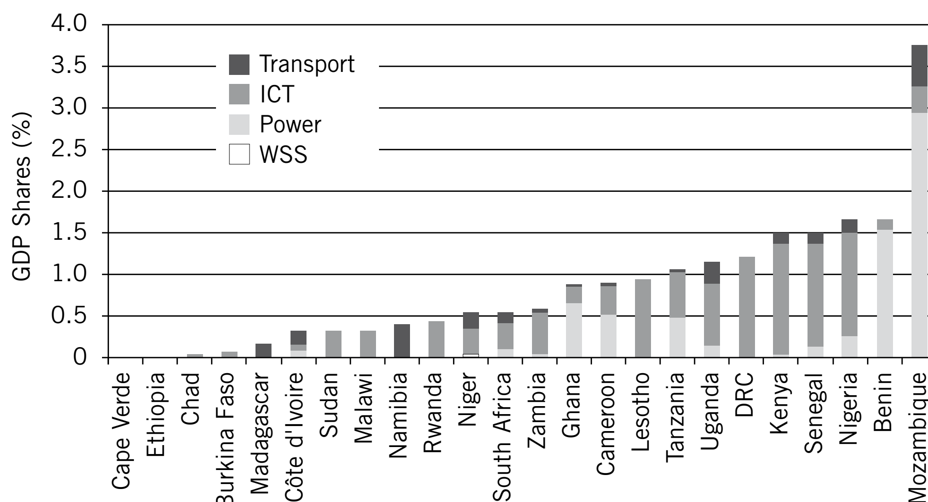



Table 6: An overview of PPP projects in Africa

| Sector | Projects | Existing experience | Future prospects |
|---|---|---|---|
| ICT | | | |
| Mobile telephony | Over 90% of countries have licensed multiple operators | Exponential increase in coverage | Various countries could grant additional licenses |
| Fixed telephony | 60% of countries have divested SOE incumbent | Controversial but with efficiency improvements | Various countries could still undertake divestiture |
| Power | | | |
| Generation | 34 IPPs invest US$2.5bn to install 3 000 MW of capacity | Frequent renegotiations, costly to utilities | Likely to continue given huge capacity needs |
| Distribution | 16 concessions and 17 management or lease contracts | One-quarter of contracts prematurely cancelled | Movement towards hybrid models with local firms |
| Transport | | | |
| Airports | 4 concessions investing less than US$0.1 bn | No cancellations, some lessons learned | Limited number of additional cases viable |
| Ports | 26 container terminal concessions investing US$2.5 bn | Few cancellations, results positive | Quite good prospects, likely to continue |
| Railroads | 14 railroad concessions investing US$0.4 bn | Frequent renegotiations, limited investment | Likely to continue, but model must adapt |
| Roads | 10 toll road concessions (RSA) investing US$1.6 bn | No cancellations reported | Only 8% of network meets traffic threshold |
| Water | | | |
| Water & sanitation | 26 contracts, mainly management or lease | 40% of contracts prematurely cancelled | Movement towards hybrid models with local firms |

*Source: PPIAF (2009)*

Arguments in favour of PPPs, and specifically of financing infrastructure through BOT arrangements and the like, include the following:

- they offer alternatives to attract new financing sources and management of infrastructure assets and services, while maintaining a public presence in ownership and strategic policy-setting;
- they offer improved efficiency, closely managed costs and faster completion times through private sector involvement;
- they facilitate contracting with well-qualified private enterprises to manage and deliver infrastructure services;
- they lower the cost of off-take, due to improved technology and efficient operation by the private sector;
- they provide infrastructure at no direct cost, owing to private financing (therefore, there is no need for any other source of financing, and the impact on the government's credit capacity and rating is limited);
- the involvement of experienced industry professionals and private financing organisations ensures an exhaustive review of project feasibility;
- they ensure the maintenance of public sector strategic control over the project (as compared to privatisation) and transfer the asset to the government at the end of the concession period (where relevant);
- if they mobilise competition to drive down project costs and improve innovation, they provide value for money;
- they involve international lenders, including international financial institutions;
- they attract further foreign investment;
- the interest of the project company in long-term facility operations generally results in high quality construction;
- they facilitate the transfer of the most up-to-date technology and know-how, including the training of local personnel;
- they lead indirectly to the development of related industries;
- they develop and deepen local capital markets; and
- they involve local lenders, subcontractors, suppliers and shareholders.

However, BOTs may also have disadvantages for the host government, including:

- the distortion of development priorities, as a government may favour projects that are financially viable over those that are necessarily appropriate for the economic and infrastructure needs of the country;

- equity and debt to provide funds for special-purpose vehicles, which may be more expensive than public borrowings, assuming that the government is able to obtain more favourable financing terms than would the private company;
- considering the complexity of the project, the need for supervision and high development cost (including the cost of the due diligence exercise and the cost of risk management);
- possible public or political resistance, in particular from labour unions and those unwilling to sacrifice any government control over infrastructure;
- the need to mitigate foreign exchange risk for BOT projects whose debt is denominated to some extent in foreign currency;
- some loss of control of an otherwise public sector operation;
- possible loss of an income stream from the sector in question; and
- the supposed increased efficiency being negated in practice by lack of competition resulting in increased costs that wipe out the 'value for money' justifications that are used initially to go the PPP route (Delmon 2009; Leigland 2010).

Despite these criticisms, the use of PPPs for closing the infrastructure gap is widely recognised, and they are being employed in an increasing number of infrastructure projects worldwide, as governments try to balance need against means (Bankwatch Network 2008).

In order for African governments to achieve their stated goals in respect of increasing private sector investment in infrastructure, there should be clear objectives, good public leadership and strong government institutional capacities for effective oversight and implementation. Experience has shown that the best way to attract private capital to infrastructure is to provide sustainable and credible policy and regulatory environments, where risk allocation, balanced with rewards, is clearly delineated between the public and private sectors (Delmon 2009).

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# 4.3 The importance of quality institutions to manage public-private partnerships

*Alta Fölscher*[1]

One of the presentations at the 6th Annual Seminar session on the role of the private sector in infrastructure development looked at the arrangements required to ensure that the role is managed appropriately. The presenter, Tumisang Moleke from the Public-Private Partnership (PPP) Unit at the National Treasury in South Africa, noted the various roles for the private sector in public infrastructure: it can design, finance, build, operate and transfer infrastructure, or any combination of these roles.

The key issues that need to be considered in involving the private sector are value for money and risk. A primary type of private sector involvement is the traditional 'outsourcing' mode, where the capitalisation is to the government's account and the government retains the assets, with the government also retaining the risk. In PPPs,

1 See, also, technical papers and case studies on infrastructure appraisal, financing and management arising from the CABRI programme on value for money in infrastructure projects at www.cabri-sbo.org.

more of the risk is transferred to the private sector as it designs, finances, builds and/or operates the infrastructure and the government purchases the complete service or enables the business, with the government retaining the capital assets. In the most extreme form of private sector involvement, the assets are privatised and all liabilities and risks transferred, with the government retaining a regulatory role.

In order to manage private sector involvement in the PPP category appropriately, the government needs to ensure that it has appropriate institutional arrangements in the areas considered below.

## Project preparation

As the cost of projects still rests with the government (while the risk is transferred and, ideally, value for money is increased) and, therefore, carries budget opportunity costs, it is necessary for the projects to be identified through the budget bidding process and to fit within national and sector priorities. A crucial part of project preparation is the conducting of feasibility studies to answer questions about project scope, affordability, value for money and risk transfer. In these studies, intergenerational equity must be taken into account. Part of this process would be constructing a public sector comparator (in other words, an assessment of the cost, risk and value for money should the private sector not be involved) to ensure that a PPP is the optimal solution to the service delivery/infrastructure problem. It is important that the project preparation process is codified in clear central government regulations and guidelines, and that all processes are documented fully.

## Procurement

The quality of PPP procurement arrangements is critical to ensuring the realisation of value for money. The procurement process should be open and competitive and based on clear bid documentation with clear instructions. A pre-qualification stage is followed by the request for proposal and bid evaluation stages. When the government's PPP procurement practices are fair and transparent, it is likely to elicit more and better private sector participation.

The evaluation process to arrive at the preferred bidder should be sound, and should maintain linkages to the feasibility study and the original objectives of the project. A key criterion should be value for money, which is realised through a combination of project design proposals, the funding terms proposed and the risk positions taken by the private sector.

## Project implementation

Before the contract is signed, the government must ensure that it has the capacity at the sector level to manage the contract. Monitoring of the contract by internal stakeholders to ensure quality and value for money is crucial. This should be supported by periodic external reviews over the life of the contract. If PPPs are new to the sector, it would be necessary to embark on a change-management process, to inform internal and external stakeholders (including the clients of the infrastructure service) on the reasons for the use of the PPP and the arrangements made in this regard. This is crucial in broadening ownership of the PPP solution, from the project team to all users and beneficiaries.

## Institutional arrangements for PPPs

The enhancement of capacity at the centre of the government to ensure appropriate development, implementation and management of PPP contracts is vital. The necessary central units develop regulatory frameworks for PPPs and can provide capacity-support and oversight. It is important that private sector capacity is matched by internal technical, financial, negotiation and legal capacity; if not available internally, these capacities must be contracted in for the PPP preparation, procurement and negotiation stages. Finally, leadership and political support are critical at the overall government, sector and project levels. The speed of decision-making, once all the technical processes have been completed, is critical in retaining private sector interest and securing contracts that ensure value for money.

# 5

# Bringing aid on budget

# 5.1 Introduction

Since 2007, the integration of aid in budget processes and its reflection in budget documents has been a key concern of CABRI. This is important not only for ensuring that aid resources are used effectively in the interest of the sustainable development of partner countries, but also to ensure that their domestic resources are used with maximum effect, that the domestic budget process is strengthened and respected and that local accountability for development results is enhanced. The 5th session at the annual seminar presented CABRI's work in the context of developments in this area, particularly country-level work by the Global Partnership on Country Systems. The paper in this chapter was prepared jointly by Aarti Shah, senior advisor in the CABRI Secretariat, Sara Fyson, policy advisor at the OECD-DAC and co-ordinator of the Global Partnership, and Alta Fölscher of the CABRI Secretariat. The paper builds on discussions at the annual seminar to review progress in the use of country systems and the key factors and processes that hinder and assist change. It presents country examples, reviews ongoing work and emphasises the key role of regional and international institutions in overcoming the barriers to integrating aid in partner country budgets.

# 5.2 Creating a regional and international network of influence on the use of country systems

*Aarti Shah, Sara Fyson and Alta Fölscher*

## Using country systems for good financial governance: An introduction

Lessons from decades of development experience have shown that for aid to be effective, donors need to respect partner country ownership of their own development policies and practices. This includes the need for donors to support a country's requests to use the country's own administrative systems to deliver aid.

The use of country systems by donor countries requires that aid operates within the framework of the national budgetary rules, mechanisms and procedures. It can imply the inclusion of aid in budgetary planning, in the budget documentation, or in the revenue and appropriations approved by Parliament, the direct disbursement of aid through the Treasury's main revenue funds, the adoption of national procurement

standards, or the inclusion of external financing in national accounting and auditing systems or reports.

The ideal combination in the use of country systems at the various stages of the budget process for the disbursement of ODA will differ not only between specific aid modalities but also between countries, as the associated benefits and risks greatly depend on the quality and strengths of the recipient country's institutional framework.

The effective use of aid resources, including putting aid on budget, remains an important priority for CABRI participating countries. Debates at the CABRI annual seminar showed that the challenges found in numerous countries are similar, and that using country systems is also about strengthening good financial governance. As such, the use of country systems is not an end in itself; rather, it is an important means to achieving better transparency, accountability and ownership over public resources in general, not only those provided by donors.

Recognising these objectives, both CABRI and the Working Party on Aid Effectiveness (WP-EFF) have ensured that this approach is reflected in their ongoing work programme. In order to provide an overview of progress towards, and key current issues in, the use of country systems, this paper reflects work undertaken since 2009 and draws from research conducted in and support provided to countries in this area by both CABRI and the Global Partnership on Country Systems.

## Perspectives on the use of country systems

Broad agreement by donors and partner countries on the importance of using country systems underlies the endorsement of international agreements to this effect by the donor community, partner country governments, parliamentary associations, and CSOs. Both the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action (AAA) stipulate that donors should use country systems, including as a first option in the case of the AAA.

Yet, while there is agreement in principle at the international level, it is important to recognise that donors and partner countries face very different incentives for the use of country systems.

Partner countries are particularly interested in the potential benefits of the use of country systems for development effectiveness. Countries need aid to flow through their systems so that, firstly, information on the total resource envelope is comprehensive. Full information informs better intersectoral allocations. Secondly, allowing countries to have a greater say in how these funds are spent creates the space for greater control, accountability and a stronger desire to ensure that the funds

are used as prudently as own revenues. Thirdly, for highly aid-dependent countries in particular, integrating aid through the range of country systems in itself can play a catalytic role in strengthening these systems. Lastly, greater transparency in the allocation of funds also points to greater transparency in the use and impact of these funds.

In contrast, while recognising the benefits, donors face incentives that result in an emphasis on risk in their perspective on the use of country systems. For donors, the use of country systems requires well-structured, comprehensive, credible and transparent budgetary institutions. Theoretically, the use of country systems thereby provides strong incentives for national governments to enhance their public financial management and governance structures. In using country systems, donors need to relinquish some control over the management of these funds, while facing pressures from their own governments and parliaments to ensure that the funds are spent appropriately. To do so, donors need to:

- understand the strength of a particular system;
- assess how much potential fiduciary and other risk may be involved in using the system; and
- agree on how much risk each development partner is willing to take in any particular context.

In principle, these two perspectives meet, and action is taken when countries provide demonstrable results on the strengthening and improvement of country systems. This would allow donors to release a certain amount of control over the management of development aid, while mitigating against the major fiduciary risks in using these systems.

However, in reality, despite international agreements on using country systems, progress made in the use of country systems has been limited. According to the Paris Declaration Surveys (2006 and 2008), between 2005 and 2007 the overall use of country public financial management (PFM) systems increased from 39% to 45%. Most progress was made in the use of national financial reporting and auditing systems, but only a small proportion of aid used budget execution and reporting systems (OECD-DAC 2008). Moreover, while the global survey reports a high percentage of aid on budget estimates, in many African countries budget documents include only direct budget support and exclude all other aid flows. A common frustration expressed by a number of CABRI participating countries is that despite efforts and evidence that country systems have improved, donors are still reluctant to integrate aid flows into national systems.

Part of the explanation for this slow progress is donors' fear of financial misuse, their reluctance to let go of the ability to directly and/or exclusively attribute development impacts to outlays, and/or their reluctance to lose control of development choices. Furthermore, in the context of the financial and economic crisis, donor attitudes to fiduciary risk have taken on aspects of outright risk avoidance rather than risk mangement in an environment of tight budgetary frameworks. Different donors have different appetities for risk; a system that is strong enough for one donor may not be so for another donor.

Progress is also slow because formal rules on approaches to aid management within donor organisations may not have changed to the extent required, and these changes may not be adequately communicated internally. Donors also need time to learn and understand the specifics of each country system. It is a common misperception that the use of country systems for aid necessitates the shift to direct budget support. Projects or heavily indebted poor country (HIPC) funds may use country systems at different stages of the budget process without being transformed into general budget support.

## Using country systems: What are the associated risks and expected benefits?

The main risks that donors associate with the use of country systems are:

- *developmental risk*, where the envisaged developmental objectives are not fulfilled;
- *fiduciary risk*, where funds are misappropriated or unaccounted for, or do not achieve value for money;
- *non-financial risk*, such as macroeconomic, governance or partnership risks;
- *procurement risk*, where the efficient and effective use of aid is hindered by national procurement standards; and
- *reputational risk*, where the reputation of the donor country is affected by governance issues or the abuse of funds (OECD 2010).

Most donors focus on fiduciary and reputational risks in the disbursement of aid, and justify their reluctance to deepen their use of country systems by citing the weaknesses of national budgetary institutions.

It is beyond doubt that sound budgetary institutions are essential in the effective use of country systems. However, it is often forgotten that by allowing aid to be integrated in the national budget process, donors can advance the quality of precisely

these institutions by strengthening accountability between the different national actors (executive, line ministries and legislature), enhancing transparency and developing capacity.

To fully assess the benefits and costs of the use of country systems, donors have to shift from a focus on the individual short-term risks and benefits to a broader and longer-term perspective, and from a focus on fiduciary risks to a focus on developmental risks. For the advantages to become evident, an overall change in donor practice and a significant amount of time is required. By using country systems, foreign aid can provide strong incentives and momentum to the government to strengthen and reform budgetary institutions, leading to improved effectiveness for all public expenditure. When donors set up parallel systems, they risk creating duplication, resulting in higher transaction costs and less sustainable capacity development. The use of country systems is expected to lead to a strengthening of the effectiveness of public expenditure as a whole, which should be a core objective of any form of official development assistance (ODA).

## Strengthening and using country systems: A key component of good financial governance

There are several ways in which aid that uses recipient country systems can help to improve financial governance. The two most important channels are the enhancement of *transparency* and of *comprehensiveness*. A transparent budget process provides the public with complete information on policy objectives, the formulation and implementation of these objectives, and the differences between the intended and the realised outcomes. Transparency throughout the entire budget process helps to prevent budgetary malpractices, such as hidden budgeting (where the real budget is known only to a select few) and corruption (Gollwitzer 2011). Greater transparency can lead to better fiscal outcomes; research shows that more transparent budget institutions are associated with greater fiscal discipline (Alt & Lassen 2003; Hameed 2005).

In African countries, where external financing often accounts for a large share of available funds, the inclusion of aid in the preparation of the budget, the budgetary documents and the government's accounting system is a key postulate for a transparent budget. It allows important insights into where aid flows are channelled and how they are employed. This also enhances the executive's accountability to Parliament, audit institutions and civil society with respect to the allocation of donor funds, and increases the pressure for the delivery of assessable results.

Comprehensiveness, on the other hand, ensures that all elements of expenditure are accounted for and subject to budgetary rules and procedures. A comprehensive

budget helps to reduce malpractices such as hidden budgeting and escapist budgeting (where the government authorises expenditures knowing that they will never occur). By integrating all forms of ODA into all stages of the formal budget process, the overall availability and allocation of funds can be monitored more easily, thereby again enhancing accountability and allocative efficiency. A comprehensive budget also provides governments with a greater say on how aid flows should be used. Do these flows complement government programmes? Is there enough absorptive capacity to implement these projects and programmes? Have they been designed in a sustainable way? Have medium-term operation and maintenance costs been taken into account? Are the right approaches being applied, given the government's knowledge of the institutional framework, the existing delivery mechanisms and the needs of citizens? Using country systems is an important element in equipping governments to lead and manage their development agendas and in governments being held accountable for their implementation by legislatures and citizens.

Oversight institutions benefit enormously from improvements in the level of comprehensiveness, transparency and accountability. The legislature and the supreme audit institution are able to exercise stronger and more effective powers of scrutiny over public expenditure in a transparent and comprehensive environment. This, in turn, reduces many of the donor risks outlined above, increasing donor trust in the system itself. Finally, by exposing weaknesses at the various stages of the overall budgetary process, transparency and comprehensiveness in PFM help to pinpoint the need for reform and to strengthen national capacity and performance.

Overall, a shift towards donor use of national PFM systems, whether entirely or at specific stages, not only decreases transaction costs and enhances the country's absorptive capacities, but also represents an important first step towards strengthening the PFM system and increasing capacity.

CABRI's recent work on good financial governance (see Chapter 2) demonstrates the need for strong institutions, capable and competent civil services, transparent and accountable governments and autonomous leadership on reform choices for countries to grow, prosper and serve their citizens. The use of country systems is an important means of reducing a country's dependency on aid flows, allowing the country to develop in a sustainable manner.

## Using country systems in practice: What lessons can we learn?[1]

While the use of country systems is a relatively new principle in aid management – with a key turning point being the 2005 Paris Declaration – there is a growing understanding amongst donors and partner countries on what the benefits/risks of not using country systems are and on what adjustments to donor and partner country systems may be required to ensure that aid is integrated in country systems to the maximum extent possible.

While the overall impact of a large number of parallel donor systems tends to be counterproductive, individual donors and their partnering country institutions face incentives to do just that: 'The incentives for using parallel systems are multiple, both for donor and for partner government staff. They include visibility, attribution of results, staff promotion, material and non-material benefits…prestige, political credit, and perceived or actual reliability and control of project funds compared to national budget funds' (Mokoro 2010).

Yet, the problems associated with the use of parallel systems are manifold and must not be underestimated. Conventional aid delivery mechanisms that set up parallel systems often translate into resources that are distributed and allocated in a fragmented way, resulting in high transaction costs and low absorption rates (see Box 1).

**Box 1: Transaction costs – Absorption rates in Burkina Faso**
The example of absorption rates in Burkina Faso clearly shows the disadvantages of using parallel systems versus country systems in the distribution of aid. The absorption rates for Partnership General Budget Support varied between 102.1% and 93.1% between 1998 and 2003. The absorption rates of project aid were significantly lower for the same period, varying between 65.1% and 74.3%. This demonstrates the increase in effectiveness that can be achieved by channeling resources through government systems.

Often, the goals of project aid that is not integrated with country plans and budgets are narrow, short-sighted and unaligned with the development objectives and policies of the recipient countries. Moreover, if several donors implement a variety of projects in an uncoordinated and isolated way, this risks the duplication of activities and the

1 With the exception of the South African case study, the case studies mentioned in this section were commissioned by the Task Force on Public Financial Management and were conducted by Mokoro Ltd.

waste of resources (see Box 2). Instead of strengthening the government systems of recipient countries, projects micromanaged by individual donors bypass government expertise and hinder the effective channelling of public funds.

**Box 2: The problem of alignment – The education sector in Rwanda**

Before the donor shift from projects to sector budget support (SBS), despite significant donor support to education projects, school maintenance could not be financed by the government in Rwanda. The reason was that the various donor projects all focused on the construction of new schools, which clearly ensured higher visibility and prestige for the donors. This resulted in a bizarre situation where a large number of new schools were built but neither the new nor the old schools could be sufficiently maintained because of a lack of funds. The shift to SBS has now enabled the Ministry of Education in Rwanda to provide schools with transfers for school maintenance through capitation grants. (See Mokoro & ODI 2009.)

The benefits of using country systems are not new, as evidenced by the example from Botswana (see Box 3).

**Box 3: Botswana's history of using country systems**

During the 1980s and 1990s many donors moved their aid off budget and the use of parallel systems became common practice. This was largely a reaction to a loss of confidence in the efficiency and the fiduciary standards of partner country public finance management. However, Botswana was a striking exception to the general trend, and kept aid predominantly on budget throughout the 1980s and 1990s. In particular, successive Finance and Audit Acts made it a requirement that all aid should be paid into a Development Fund; links between recurrent and development budgets had legislative backing; budget classification system, allied to computerised accounts, kept track of sources of funding (including donors) as well as lines of expenditure; even though donor funds were often earmarked, as a result of the use of sector ceilings (including aid), the government retained discretion over the use of those funds. Botswana had thoroughly integrated aid into all aspects of its public finance management. During Botswana's period of greatest aid dependency, most aid was on plan, on budget, on Parliament, on Treasury, on accounting and on audit.

*Source: Government of Botswana (1986)*

Three of the major benefits arising from the channelling of resources through recipient government systems are enhanced accountability (see Box 4), incentives for strengthening government systems and building capacity (see Box 5 and 6) and improved treasury management (see Box 7).

**Box 4: Enhanced accountability – Uganda, Tanzania and Mozambique**

The increased amount of sector funding making use of domestic systems in Uganda, Tanzania and Mozambique has enhanced the role of formal budgetary procedures and accountability systems for sectoral funds. This implies that aid at the sector level has become subject to formal budgetary rules, procedures and controls. As Mokoro (2010) explains, this provides significant incentives for institutions, at both the sector and the national level, to become more involved in the budget process. At the same time, aid being channelled through sector government systems has increased the donors' and the government's attention to accounting and audit systems, thereby providing important incentives for reforms.

**Box 5: Using country systems to enhance development impact – Vietnam**

A group of bilateral donors in the mid-2000s agreed to more permissive rules regarding use of country systems, enabling them to balance the greater development impact and sustainability of using country systems against the potentially higher fiduciary risk. Bilateral donors took the view that committing to the use of country systems even where there were recognised shortcoming helps to advance the reform process. These donors began to use country systems, both through greater use of new aid modalities and by changing the management arrangements for projects.

**Box 6: Changing incentives for capacity-building in Uganda**

In the late 1990s, Uganda's rural water sector was facing severe problems in delivering water and sanitation services, mainly due to capacity constraints at the local level. In 2000, district water grants to local governments were introduced. The government allocated resources from debt relief and general and sector budget support through these conditional grants to local governments where the establishment of offices and the recruitment of qualified staff were explicitly supported by the grants. The fact that funds were transferred for delivery while building capacity meant that there were stronger incentives to attract and retain qualified personnel. Funds were only transferred upon delivery. Using

country systems empowered districts to channel donor funds where they were needed most. This enhanced the effectiveness of donor resources in achieving the desired outcomes, and greatly improved capacity and incentives at the local level. (See Mokoro 2010.)

**Box 7: Improved treasury management – The health sector in Zambia**

Putting aid directed at the health sector on the Treasury has greatly enhanced the accountability of the government in the use of these funds in Zambia. Generally, all resources on the Treasury are subject to the oversight of Parliament and the Office of the Auditor General. This implies that by putting donor funds on the Treasury, the oversight power of these two institutions is extended to a larger proportion of resources, which, in turn, ensures increased transparency in the allocation of donor money.

The use of country systems requires not only adjustments in donor policies and systems, but also in how partner countries manage aid resources. In many cases, bringing aid on budget (or through country systems), notwithstanding the modality and type of flow, will require legislative/regulatory changes, institutional changes and changes to the budgeting instruments and documentation of the partner country. As Box 8 illustrates, the process is in essence one of integrating aid management and budget management systems within the country.

**Box 8: Putting aid on budget in South Africa**

A recent review of ODA to South Africa between 2000 and 2008 highlighted that poor integration and reflection of aid on budget adversely affects the efficient and effective use of aid. A main finding of the review was that whereas the integration of aid in the public resource management cycle may arguably not be visibly critical, it is crucial for the effective use of aid itself. While aid amounts to about 1% of the budget in South Africa, it is an important resource for funding developmental activities. Besides, when social grants are excluded, its share of total resources increases. Also, it is concentrated in certain sectors and regions, where it forms a much larger proportion of funds.

Until now, aid in South Africa has been managed in parallel with the budget. A significant portion of the ODA is disbursed through third parties – like project management companies or NGOs. Aid that is disbursed through government systems is managed through the Reconstruction and Development (RDP) Fund, accounted as an extra-budgetary fund. With the exception of a few departments where the value of aid has been recognised, aid has not featured

visibly in spending agency budget and accountability processes. The result has been that officials in charge of ODA-funded programmes have not been held accountable for the use of ODA to the same extent that they are accountable for domestic resources. This has undermined ownership (the key factor in effective programme management according to the review), with a ripple effect through alignment, management for results and mutual accountability, notwithstanding the ODA modality used.

The findings of the review strongly suggest that the efforts by the International Development Co-operation (IDC) Chief Directorate in the National Treasury (the central agency responsible for aid co-ordination in South Africa) to bring aid on the budget should be supported. To address the problem, the IDC recently formulated a package of measures comprising the following main initiatives.

*Addressing weaknesses in the regulatory framework for managing ODA*. Currently, ODA that is disbursed through country systems is covered by the RDP Act and the procedures developed in terms of the Act. The management of all ODA is anchored in the Public Finance Management Act requirement that accounting officers are responsible, *inter alia*, for the effective management of all resources, and that the Treasury must issue instructions for the 'management of gifts to the state'. However, the Treasury regulations are largely silent on the management of ODA, with the result that chief financial officers (CFOs), who manage budgeting and financial accountability processes, pay insufficient attention to ODA. Amending the regulations to ensure that ODA comes into the purview of the CFOs and budget processes is a necessary step for effective integration of aid into budget processes.

*Integrating aid into central-level budget processes*. Aid has long been reported in the medium-term expenditure framework (MTEF) process, and in the budget documentation. However, it has not been considered in central-level deliberations during the budget preparation process. One factor has been that the information on ODA has been incomplete, with the result that it has not been possible to fully assess its importance for any one sector or across sectors. This has resulted in weak demand for departments to provide good information on ODA and to consider or oversee aid properly within their own processes. The IDC, which is part of the Budget Office, is providing direct support for the 2011 budget process, generating better information on ODA and highlighting opportunities for using ODA better.

*Improving reporting on ODA to develop political accountability*. ODA agreements have been tabled in Parliament as a procedural measure. Yet, few parliamentary committees have paid attention to ODA as a resource in their oversight processes,

partly because reports have not been provided routinely to Parliament. The IDC/National Treasury is developing measures to address this weakness: a first step is the provision of quarterly reports on ODA to the central appropriations and finance committees. It is envisaged that an annual report on ODA flows, use and results will be developed. The reporting of ODA in departmental annual reports and budget documentation will also be improved.

*Developing the role of aid co-ordinators in departments*. ODA co-ordinators in national and provincial departments are important actors in the aid management cycle. However, they have not been sufficiently empowered to bring aid into departmental budget and accountability processes. Key factors are the position of ODA co-ordinators in departments, their mandates and their skills. The IDC is undertaking a programme to build ODA co-ordinators' capacity and to address the institutional factors.

*Building an aid information system*: The integration of aid in budget processes and its reflection in budget documentation is only as good as the information available on aid flows. Central management of aid information has been hampered by both poor reporting by donors and poor reporting by recipient institutions. The IDC is in the process of developing an aid information management system to address weak information on ODA and to enable it to play an effective role in bringing aid on budget and on reports.

These measures will support the ongoing efforts of the IDC to get more donors to disburse higher proportions of their aid through country systems.

## The importance of aid information

The South African case clearly illustrates the importance of aid transparency. At the heart of using country systems lies the quality, timeliness and accessibility of information on aid flows. The 2008 Putting Aid on Budget report refers to quality in terms of completeness, credibily (predictability), level of disaggregation and detail.

The AAA committed donors to 'publicy disclose regular, detailed, timely information on volume, allocation and, when available, results of development expenditure to enable more accurate budget, accounting and audit by developing countries'. Such information allows for partner countries to integrate aid better into their national processes and for improved reporting to stakeholders on the results achieved from delivering aid. Several sources provide this kind of information, more or less comprehensively. About 30 countries now have aid information management systems (AIMS) at country level. A recent survey showed that data in these AIMS are

usually robust, and strongly correlated with DAC data. Though, one criticism is that they tend to be independent of, and disconnected from, ministries dealing with public finance management systems.

The OECD-DAC provides an exhaustive database (called "CRS") of all aid interventions (budget support, projects, other types) from DAC donors and from a dozen non-DAC countries and institutions. These statistics, which are properly scrutinised, consistent and coherent, are available online annually, after the end of the year. At the time of writing, some improvements were under consideration, such as a new database view adapted to developing countries, improving timeliness (quarterly information on disbursements), more detailed descriptions, geographical targets and disbursement channels. The DAC also collects aggregate information on forward spending by country and, in two countries (Rwanda and Ghana), is piloting the release of the detail of this information for some donors.

In 2008, several donors and international NGOs spearheaded the International Aid Transparency Initiative (IATI) with the aim of making information about aid spending easier to access, use and understand.

At the time of writing, the process to ensure that the IATI standard fulfils partner country aid information needs to an appropriate degree (i.e. striking the right balance between the cost of providing information routinely and the benefit of the information being available) was still underway. Ensuring that aid flows are sufficiently transparent for partner countries to have the necessary information in the right formats to align aid better with country budgets is critical. The IATI process is aimed at developing standards on the extent and detail of aid information that donors publish, the timeliness of the publication and the formats in which the information is published to ensure accessibility to all stakeholders. Based on the CRS standards, the additional aspects that are under consideration in respect of the alignment of aid information with partner country budgets include:

- better alignment of aid information with country financial years and more timely information through quarterly publication of aid data;
- increased clarity on aid type (e.g. budget support, projects, experts, scholarships) and financing type (e.g. grant, loan) and disbursement channel;
- determination of the value of aid flows in local currency;
- identifying all country and third-party institutions involved in delivering aid activities;
- estimating medium-term aid flows;
- the geographic location of aid activities where relevant; and

- information on conditions and expected results of aid activities.[2]

Key aspects of the proposed standard are: the requirement to publish timely information on planned and actual disbursements for inclusion in country budgets, and actual use of aid that is not disbursed through country systems for inclusion in country reports; and the classification of each activity in line with the classifications used by partner countries to allocate resources and manage the budget, through the inclusion of a partner country budget identifier in the standard.

If agreed upon and implemented, AIMS, CRS and the IATI standard will go a long way towards improving the routine and systematic flow of information on all aid between donors and partner countries and between partner country institutions. This will greatly enhance the breadth and quality of aid information available to partner country institutions for planning and budgeting.

## Creating a network of influence: How regional and international bodies can support country-level agendas

One way to achieve the Paris Declaration principles is to use a legitimate institution, such as CABRI or the WP-EFF, to broker change by providing both technical inputs and political leverage for change at regional and international level.

### In-country support for putting aid on budget: progress so far

In order to take into account country specificities and political bottlenecks at country level, both regional and international partnerships have been called on to support and facilitate change in this area.

*CABRI*: The work undertaken jointly with the Ministry of Economy and Finance in Rwanda in 2008 was a first step for CABRI in country-level support. It has been instrumental in setting a government-driven reform agenda for aid management and providing valuable learning experience for the network on how to use its expertise optimally in supporting individual countries under key CABRI themes[3]. This specific work built on CABRI's engagement in a regional dialogue focused on ways in which countries can strengthen their PFM systems, and emphasised the increasingly critical role budget officials play in managing aid flows. CABRI has also conducted a ten-country case study on the reflection of external development assistance in national budget processes.

2 See www.aidtransaprency.net for more detailed information on the IATI standard.

3 See related paper in the 2009 Annual Seminar Publication as well as the CABRI Brief for more detail at www.cabri-sbo.org.

*WP-EFF*: There is also full recognition at the international level by the WP-EFF that more progress in implementing the Paris Declaration and AAA needs to take place at the country level, driven by partner countries as well as by donors. As a result, the WP-EFF is supporting increased in-country consistency between headquarters and field-level implementation of aid effectiveness commitments, and ensuring that technical work defined at the international policy level is both relevant and enables progress and impact at the country level. As part of this recognition to move the debate closer to country realities, the Global Partnership on Country Systems has begun facilitating (where countries request it) progress in specific areas that are relevant to the country concerned (see Box 9).

In Africa, the complementarity of the work of CABRI and the Global Partnership has resulted in an agreement in principle to co-ordinate country-level support.

**Box 9: Ghana's country systems initiative**

Effectively managing foreign financing represents a key challenge to the government in Ghana, where aid accounts for close to 20% of the total annual government budget resources and for 10% of GDP. In 2008, the Survey on Monitoring the Paris Declaration identified a need for increased engagement in the enhancement of aid effectiveness in Ghana, in particular in the use of country systems. The survey showed that the improvement in quality of Ghana's PFM systems had not been mapped by an increase in their use by donors.

As a result, the government of Ghana, backed by the results from the Survey on Monitoring the Paris Declaration, took an important step in facing up to its donors and asserting its right to have foreign financing directed through its country systems. The use of country systems is now a core element of Ghana's Aid Policy (2010). In order to further support the implementation of this important commitment in Ghana, the government has requested that the Working Party on Aid Effectiveness, as an international body with representation from both the donor and partner country communities, provide both technical and political backing to this endeavour.

The Global Partnership facilitated a dialogue with the government and then with local donors to identify a number of practical areas where immediate progress should be envisaged. These included progress in the important areas of audit, budget and accounting – allowing the government to better plan its resources, receive more accurate information on its predicted aid flows, and to be able to better account for the use of all of its resources to Parliament. As a result of strong government and local donor leadership in this area, progress has been achieved in a number of areas.

In the auditing sector, a working group now provides a forum for dialogue between the government, the donors and other main actors, and promotes reforms to deepen the use of country systems. The Audit Sub-Sector Working Group, which is co-chaired by the Auditor-General and one development partner, has begun work to improve the effectiveness of aid in this sector in four ways:

- harmonising the audit language and terms of the donors;
- harmonising the audit requirements;
- harnessing and co-ordinating donors' support to Ghana's Audit Service (GAS); and
- facilitating and co-ordinating the policy dialogue between donors, GAS and other Ghanaian institutions.

When it comes to better accounting for development resources, it has been agreed that immediate action is required on improved sharing of information between donors and the government of Ghana. Furthermore, increased dialogue between the donors' accounting officers, the national accounting bodies and the relevant government agencies is envisaged.

Concerning the budget process itself, the government of Ghana has taken the leadership in providing training to donors in national budget practices and procedures, so that they will be better able to assess their strengths and use them where possible. Donors and the government have also identified ways of improving the quality and reliability of donors' projections in the budget. This includes joint financial forecasting and the integration of donor data and information into the budget process.

The next steps include:

- the presentation to the Working Party on Aid Effectiveness of these results and, importantly, the identification of where donors are not meeting their engagements;
- establishing clear recommendations on putting aid on budget; and
- supporting Ghana in the preparation of HLF-4 and showcasing progress in each of the identified areas above.

The work undertaken in this area by CABRI and the Global Partnership on Country Systems during 2010 has been instrumental in setting a reform agenda for putting aid on budget. In a few countries, which have requested support at both the regional (CABRI) and the international (Global Partnership) level, a process has been initiated that allows national governments to take the lead in setting the country systems agenda. Ghana's experience clearly demonstrates the importance of working at the

country level and of recipient countries taking the lead in this process in order to ensure alignment with their country-specific needs. The examples of Rwanda and Ghana also underline the importance of countries enhancing their own capacity in assuming more responsibility and in negotiating with their donors.

## Building a network of influence

The G20 statement in Toronto in June 2010 outlined the need for 'specific actions for greater transparency, stronger accountability, improved institutional governance, deeper country ownership, more decentralization and use of country systems where appropriate'.

In the run-up to the High Level Forum on Aid Effectiveness, to be held in Busan in November 2011, and the target date for reaching the Millennium Development Goals, partner countries will need to strengthen their own networks to lobby international platforms on delivering better quality aid.

Research has shown that parallel networks set up to lobby larger processes such as the G20 can help influence the debate and ensure that the less dominant view is heard (Martinez-Diaz & Woods 2009). In ensuring progress on the road to Busan and beyond, both CABRI and the Global Partnership can assist in building a stronger network of influence in the following ways:

- supporting senior budget officials to create space to negotiate terms and conditions for using country systems, to reach agreement on using country systems (which systems and which aid modalities), to lead the decision-making process (through consultative group meetings, for example), and to implement in-country agreements;
- providing substance to the 'putting aid on budget' arguments through country case studies across the region,
- monitoring and reporting on progress at both the regional level (through CABRI) and the international level (through the Global Partnership on Country Systems); and
- influencing the outcomes and agreements at the international level (with support from the Global Partnership), including at the High Level Forum on Aid Effectiveness (Busan 2011).

The High Level Forum on Aid Effectiveness, which heralds the end of the Paris Declaration cycle, provides such a network with the opportunity to both assess progress and bottlenecks since 2005 and to put on the agenda issues that were not at the forefront in 2005.

Based on the existing evidence on country systems, a number of important questions arise as the aid environment is changing and a more nuanced view of risk is needed. Can the rhetoric ever really match the practice on the ground on the use of country systems? To what extent will non-traditional donors adhere to these principles? How can these be applied and localised for fragile states and new financing priorities (e.g. climate change)? Can transitional countries (from low-income to middle-income) push the agenda forward? What role can an international partnership like the Working Party on Aid Effectiveness play as a broker in the political discussions at country level?

## Conclusion

This paper has presented the potential benefits of increasing the use of country systems, especially for partner countries, and has considered the risks that donors perceive. The examples of South Africa and Ghana illustrate country-led initiatives to integrate aid into the budget process. CABRI's work at the country level suggests that several enabling conditions need to be in place in order for partner countries to facilitate significant progress.

### A strong interface between the aid management unit and the budget office

The CABRI/AfDB (2008) budget practices and procedures report highlights that there is a great degree of fragmentation with regard to who is responsible for the aid management function. Out of the 26 countries surveyed, 15 reported that two or more government units were jointly responsible for aid management. The responsibilities often are divided between various ministries (Finance, Planning, Foreign Affairs and sometimes the President's Office), which makes the process of integrating aid flows into the various systems far more complex.

In theory, where the aid management unit is located within the Ministry of Finance (or the Central Budget Authority) co-ordination should be easier to achieve. Even so, CABRI's work in the area has suggested that aligning information flows, processes and systems, and managing political tensions around authority, power and responsibility, are not simple tasks. They require concerted effort from both parties and need strong leadership from the head of the Ministry of Finance and/or the Minister of Finance.

The report highlights another important characteristic that relates to how negotiations with donor agencies are carried out when designing new aid projects/ programmes. In some countries, line ministries have the space to engage in

direct negotiations with donors. The more decentralised the process, and without standardised rules and procedures, the more difficult it is to integrate all aid flows fully in the budget process.

### Increasing development partners' understanding of country systems

To use country systems, donors need to educate themselves in the intricacies of a country's system. In particular, knowledge of the critical points in the process, where information needs to be provided, negotiations need to occur and funds need to be released, is important in allowing countries to manage the risks that are associated with relying on development aid (unpredictability, volatility, etc.). A second aspect is that of managing expectations.

### Developing strategies to manage risk and not merely avoid risk

Understanding how a system works also allows countries to assess the fiduciary and development risks that may be attached to a particular system. Donors need to be clear up front on how much risk they are willing to take and on the strategies they have in place to manage that risk, and not only to avoid risk at all costs (including the cost of undermining development objectives).

### Timely and comprehensive aid information in line with the partner country's budget format

The use of country systems does not refer to a shift to budget support or the use of country treasury and financial management systems only. In principle, all aid (notwithstanding modality or the type of flow) can and must be integrated with country systems at the planning and budgeting phases of country resource management cycles. A key impediment to achieving this is the poor timeliness, coverage, usefulness and accessibility of donor information on aid flows. The agreement of an appropriate standard on aid transparency and its application by all donors is a necessary step to improve aid transparency, which, in turn, is a necessary step towards achieving the commitments of the Paris Declaration.

### Modifying development partner rules and procedures and communicating changes to field offices

Differentiating strategies to manage risk and providing information in line with a partner country's budget format alone may require changes in a development partner's rules and procedures. Using different aspects of a country's systems, be it in procurement, auditing or financial accounting for various aid modalities, would require greater flexibility in the way in which many donors currently operate, and

changes to the way aid instruments themselves are designed. For significant progress across countries, policy and procedural change would need to be directed at the headquarters' level. Such changes would need to be communicated clearly to field offices and partner countries.

CABRI and the Global Partnership on Country Systems's approach to working at the country level and feeding the findings and lessons through to regional and international networks of influence will be an important vehicle in pushing for change. While both parties have an important role in steering the international discourse, providing guidance and encouraging good practices, progress on the ground will depend primarily on the willingness and attitude to change on the part of both donors and recipients.

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