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Making Budgets Work: The Implementation Challenge

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Acronyms and abbreviations

ABB	activity-based budgeting
AFROSAI	African Organisation of Supreme Audit Institutions
ATAF	African Tax Administration Forum
CBM	chief budget manager
CFA	central finance agency
IBP	International Budget Partnership
IMF	International Monetary Fund
HIPC	Heavily Indebted Poor Countries
MPP	Ministerial Performance Project
MPR	Ministerial Performance Report
MTEF	medium-term expenditure framework
NDP	National Development Plan
OBI	Open Budget Index
ODI	Overseas Development Institute
PBB	programme-based budgeting
PEFA	Public Expenditure and Financial Accountability
PFM	public financial management
SOE	state-owned enterprise

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Introduction: Making budgets work – closing the implementation gap

Alta Fölscher

Making budgets work is critical for efficient and effective service delivery, economic growth and socio-economic development. Senior budget officials from across Africa gathered in Kigali on 17 and 18 August 2011 for the 7th Annual Seminar of the Collaborative Africa Budget Reform Initiative (CABRI), to share knowledge on common challenges of budget implementation on the continent.

In the past two decades, many African countries have initiated comprehensive reforms to modernise their budget systems. Effective and transparent budgeting is the cornerstone for implementing a country's economic and social policies. While budget preparation has improved considerably, challenges persist around the implementation of budget reforms and execution. Recent research using cross-country datasets has shown that: generally budgets in Africa are made better than they are implemented; while legal frameworks and formal process reforms may succeed, effective changes to practices lag behind; and central ministry reforms are easier to implement than reforms that require changes in behaviour at spending agency level (Andrews 2010).

The 7th Annual Seminar explored the problem from the perspective that institutions matter, and that changing behaviour requires not only a focus on specific interventions aimed at the behaviour itself but also broader attention to the incentives that organisations and individuals face. Budget outcomes are a function of incentives created through the formal and informal rules of the budget and other systems, and the management arrangements to which budgetary actors are subjected. The seminar programme was structured around this central theme, drawing on selected current reform concerns of CABRI countries. Particularly, seminar participants were asked to share their experience of how the budget function is shaped by:

- the legal framework (the formal rules that govern budgeting and public financial management);
- the structure of organisations that lead it (the management arrangements at central level); and
- the rules at sub-national level that govern the financing of services and the ability of ordinary citizens to demand accountability and service delivery.

Common factors in weak budget execution systems

The first session at the seminar sought to isolate common factors across CABRI countries that contribute to weak budget execution systems. While the discussion highlighted technical weaknesses in planning and various systems associated with budget execution, participants pointed to governance and capacity shortfalls, as well as poor reform implementation practices, as important underlying factors in slow budget execution improvements. Chapter 2, titled 'Framing the challenge: Common factors in weak budget execution systems', provides an overview of presentations and discussions during the session, listing the common themes in the contributions.

While the focus of the session was on budget execution, presenters and participants pointed to the vicious cycle of poor planning and budgeting resulting in significant deviation from and remaking of the budget during budget execution, which, in turn, creates even worse incentives for good planning. In addition, Florence Kuteesa, from the Fiscal Affairs Department of the International Monetary Fund (IMF), emphasised in her presentation, the negative effect of high institutional fragmentation in the budget preparation process on making budgets work for policy objectives and on ensuring that planning is resource constrained. This is particularly true for countries that receive high development assistance support. Edward Hedger, Head of the Centre for Aid and Public Expenditure at the Overseas Development Institute (ODI), shared with participants the results of research undertaken by the ODI on public financial management (PFM) reforms in fragile and post-conflict states. Across the case study countries, which included Liberia, Sierra Leone and the Democratic Republic of Congo in Africa, parallel systems and poor information flows to the central finance ministries on donor assistance undermined co-ordinated and consolidated budget preparation. The lack of predictability and high volatility of flows compromised basic budget planning and execution, and caused fragmentation throughout the budget cycle.

Overall, fragmentation in budget planning on account of development aid flows undermines both the incentives faced by sectors to participate fully in the budget preparation process and local accountability for budget execution.

While CABRI countries have undertaken PFM reforms to address these issues – like medium-term expenditure framework (MTEF) and programme-based budgeting (PBB) reforms, with heavy emphasis on reducing fragmentation and reintegrating budgeting – such reforms do not take root easily. The ease of changing procedures on paper does not translate into easy improvements in functionality. Political will, human resource shortfalls and the absence of reform implementation strategies aimed at institutional change management are key factors behind slow implementation.

Poor budget credibility at the macro level – the degree to which available resources and their distribution to spending agencies reflects the enacted budget – has a knock-on effect on the ability of Parliament to hold spending agencies to account for budget execution. Frequent budget adjustments, reallocation of resources and virements mean that the budget becomes a pool of resources, rather than a binding prioritisation framework. The lack of timely, comprehensive and quality information on budget execution, in turn, means that much of this occurs within the executive, out of view of oversight institutions like Parliament and ordinary citizens; this was conveyed in the presentation by Vivek Ramkumar, manager of the Open Budget Initiative of the International Budget Partnership. The Open Budget Survey 2010 found that budget oversight was weak in a high proportion of the African countries assessed. For example, 18 out of the 27 African countries surveyed scored in the lowest two categories of minimal and scant information provided by the executive; more countries provided information in the budget preparation phase than in the budget execution phase; in only six of the African countries surveyed did legislature committees hold hearings on budgets in individual ministries; and in 12 of the 27 countries, audit reports were not scrutinised at all or only some reports were scrutinised by a committee of the legislature.

Similarly, in fragile and post-conflict states, budget reform programmes have not balanced technical changes in the executive budget functions with reforms that enable legislatures to play an effective role in budget oversight. The constraints on oversight have shown up particularly in the effectiveness of parliamentary follow-up.

Discussion at the seminar emphasised the importance of improving the content, accessibility and usefulness of budget documentation as key measures to engage the legislature and the public, and catalyse improved accountability.

Accountability, however, is a function of the overall political economy of a country. Budget systems do not run in isolation, but are a component of the structure of the state, which is inherently political. Political decision-making in the PFM system and how to ensure that it is conducive rather than detrimental to good budget outcomes was a recurring theme not only in the first session, but throughout the seminar. Political commitment and reform leadership are key factors in establishing and improving PFM systems. Within the political cycles of countries, political commitment is incentivised when regaining financial control and securing donor support become political priorities. However, PFM is not the instinctive first priority for governments; in fragile states, for example, PFM imperatives can take second place to domestic pressures to secure and maintain political stability. Similarly, in most countries, sound PFM practices can easily become victim to short-term political interests, as ministers divert allocated funds for new spending priorities. Cabinet processes, instead of being the engine room for internal accountability for budget execution, also can become opportunities for trading and lobbying for spending not catered for in the budget.

Weak human and institutional capacity further slows down the effective implementation of PFM reforms. The discussion emphasised poor institutional capacity for maintaining formal budget execution systems, and the correlation between ineffective reforms and insufficient attention to the availability of and potential to build appropriate capacity in the design of reforms. Furthermore, change management processes and systematic, sustained capacity building were commonly neglected in reform implementation, particularly with regard to deconcentrated agencies and their staff.

Finally, the discussion in the first session emphasised the role of external intervention and influence in setting PFM reform agendas. This influence is both positive and negative. Reform dialogues and conditionalities attached to debt relief and budget support programmes can be linked to reform progress. However, in many countries the progress might be limited to formal changes without corresponding changes in the effective functioning of the system. These can occur only in areas of the reform agenda that are owned by local actors.

In conclusion, participants in the first session emphasised that solutions should be driven at country level. Forward reform programmes, therefore, should look at how budget transparency improvements can incentivise changed behaviour, should propose reforms that can be implemented and be strategic about reform implementation, should expect reform success to take time and be consistent in their reform priorities to allow change to occur; and should refocus on budget credibility as a key value.

Form and function in budgeting

The ability of ministries of finance to execute their crucial management duties in the economy and public finances is a function of their formal structure and mandate, the quality of their human resources and their relative standing in relation to other state institutions. The institutional foundation of fiscal entities is part of getting the basics right in the implementation of the budget. In the second session of CABRI's 7th Annual Seminar, senior budget officials engaged with recent research on the role and function of the ministry, given institutional arrangements and underlying political economy drivers.

In Chapter 3, Björn Dressel, a senior lecturer at the Australian National University's Crawford School of Economics and Governance, highlights key institutional and political economy trends that emerged from the research, and discusses the implications for strengthening finance ministries. Central finance agencies (CFAs), in other words the core ministries for managing public finances, are uniquely positioned, strategically and operationally, to influence economic outcomes. Yet, efforts to enhance the role and functioning of CFA's in many low- and middle-income countries have been mixed, at best. While in some countries CFAs function as transformative agents of change, in others they have failed in this respect or have not been able to sustain this role. Often they are ill-configured, have unclear and conflicting mandates and lines of accountability, and are hampered by capacity problems.

Dressel argues that it is necessary to move away from a purely technical view on PFM matters to a more distinct political economy view. In thinking about CFA 'capabilities', this approach would consider them as primarily embedded in a wider political, economic and structural context of a country. The value of this is in understanding that whereas human resource, technical and technological CFA capacity is necessary for effective budget systems, it does not necessarily translate into capability or performance. For example, a weak configuration and/or organisation of inputs, and a high-cost operating environment, perhaps marked by a lack of authority, may mean that even when capacity is high, capability may be low. Enhancing the capabilities of a CFA brings political economy analysis to the fore. More specifically, this involves a careful mapping of the key interfaces of a CFA with the wider institutional realm, including the formal political institutions (executive, legislature and judiciary), administrative institutions (line ministries and decentralised units), civil society (interest groups, media, etc.) and external actors (donors, international financial institutions and capital markets), as well as within the CFA itself.

A study undertaken by the World Bank combining case studies of CFAs (of which six were in Africa) and the analysis of a database on CFAs in 55 countries provided important findings on the organisational structures, staffing and technology systems of CFAs. It showed, *inter alia*: a wide variation in practices from country to country; a tendency, though, for policy functions to remain with the finance ministry, but operational functions to be devolved; and an increase in fragmentation of CFAs in middle-income countries compared to low-income countries, but a resurgence of fragmentation in high-income countries as functions become highly complex and other actors become powerful sources of financial influence.

Factors that interfere with the capability of CFAs include the use (and misuse) of presidential power, the fragmentation of CFAs for political gain, the internal constraints of CFAs such as the rise of informal practices and erosion of bureaucratic capacity, and donor co-ordination of CFA reforms.

The World Bank's and other studies suggest key parameters for CFA reform, according to Dressel, including that CFAs should be realistic and focus on what can be done within their political economy constraints and on the mobilisation of internal capability before seeking external support for capacity. Where there is a stagnant reform environment, attempts should be made to build partnerships with groups that can exert effective pressure on governments to reform – whether civil society, reform-oriented political actors or external oversight agencies, such as supreme audit institutions.

In the second part of the session, participants shared their experience of the interplay between structure and functions along two main themes, merging or splitting planning and budget functions and structuring relationships between the ministry of finance and spending agencies. In Chapter 3, Anke Braumann draws on the discussions and additional sources to argue that countries' experience supports the notion that structures do matter, but capability matters more.

Many CABRI countries have a history of alternating between an institutional structure that merges planning and budgeting in one ministry, and a structure that makes separate ministries responsible for these functions. This is no accident; there are costs and benefits to effective budgeting and PFM associated with either structure and, in practice, countries tend to revert to the one when the cost of the other becomes too high. Fragmentation can be multiple: the ministry of finance function can be split further between a ministry of the economy and a ministry of finance.

A central premise of the discussion at the seminar was that both merged and split ministries have pros and cons.

- The strength of a fragmented system lies in the separate focus and equal importance that can be laid on the planning function and the budgeting function. Separating the planning and budgeting functions also prevents the accumulation of authority in one minister, while supporting the development of highly specialised agencies and staff responsible for the planning and budgeting of a country. An important drawback of separating budgeting from planning is the loss of a resource-constrained approach to planning. The study on PFM in fragile and post-conflict states also found that separation can slow down the reform process. At the same time, separate ministries require more staff, and duplicate processes at line ministry level.
- A joined-up planning and budgeting function brings real benefits in terms of fiscal discipline, integrated planning and allocative efficiency. By having one ministry in charge, the planning/budgeting coherence at the centre translates into better coherence at spending agency and programme level. Problems in the full cycle can be identified more easily – as one ministry has a complete overview – and the reforms to address them approached more coherently. The challenging aspect of the merged planning and budgeting function is that the planning function receives insufficient focus. The concentration of all power in only one ministry can also result in some resistance by line ministries and can undermine co-operation in the budget process. Also, the plethora of tasks in a consolidated ministry can lead to overstretched human capacity.

Ultimately, what matters is how well a ministry leverages the benefits and manages the drawbacks. For instance, ministries create two divisions on the preparation side of the budget, one with responsibility for planning and the other for budgeting, but merge the execution of both budgets in one division. The planning function can be strengthened by raising the planning responsibility to a very senior level in the ministry in order to maintain the focus. Some countries have a structure whereby planning and budgeting are merged at the centre, but remain apart at the line ministry level. This means that the centre can ensure proper co-ordination, and that planning occurs at the level where better information and knowledge exists for a sector. Other countries operate with a joined-up ministry, but create a planning authority or planning commission, which often advises the president.

However, participants also pointed out that, in many cases, separation of the planning and budgeting function into two or more ministries is not necessarily driven by technical concerns; rather, it is the result of political imperatives, such as a desire to weaken the finance ministry or as part of a general increase in Cabinet posts.

The relationship between the finance ministry and the line ministries of a country more often than not is characterised by tension. Whereas the ministry of finance has an interest in keeping spending within affordable levels, and has to advise on trade-offs between line ministries' spending requests, the incentive for a line ministry is simply to maximise its share of available resources. This natural tension is often exacerbated by information asymmetry, which leads to mistrust. Participants at the seminar identified challenges that add to mistrust between the line and the centre.

Instead of having institutionalised means of information-sharing that render decision-making more transparent, there is a culture of mutual suspicion between the CFAs and their line ministries. This leads to the finance ministry not sharing information on budget constraints and imposing arbitrary cuts, and the spending agencies not sharing information on where cuts could be made, but instead overstating their budget needs up front.

Line ministries use various ways to undermine planned priorities. They spend allocated funds differently, bypass formal commitment approval processes, subvert financial management systems and then seek approval at the political level, weakening ministry of finance authority and functioning. Line ministries often overstate their fund requirements for the first two quarters and then use surplus funds to ends other than those stated in their cash-flow projection. At the same time, finance ministries do not provide certainty on forward available cash, triggering inflated statements of need.

CABRI countries, however, have developed various mechanisms to prevent or counteract budget wars between finance and line ministries:

- Finance ministries need to become more participatory and transparent in their engagement with line ministries. A periodic dialogue with the Cabinet or councils of ministers to explain fiscal constraints and to engage them in developing solutions (such as reprioritising programmes) is one important action in this regard. Countries have also established dialogue mechanisms at the official level, such as focal points in the finance ministry for exchange with clusters of ministries.
- Some countries have formalised decision paths and enforced guidelines on the procedures line ministries should follow when seeking political permission for expenditure that is not appropriated or not authorised in terms of in-year cash management. This is applied to all ministries without favour, resulting in peer pressure at the political level to follow the rules.
- CFAs must build cash-flow management practices by developing clear rules for the allocation of available cash and by making timely and predictable cash disbursements in a transparent manner, for example through multi-agency committees.
- CFAs need to provide technical support and mentoring to line ministries so that they are able to comply with regulations and enforce budget reforms. Countries have benefited from programmes that focus capacity-building efforts on accounting officers. Participants were clear that the key to improved control over public finances at the line ministry level is holding accounting officers to account, in line with their legal obligations. When accounting officers are not sanctioned, officials within line ministries are less likely to be sanctioned.

Seminar participants agreed that primary responsibility for addressing conflicts between the centre and the line rests with finance ministries, in the light of their role as custodians of public funds.

Setting the rules: legal frameworks for public financial management

The outcomes of the budget process strongly depend on whether there are clear rules for formulating, executing and reporting on the annual budget, as well as a clear statement of medium-term fiscal policy objectives (Lienert & Fainboim 2010). It is in this light that many countries periodically review their PFM legal frameworks to ensure that: (a) adequate laws are in place; and (b) they are appropriate for and conducive to good financial governance and budgetary outcomes. As elsewhere in the world, legal frameworks in Africa vary in their development, and often embody legacy systems. How these systems are reformed, and the reforms imbedded in law, also varies depending on country context and objectives. The annual seminar examined the challenges in developing, implementing and enforcing PFM legal frameworks in Africa. The seminar also explored the incentives and commitment controls that can be put in place to enforce a legal framework.

Gert van der Linde, Lead Financial Management Specialist at the World Bank, gave an overview presentation stressing the importance of a legal framework that supports key areas of the PFM process, specifically: the accountability relationship; the budgeting process; budget execution; accounting; and reporting. The vision underpinning the budget system, the legislative framework regulating it, and the standards, processes, systems and data requirements must be aligned with country-specific needs and capacity. Van der Linde highlighted the importance of getting the basics right in implementation, maintaining and protecting key stakeholder buy-in (inculcating change management processes) and, ultimately, showing results.

In Chapter 4, Nana Boateng, GIZ[1] Advisor to CABRI, draws on the country presentations in the session to discuss how and why countries reform legal frameworks. Rwanda and Morocco offer good examples of countries reforming their legal framework to capture a shift in their budget system to programme performance-based budgeting. Morocco's case was presented by Mohammed Haddad, Deputy Budget Director Morocco, while Elias Baingana, Budget Director Rwanda, presented the Rwanda case. The adoption of new laws may also address specific budgetary problems, as was the Zambian case, presented by Pamela Chibonga, Chief Budget Analyst Zambia, where the lack of a legal framework in the budget process allowed for excessive discretionary practices and a lack of harmonisation between the budget process and national development planning.

Despite shifting from a resource-based to a programme-based budget in practice, the Organic Budget Law in Morocco did not include any references to a 'programme'. Yet, at the start of the reform, the Organic Budget Law was not revised; all the measures adopted were based on statutory texts such as decrees, orders and circulars. The implementation was rolled out according to the 'GPP' (gradual, participative and pragmatic) approach. Rather than reforming the main law up front and risking getting it wrong, various legal, institutional, administrative and capacity-building reforms were undertaken to support the reform process.

1 GIZ: Deutsche Gesellschaft für Internationale Zusammenarbeit (German development cooperation).

Important statutory texts included the Prime Minister's Circular of 2001, which aimed at adapting the planning and execution of the state budget to the devolution framework, and the Prime Minister's Circular of 2003 on partnership. The development, communication and distribution of guides, together with formal training, also underpinned the process. The experimental approach made it possible to identify a number of difficulties that would have to be managed.

When the legal reform was undertaken, this too was done on a participative basis, with the involvement of all key agencies, underpinned by the necessary political backing. The proposals for the reform of the Organic Budget Law were based on four main axes: (a) improving performance in public sector management; (b) increasing transparency; (c) strengthening the sustainability of public finances; and (d) extending the role of Parliament in the budget debate. Enacting the new law, however, was not intended as the end of the reform. Communication, awareness-raising initiatives and training are necessary on the content and benefits of the reform. Managers will need support to strengthen their management capacity, and their skills will have to be aligned to the new management methods.

In Rwanda, the new PFM law was enacted after a long period of debate on the objectives of reform. The Organic Law on State Finances and Property covers the budgeting and accounting cycle in Rwanda, and has provisions that give rise to other legal instruments on procurement, treasury management, internal audit and external audit.

Before the enactment of the Organic Budget Law, the budgeting and accounting functions were guided by the 1979 Decree-Law No. 23/79. This law was problematic: it was not consistent with modern PFM; it only focused on the annual budget; it favoured line-item budgets; it promoted a dual budgeting system; and the principle of a unitary budget was not fully respected. There was also lack of transparency in cash management, and it was overly complex. Several of its envisaged administrative arrangements were never implemented. Finally, it did not provide clarity on the respective roles of Parliament and the executive.

With the enactment of a new constitution in Rwanda and the adoption of Vision 2020, the emphasis shifted strongly to outcomes and results. This had to be reflected in the new PFM law. The new law brought about fundamental changes in the PFM landscape, including programme and medium-term budgeting, the abolishment of the Courts of Accounts, the introduction of internal audit, the simplification of tax administration, and changes to the country's budget preparation processes and reporting framework.

Several gains, underpinned by changes in the formal rules, have been made since the undertaking of the PFM legal reforms. However, challenges have been encountered in the process. Key among these were the limited staff and institutional capacity to effectively execute the new PFM law and its associated laws, regulations and instructions, and the absence of critical statistical data for effective planning and monitoring. Donor requirements, such as banking arrangements and complicated accounting functions, also did not always fit easily with the provisions of the new law.

Key lessons learnt in Rwanda include that sound leadership is essential in implementing a new PFM law, as is generating awareness and creating and sustaining a critical mass of technical skills at the centre to drive the reforms. Ongoing dialogue with stakeholders and a rolling strategy for implementation are also important factors.

Zambia is currently undergoing a comprehensive reform of its PFM laws. These reforms were necessitated by the lack of a legal foundation for the country's national development planning framework and modern budgeting mechanisms, which meant that procedures and timetables were ad hoc and without legal basis.

A constitutional requirement in 2009 for new budgeting and planning legislation provided an opportunity to incorporate scheduled changes in the governance architecture into the PFM legal framework, in particular the devolution of functions to district-level councils and a strengthening of the oversight role of the National Assembly in the constitutional reforms.

However, Zambia has encountered challenges in developing the legislation, not the least of which is that two important underpinning processes, namely the constitutional reforms and devolution to district councils, have stalled. Secondly, the consultative process involving the National Assembly and civil society and institutional rivalries between planning approaches and institutions have also slowed down the process of drafting a new bill.

Fiscal decentralisation to support improved spending for service delivery

The decentralisation of government functions from national to sub-national level is argued to be a critical mechanism for the translation of public resources into responsive, effective and efficient public services. However, these benefits of decentralisation do not emerge automatically. They depend on the degree of autonomy afforded to sub-national governments in practice, the quality of PFM systems and technical and managerial capacity at the sub-national level and, critically, on the design and transparency of intergovernmental fiscal transfers.

The fourth session of the Annual Seminar considered two of these aspects, focusing on the actions required from central government. In the first sub-session, participants looked at intergovernmental fiscal transfer design and access to borrowing as important determinants of sub-national budget effectiveness and adequacy. François Paul Yatta, an independent researcher from Niger and co-author of the Africa chapter in the *Second Global Report on Decentralisation and Local Democracy* (see UCLG 2010), presented on the challenges and practice of fiscal decentralisation in Africa. In the second sub-session, participants engaged with the necessary transparency requirements in respect of fiscal decentralisation to enable local accountability for local service delivery and national accountability for the management of fiscal decentralisation. Jason Lakin, programme officer and research fellow at the International Budget Partnership (IBP), set out six draft transparency and participation principles developed by the IBP and its partners for transparency, participation and financial management at the sub-national level. Chapter 5 provides readers with a summary of the presentations and discussions.

In the last 20 years, many countries in Africa have decentralised expenditure responsibilities to sub-national government. The financing of these responsibilities through fiscal transfers or own revenue sources is critical in ensuring local accountability and the delivery of services. There are no standard patterns for fiscal decentralisation in Africa. Different countries have different configurations of revenue and expenditure assignment across differently structured levels of government, and the degree of decentralisation differ widely. For instance, local government authorities may be responsible for 0.3 per cent of consolidated expenditure (in Togo) or 23 per cent (in Uganda).

In practice, however, as set out by Yatta in his presentation, effective decentralisation is hampered by unclear legal frameworks and excessive budget controls by central government on local spending, which weakens local accountability. External financing modalities further undermine local government autonomy. Modern aid modalities (for example, budget-support and sector-wide modalities) result in the recentralisation of policies and functions in key decentralised sectors such as education, health, water and sanitation.

The design of revenue-assignment and fiscal-transfer systems, therefore, is critical for the benefits of decentralisation to be realised. Yet, with the exception of a few countries, practice is poorly developed. The prevalence of ad hoc decision-making underpins some of the key challenges associated with intergovernmental fiscal transfers in Africa. Grant systems also fail to address inequalities between regions systematically. It is rare to find formulas that promote equalisation of fiscal revenues. Many financing formulas are based on pre-decentralisation expenditures, which reflect choices made by the national government in the past, and not the current needs as defined by the assignment of expenditure responsibilities. Even where fiscal transfer design might be better, realising the transfers can be problematic. According to Yatta and Vaillancourt (2010), a pressing issue is the irregularity and unpredictability of actual transfers. In some cases, national transfers – even if allocated – never occur.

Borrowing by sub-national authorities is also supressed. Of the more than US$2 000 billion in municipal bonds in circulation throughout the world, barely 1 per cent are issued by African local governments, and then mainly by municipalities in South Africa and Morocco. Chapter 5 sets out three leading constraints on the development of local governments' capacity for borrowing: legal framework limits; limits on local government resources, preventing access to capital markets at affordable rates; and lack of adequate budgetary tools at the local level to allow for responsible borrowing.

Finally, Yatta pointed out in his presentation that weak local capacity and accountability contribute to continued resistance by central governments to the decentralisation of functions in practice and the provision of resources in a predictable manner.

The presentation by Jason Lakin looked at exactly this issue: the institutional arrangements that need to be in place in order for local accountability to be active and effective.

Many of the IBP's partners in Africa work at the sub-national, local or community level, monitoring policy, tracking financial flows to the local or sub-local level, tracking the funding of core mandates and working with local leaders to influence expenditure choices and implement budgets effectively. It is a common experience of the IBP and partners that budgets at the local level tend to be even more opaque than budgets at the central level.

In response to this common state of affairs, the IBP formed a working group on sub-national advocacy in 2010, with partners from Uganda, India, South Africa, Kenya, Indonesia and Ghana, among others. The group has elaborated six principles of sub-national budget transparency, participation and financial management, and is in the process of refining the principles and writing them up with rationales and examples. The principles are the following:

- Sub-national governments should provide fully transparent and comprehensive information to the public regarding both budgeted and actual revenues and expenditures, through all four stages of the budget process (formulation, approval, implementation and evaluation).
- Sub-national governments, like national governments, should be audited internally and externally, and external audit findings should be made available to the public within a reasonable time frame.

- Where sub-national governments have discretion over the use of funds that have been transferred to them from other levels of government, or funds collected through their own revenue sources, opportunities should be provided for local assemblies (where these exist) and citizens to give input into the budget process at multiple points from allocation to implementation and evaluation.
- The executive's budget at central and sub-national level should contain detailed information (quantitative and narrative) related to intergovernmental transfers, including, at least, their size, all rules for receiving and spending them, their distribution, the rationale for this distribution, and, where applicable, the formula by which the distribution is calculated.
- The distribution of resources across sub-national units should take account of equity considerations, and should be driven by the need/demand for services, rather than exclusively by 'supply-side considerations', such as the existing supply of infrastructure and personnel.
- Where funds are decentralised, the executive budget proposal or other publicly available, easily accessible central government documents should contain narrative information detailing the responsibilities of each level of government for the delivery of the decentralised services, the public offices or public officials within each level of government that are responsible for specific services, and the fund flows associated with those responsibilities.

Conclusion

The 7th Annual CABRI Seminar looked at common problems that underpin poor budget execution. Discussions were oriented not only to understanding the problem, but also to the sharing of effective practices by participating countries in addressing the problem.

While there are many technical problems that result in poor budget execution, two recurring themes at the seminar were around the pivotal role of politicians and the political environment either in supporting effective budget execution, financial controls and policy implementation or in undermining budget credibility, scuppering PFM reform efforts and slowing down improvements in service delivery. Participants agreed that political will was the first necessary condition for closing the implementation gap.

The second theme was the operational shortcomings of reform processes. In a nutshell, reform implementation does not engage deconcentrated actors sufficiently, ignores the need for change-management processes, undertakes capacity building in an ineffective and short-term manner and, as a result, never fully deals with the prevalence of informal systems. It is time for PFM practitioners to realise that technical changes without attention to these 'soft' factors will result merely in new ways to bypass the system, unless incentives are addressed.

Across the discussions at the seminar, five 'solution-oriented' themes emerged.

- *Do we have the right tools to manage politics?* The budget is the coalface where the political meets the technical. It is the system through which resources are allocated and used to achieve policy objectives. That is at the heart of politics. Participants acknowledged that whereas there is a lot of learning on how to use the political nature of budgets in the interests of good budget outcomes, this learning is not yet externalised and available among practitioners to a sufficient degree. Useful tools are political economy analysis, understanding how to be pragmatic and which compromises to make, and honing the skills of negotiating trade-offs.
- *Are we taking sufficient account of context appropriateness, and is the vision coherent, clear and simple?* Participants' contributions pointed to the need for matching reform proposals to the context and building capacity internally in finance ministries for reform implementation, and for being aware of when opportunities in the political cycle are present to accelerate reforms and to use these windows to turn capacity into capability. Emphasis was also placed on the need to ensure that system coherence is maintained across reforms. This would only be possible if reform agendas unfold within a systematic framework based on a clear and long-term vision for the PFM system.
- *Transparency, oversight and social accountability.* This theme centred on the increased understanding that technical reform is not enough. Finance ministries need to look at mechanisms to build oversight and social accountability, in order to change the incentives under which ordinary public servants, their leaders and political office-holders operate. This means engaging with new stakeholders, such as civil society groups, and in a new way with familiar actors, such as parliamentarians.
- *Soft issues – technical design is not enough*. Furthermore, reform implementation plans should no longer be only about technical changes to systems. They should include raising the awareness of all parties, including all stakeholders, to change the incentives for all affected parties. Change-management processes are important. Who are the likely champions of reform in organisations? How can they be supported? How can incentives

be changed in the short term to shift practice to another platform? What sanctions are effective?

- *Reforms take time and face varying contexts*. Finally, participants' contributions highlighted how successful reform can sometimes take ten years and more to embed in practice. It is important to see a reform process as cumulative and to discern when the context is right for faster progress, and when it is not, necessitating a retreat from introducing new reforms and providing space for consolidation and systematic capacity building.

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2

Framing the challenge: Common factors in weak budget execution systems

Compiled by Alta Fölscher

2.1 Introduction

The theme of the 7th Annual CABRI Seminar – Making Budgets Work: The Implementation Challenge – was driven by data that point to budgets being made better than they are implemented. The first session at the seminar sought to isolate common factors across CABRI countries that contribute to weak budget execution systems. Florence Kuteesa, advisor at the Fiscal Affairs Department of the International Monetary Fund (IMF), introduced the discussion by highlighting how inefficiencies in both budget planning and budget execution prohibit budgets from being executed as planned, and prevent the translation of governments' objectives into spending and public services. Edward Hedger, Head of the Centre for Aid and Public Expenditure at the Overseas Development Institute, reflected on key findings from a recent study on public financial management (PFM) reform in fragile states that illustrate common challenges. Vivek Ramkumar, Manager of the Open Budget Initiative at the International Budget Partnership, used the findings of the 2010 Open Budget Index to illustrate how transparency deficits contribute to poor budget execution practices. This chapter draws on the presentations and subsequent discussion by country delegates at the first session, to set out common factors in poor budget execution practices across countries, and to highlight how countries have tried to address these factors.

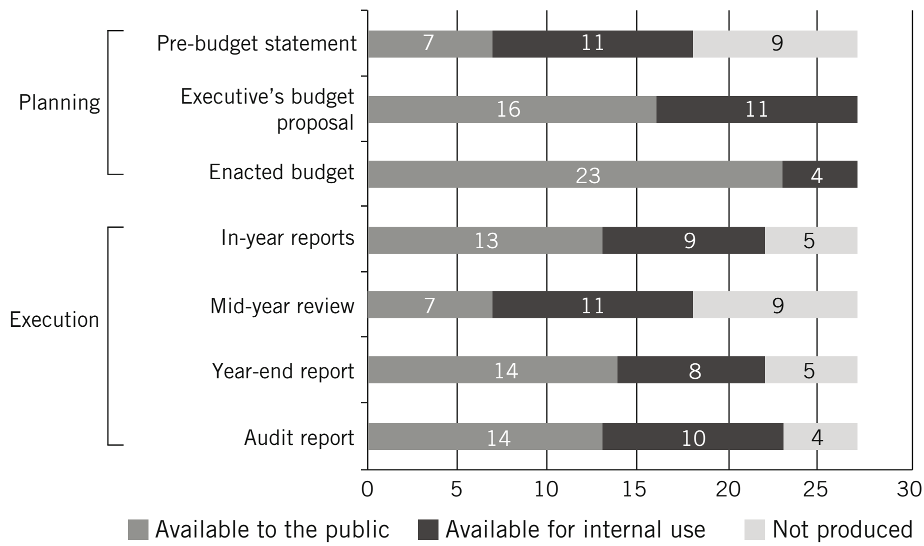
2.2 Budget execution improvements, enabling accountability and building capacity

PFM reforms are common across CABRI member and participating countries. Donor engagement in this area has increased significantly, particularly since 2000 (Westcott 2008). Yet, despite significant investment in this area, deep challenges remain. The key theme for the seminar – Making Budgets Work: The Implementation Challenge – relates to research findings in the last three years that in Africa the challenges associated with budget execution appear to be more difficult to address than the challenges associated with budget preparation.

Cross-country standardised PFM assessment instruments, such as the Public Expenditure and Financial Accountability (PEFA) assessment framework and the International Budget Partnership's Open Budget Survey, have generated reasonably comparable datasets across African countries, which point to higher functionality in budget preparation than budget execution on average. As first noted by De Renzio (2008) and confirmed by Andrews (2010) for African countries, average PEFA scores for indicators that reflect upstream budget institutions are higher than for downstream institutions. Upstream indicators include indicators assessing systems of strategic budgeting, budget preparation and legislative budget preparation, while downstream indicators include indicators assessing systems for resource inflows (tax, borrowing and donor inflows), cash management, procurement, payroll and internal controls, internal audit, accounting, in-year monitoring and annual reporting, and external audit. The Andrews study found that in 31 African countries, the difference in average upstream and downstream scores was just under 0.25, with twice as many countries scoring D on downstream dimensions than on upstream dimensions (Andrews 2010).[1]

The Open Budget Survey findings similarly reflect that countries are more transparent in respect of decisions made during budget preparation, than during budget execution. Data for 27 African countries from the 2010 Open Budget Index (OBI 2010) show that whereas 16 countries make the executive's budget proposal publicly available, and 27 countries do so with the enacted budget, only 13 publish in-year reports, 14 year-end reports and 15 audit reports (see Figure 2.1).

Figure 2.1: African countries more open in budget planning than budget execution



Source: OBI (2010)

1 In the PEFA assessment framework countries are scored 'A' when they comply with all the characteristics selected to describe good practices in a specific dimension, and 'D' when their systems are reflective of the lowest configuration of characteristics. The Andrews study, like the prior De Renzio study, calculated averages by equating an 'A' score to 4 and a 'D' score to 1, with scores in between converted accordingly.

The opening session of the seminar looked at common factors in CABRI countries that drive poorer performance. The following are key themes across the presentations and discussion.

Weaknesses in planning and budget preparation

While poor budget execution – as measured by variance between planned and actual budget aggregates, inefficiencies in spending and weak achievement of stated spending objectives – can be related to weak institutions in budget execution, it is also rooted in shortcomings in budget preparation. As set out by Florence Kuteesa in her presentation at the seminar, poor linkages between countries' national and sector development objectives and actual spending are primarily due to the fragmentation of planning at all levels of government.[2]

Ministries of finance, which oversee central budget preparation, often are not adequately engaged in processes to set national and sector objectives, which are located in planning ministries and agencies. This results in weak strategic guidance on priorities and insufficient awareness of resource constraints in planning processes. When the fragmentation of planning and budgeting at the central level feeds through to line ministry level, the situation is worsened. At the sector level, priorities are also strongly influenced by external financing providers, resulting in even further fragmentation. Consequently, policy decisions across government are neither co-ordinated nor constrained by resources; there is a lack of clarity and consistency on and commitment to expenditure priorities.

The fragmentation caused by external financing flows was also highlighted in the study on fragile states, which illustrated how multiple, separate flows of external aid are targeted at different priorities across ministries, making budget preparation highly complex.[3] Often there is widespread use of parallel systems and a lack of information available to the finance ministry regarding external flows. A failure to link budgets and policy and to link development and recurrent budgeting is also common, with separate institutional arrangements for investment and recurrent planning and budgeting.

2 Kuteesa (2011). See www.cabri-sbo.org.

3 The study, which undertook eight country case studies, of which three were in Africa, was conducted by the Overseas Development Institute and commissioned by the World Bank Fragile and Conflict Affected Countries Group (OPCFC) and the World Bank Public Sector and Governance Group. This paper draws on the discussion of the study by Edward Hedger from the ODI at the 1st session of the 7th Annual Seminar, and the materials of a workshop on the study held in Nairobi on 20th June 2011.

Earlier CABRI research (see CABRI 2008, 2010) pointed to this fragmentation undermining the incentives faced by sectors to participate fully in the budget preparation process, as well as local accountability for budget execution. A study undertaken for the PEFA secretariat (Sarraf 2005) also points towards the budget integration problems caused by the exacerbation of the initial separation between development and recurrent budgets (inherited by countries from post-Second World War practice in Europe) by channelling external financing through development budgets, whether for investment spending or not.

Furthermore, in fragile states, high levels of volatility and unpredictability and poor information on the timing of disbursements, combined with high levels of aid dependency, compromise basic budget planning and cause fragmentation throughout the budget cycle. This reflects experiences in most CABRI countries receiving development assistance flows.

CABRI countries have undertaken PFM reforms to address these issues. Key amongst these are medium-term expenditure framework (MTEF) type reforms, which are aimed at integrating various sources of financing within a consolidated framework to facilitate the making of trade-offs between priorities. Related reforms to improve linkages between national priority objectives and spending, such as the introduction of programme and performance-oriented budgeting, are also common. However, countries pointed to the difficulties experienced in these reforms taking root and delivering on their objectives. Key factors are the political will to ensure that the reforms are effective, human resource shortfalls in implementing the reforms, a lack of focus in reform efforts on managing the required changes in practices at line ministry level and weak availability and integration of information on donor financing. Some of these are discussed in more detail below.

Countries reported progress, however, with upstream reforms, acknowledging that progress is inevitably slow and requires constant adaptation of the reform plans (see Box 2.1 on the Mauritian experience with programme performance budgeting, which reflects key themes raised in the discussion).

Box 2.1: Reform implementation in Mauritius

Mauritius acknowledged that budget reform is a long-term process and that impact takes time to materialise. The Ministry of Finance and Economic Development of Mauritius has adopted a gradual or cumulative approach to budget reforms.

A key aspect of the reforms is the introduction of a programme-based approach to budgeting (see Ba 2010). Having put a broad framework for programme-based budgeting in place, the focus is on linking planning and budgeting in practice. The ministry is asking line ministries to prepare strategic plans and to base their budget proposals for the next three years on these strategic plans. The rationale is that the strategic plans are derived from long-term plans.

In addition, the ministry is reducing the number of indicators, placing emphasis on fewer but higher quality and more appropriate indicators. Emphasis is being put on new or improved data series that measure the quality and level of service for which funds are being requested and appropriated. In the earlier years, the ministry had to accept what line ministries were proposing (mainly output indicators); now, the ministry is engaged more actively in getting the right indicators in place.

Mauritius also emphasised the need to take into account the implementation capacity of line ministries, in terms of both human resources and technical expertise, when designing reforms.

Source: Seebundhun (2011)

This experience was also reflected in fragile states. Whereas multi-year fiscal planning was introduced successfully, and getting a basic annual budget 'up and running' was an immediate priority to ensure that government expenditure could be authorised, executed and reported against, there was limited success in extending these reforms to medium-term expenditure planning and programme budgeting in many post-conflict countries.

Poor budget credibility

When these budget preparation weaknesses are combined with unrealistic revenue projections, leading to persistent cash shortages during the budget year against the approved budget, countries' focus on maintaining fiscal discipline creates the circumstances for the budget to legitimately be remade during the spending year, as decisions need to be reached on which approved spending objectives should be financed with the available cash.

An initial impact of this practice is that the ability of Parliament to hold the executive to account for budget implementation in line with the approved budget is undermined. Frequent budget adjustments, reallocation of resources and virements mean that the budget becomes a pool of resources, rather than a binding prioritisation framework (Kuteesa 2011). The resulting lack of discipline in budget execution also allows the introduction of new spending priorities during the fiscal year, in turn undermining incentives on planning and budget discipline and locking countries in a downward spiral.

Transparency and horizontal accountability remain weak

Despite the budget-execution reforms in post-conflict states yielding results, these results have not been translated into improved budget accountability and oversight. Reforms enabling legislatures to play an effective role in budget oversight have received less attention and have registered less progress. The main constraints on effective oversight concern parliamentary follow-up and oversight. However, greater openness, by virtue of improved fiscal and financial reporting, has led to some improvement in engagement by civil society with the budget and spending.

The Open Budget Survey (OBI 2010) found that budget oversight was weak in a significant number of African countries assessed. Besides looking at the coverage of information provided to the legislature throughout the budget cycle, the survey also probed how budget processes provided access for the legislature and the exercise of its powers. Key findings for Africa in the survey were the following:

- Eighteen out of the 27 African countries surveyed, scored in the lowest two categories of minimal and scant information provided by the executive. However, 13 out of 26 countries improved their scores since 2008. Uganda, Ghana, Namibia, Botswana, Kenya, Egypt, Malawi and Tanzania scored in the middle group of countries that provided some information, while South Africa achieved the highest score of the 94 countries surveyed worldwide.
- As is illustrated in Figure 1, more African countries provided information in the budget preparation phase, than in the budget-execution, reporting and audit phases.
- With regard to the budget process, the executives in 16 of the African countries surveyed do not consult with the legislature as part of the process of determining budget priorities.
- In 11 of the African countries surveyed, the legislature receives the executive's budget proposal less than six weeks before or after the start of the fiscal year; in only nine countries does the legislature receive it more than three months before the start of the fiscal year.
- In only six of the African countries surveyed can the legislature make unlimited changes to the budget. In 11 countries, the legislature can make no changes, or its authority is very limited.
- In 11 of the African countries surveyed, legislature committees do not hold hearings on the budgets of individual ministries. In 19 countries, the pubic cannot provide testimony at these hearings, even if they are held.

- In 12 of the 27 African countries surveyed, audit reports are not scrutinised at all by a committee of the legislature, or only some audit reports are scrutinised.
- Finally, the survey found that in 17 of the African countries surveyed, the executive can move funds between administrative units without seeking input from the legislature (or the amount allowed is significantly large enough to undermine accountability to the legislature) or it can move funds and only seek approval afterwards.

Taken together, these findings point to key factors in the institutions that govern the relationship between the executive and the legislature that undermine strong horizontal accountability. A study on the status of good public financial governance in Africa, jointly undertaken by CABRI, the African Tax Administration Forum (ATAF) and the African Organisation of Supreme Audit Institutions (AFROSAI), also identified weak fiscal transparency and weak accountability institutions as key factors detracting from good public financial governance in Africa. Specifically, the study found that: (a) despite evidence of better internal availability of information, too many countries still provide scant or no information on fiscal decisions, the state of the public finances and the compliance of actors in the public resource management cycle with laws and regulations; and (b) African countries perform poorly in terms of budgetary oversight, due largely to inadequate independence, a lack of resources and procedures in supreme audit institutions, deficiencies in parliamentary powers, lack of political will to follow up on the recommendations of supreme audit institutions and a lack of co-operation by the executive (CABRI, ATAF & AFROSAI 2010).

Discussion at the seminar emphasised the importance of improving the content, accessibility and usefulness of budget documentation as a key measure to engage the legislature and the public, and to catalyse improved accountability. The example of Uganda was provided, where improved coverage and usefulness of information to the legislature triggered increased interest in budget oversight (Kuteesa 2011).

Political engagement in the budget process

A key theme in the first session and throughout the seminar was the impact of political decision-making on discipline in the public financial management cycle. The impact can be both positive and negative. Key aspects highlighted in the first session include the following.

- In fragile states, domestic political commitment and reform leadership were key factors in establishing PFM systems. Political commitment was often incentivised because a functioning PFM system was required to centralise financial control, secure the allocation and execution of public spending and build government and state legitimacy. The role of improved PFM in supporting the flow of external financing, on-budget aid and international recognition was also an important driver of political commitment. The finding across states was that the choice of minister of finance was fundamental; in many states the minister was a former or seconded staff member from an international financial institution, with international contacts and reputation. At the same time, however, PFM was not the first or instinctive priority for the government in fragile states. The dominant domestic political pressures were to secure and maintain political stability across groups, which influenced the distribution of portfolios and the allocation of spending.
- Participating CABRI countries reported in the discussion on how efforts to improve discipline in budget execution were undermined frequently by politicians presenting new spending priorities during the fiscal year. Cabinet processes, instead of supporting vertical accountability for budget execution, became opportunities to lobby for areas not catered for in the budget.

Acute human and institutional capacity weaknesses and prevalence of informal practices

Both the discussion in the first session and the formal presentations highlighted how weak human and institutional capacity slow down effective implementation of PFM reforms. In fragile states, protracted conflicts reduce the imprint of historical practice, destroy physical infrastructure and lead to qualified professionals emigrating. The result is that formal systems and processes are displaced by fragmented and informal practices, which were already features (in some cases) of the pre-conflict era.

The prevalence of informal practices during budget execution, and their acceptance as the norm, is an important driver of weaker performance in budget execution. The 2010 CABRI et al. study found that formal and informal institutions interact in each of the areas of the resource management cycle. Despite states reforming legal frameworks, establishing and reforming institutional structures and introducing new approaches, rules and procedures, and decisions continue to be influenced by well-entrenched informal practices. In budget management, the bypassing of budget planning processes and execution controls undermines the rule of law. The formal procedures of audit and oversight are often delayed interminably or are merely procedural. Overall, the study found that the persistence of informal practices in financial governance is entrenched in the incentives that key stakeholders from the civil service, the executive and legislatures face (CABRI et al. 2010).

The discussion also emphasised the correlation between ineffective reform and insufficient attention to the availability of capacity in the design of the reforms. In this, again, it echoed the findings of the good public financial governance study (CABRI 2010), which highlighted how common reforms in PFM on the continent – such as the development and use of sophisticated fiscal forecasting models, the development of costed sector plans, the implementation of financial management information systems, the shift to a risk-based system of internal audits, the development of professional audit capacity and full oversight of increasingly sophisticated public finance approaches – require high professional technical and managerial skills that are very rarely available.

Change-management and capacity-building neglected in reform implementation

Discussion from the floor highlighted the importance of reform implementation including a change-management approach. Designing new systems, changing the law and issuing instructions from the centre are usually not enough to change how decentralised actors behave. As much of budget execution is under the control of actors in ministries, departments and agencies (and, in some cases, sub-national governments), budget execution improvements require active engagement by reform drivers with organisational change at these levels. Yet, to date, this (and capacity development) has been either overlooked or only thinly included in strategies for reform implementation.

The presentation on PFM in fragile states highlighted how early reforms primarily focused on central PFM ministries and agencies, and on budget execution, because the objective was to establish financial control and fiscal discipline. The control was established by strengthening the finance ministry and central agencies, and removing the discretion of decentralised agencies.

This early and consistent priority given across cases to budget execution reforms paid off, with revised charts of accounts, centralised cash management, automated treasury systems, strengthened commitment controls and improved fiscal and financial reporting being common focuses.

Where reform efforts were expanded to line ministries, the focus was often on the social sectors (health, education and social protection) through donor-involved mechanisms such as sector-wide approaches, pooled funds or technical assistance coupled to sector support programmes. In both post-conflict and other states, reform processes in respect of sub-national PFM came long after central reforms. An exception that was highlighted here is Sierra Leone, where improvements in sub-national PFM were part of early reform initiatives. This included the roll-out of automated control and accounting systems to ministries, departments and agencies.

The weak attention in PFM reforms to institutions and capacities at deconcentrated levels of government highlighted at the seminar correlates with the Andrews (2010) findings based on the PEFA results for 31 African states that where PFM dimensions involved concentrated actors (such as bank reconciliations), the average score is much higher than aspects involving deconcentrated actors (such as the reconciliation of suspense accounts and advances). Almost twice as many countries scored 'D's on deconcentrated dimensions than on concentrated dimensions.

External intervention and influence

Finally, the discussion emphasised the role of external intervention and influence in setting PFM reform agendas. In the fragile states and other CABRI countries, policy dialogue and policy conditions, through the Heavily Indebted Poor Countries (HIPC) initiative and IMF programmes and budget support, to name a few, played a role in catalysing or driving reform progress by governments.

However, in many countries the progress might be limited to formal changes, without corresponding functional or transformative measures, as the underlying incentives remain unchanged. Formal changes are instituted (for example, the establishment of internal audit and procurement units, in line with changes in the legal and regulatory framework) but with limited functionality (internal audit remains inactive or ineffective or, in practice, the new procurement processes are bypassed with business as usual).

Again this discussion reflects the finding of both CABRI at al. (2010) and Andrews (2010) that African countries have put in place formal legal frameworks and changed formal processes, but that changes in behaviour lag behind. Further research by the International Budget Partnership also shows that several countries have enacted budget laws containing transparency provisions. However, practice lags behind these laws. In some cases, this is because the laws are not sufficiently explicit and detailed on budget transparency requirements (see Table 2.1).

The recommendations arising from CABRI et al. (2010) highlighted the urgent need for African countries to take charge of their reform agendas, and to develop reform plans that are country-appropriate. This would require the development of technical capacity to lead reforms, the positive effect of which was illustrated by examples from Mauritius and Uganda

Table 2.1: Extent of transparency provisions in budget laws

Extent of transparency provisions in budget laws	Number of countries	Country names
No provisions	10	Algeria, Angola, Botswana, Burkina Faso, Ethiopia, Madagascar, Mali, Mozambique, Namibia, Sudan
Minimal provisions	6	Ghana, Kenya, Senegal, Tanzania, Uganda, Zambia
Extensive provisions	5	Liberia, Nigeria, Rwanda, Sierra Leone, South Africa

Source: Ramkumar (2011)

2.3 Conclusion: important focuses in addressing weak budget execution

The first session at the 7th Annual CABRI Seminar highlighted key factors driving weak budget execution (compared to stronger budget preparation) in CABRI countries. The discussion emphasised how weaknesses in budget planning and budget execution are mutually reinforcing, as poor planning requires frequent adjustments during budget execution, which, in turn, undermines horizontal and vertical accountability and discourages effective planning and budget preparation, as in-year processes decide the real budget.

Participating countries reflected on their reform programmes to address weak budget execution, in the light of presentations on budget transparency and accountability, and PFM in fragile states. Discussion emphasised: the compounded effect of fragmentation in budget planning and execution; poor budget credibility; external influence on reform programmes emphasising reforms requiring high capacity; a focus in reforms on centralised mechanisms and actors; little or no focus in reform implementation programmes on capacity development and organisational change management throughout government; the prevalence of informal practices; and weak transparency and horizontal accountability.

The discussion framed the issues as being about bottom-up and top-down shortcomings throughout the budget process, as well as being driven by technical and governance deficiencies.

Participants emphasised that solutions should be driven at country level. Taking that into account, in order systematically to address budget execution deficiencies, future reform programmes should, among other matters:

- look at how budget transparency improvements can incentivise changed behaviour. The session set out the links between budget transparency and improved accountability through legislative and public engagement. However, it also identified how transparency alone is not always enough: reform programmes should be more deliberate about the mechanisms through which transparency could translate into higher accountability.
- design reforms that can be implemented, and be strategic about reform implementation. The session included significant discussion on the need to broaden the focus of reforms from the centre of government and ministry of finance's top-down mechanisms to building capacity and changing the behaviour of bottom-up actors.
- acknowledge that effective change takes time, and countries should be very strategic in targeting the functional changes they would like to see. These changes should then be effected through long-term, responsive implementation programmes aimed at a desired outcome, rather than specific technical mechanisms.
- refocus on budget credibility as a key value, with the implications this has for budget preparation, budget execution and vertical and horizontal accountability mechanisms.

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3

Form and function in budgeting: Structures matter, but capability matters more

3.1 Introduction

The ability of ministries of finance to execute their crucial management duties in the economy and public finances is a function of their formal structure and mandate, the quality of their human resources and their relative standing in relation to other state institutions. The institutional foundation of fiscal entities is part of getting the basics right in the implementation of the budget. In the second session of CABRI's 7th Annual Seminar, senior budget officials engaged with recent research on the role and function of the ministry, given institutional arrangements and underlying political economy drivers. In this chapter, Björn Dressel, a senior lecturer at the Australian National University's Crawford School of Economics and Governance, outlines key aspects of his presentation at the seminar, including the findings of an explorative World Bank study that combined analysis of institutional data on the central finance agencies of 55 countries with ten in-depth case studies. In his article, Dressel highlights key institutional and political economy trends that emerged from the research, and discusses the implications for strengthening finance ministries. The article is juxtaposed with shorter reflections on the seminar discussions about two key sets of institutional arrangements that affect the finance ministry's role, namely whether the finance ministry incorporates both planning and budgeting functions, and the relationship between finance ministries and spending agencies. Anke Braumann, GIZ advisor to the CABRI Secretariat, compiled these brief reports.

3.2 Enhancing the capabilities of central finance agencies

Björn Dressel

Central finance agencies (CFAs), in other words the core ministries for managing public finances,[1] are uniquely positioned, strategically and operationally, to influence economic outcomes (see CGD 2008). As the agency in control of public resources, a CFA marshals and deploys resources to achieve desired objectives and outcomes, while simultaneously exercising guardianship over the public purse through its institutional roles, provision of incentives and administrative culture (Wanna, Jensen, De Vries 2003). Combined with the numerous other functions (core and non-core) that CFAs undertake, they are assigned predominant responsibility for the shaping

1 Terminology and organisational structures differ across countries. Some countries use the term 'Treasury', others 'Department of Finance' or 'Ministry of Finance'. Organisational structures also tend to differ. Some countries opt for a single super-ministry responsible for finance, economy, planning and industrial policy; many others scatter accountability for fiscal and economic management among ministries (e.g. Ministry of Finance and Ministry of Economy). There is also the option to separate the Ministry of Finance from the budgeting function. Hence, 'central finance agency' is used as an encompassing term to describe the core ministry for managing public finances (single or in multiple combinations).

of resource decisions and supervision of the public finances.[2] Moreover, as the *first among equals* of bureaucratic agencies and, thus, the 'nerve centre' of government, CFAs are also central to reform itself; often their power and leadership critically determines the scope and content of the reform process (Scott 2008).

However, efforts to enhance the role and functioning of CFAs in many low and middle income countries have been mixed, at best (IEG 2008). In some cases, CFAs have become truly transformative agents of change, providing critical leadership for a wide array of PFM reforms that have had far-reaching effects on macroeconomic stability and the efficiency of resource allocation and, thus, on growth and poverty reduction. In others, however, they have either failed to assume a transformative role or failed to sustain it over time. Instead, much to the detriment of economic outcomes, CFAs have often been ill-configured and have had unclear and conflicting mandates and lines of accountability. Their effectiveness has been hampered further by capacity problems in areas like human resources, accounting and budgeting, and information technology. The question then is: What explains these very different outcomes? Perhaps more importantly: How do we go about strengthening CFAs?

Drawing on debates about problem-driven governance and political economy analysis (see Fritz, Kaiser & Levy 2009) and presenting findings from a recent World Bank study of CFAs in low income countries, this paper argues that what is needed is to move away from a purely technical view on PFM matters to a more distinct political economy view. This view should shift the debate away from the current paradigm of capacity building to a more distinct focus on 'capabilities' and, in doing so, should consider the broader embeddedness of a CFA in the wider political, economic and structural context of a country. Combined, such a view promises to open up new avenues for current efforts to strengthen CFAs, above all by providing a set of reforms that are a 'good fit' for a given context, and thus can rely on country ownership.

Towards a political economy framework of CFA strengthening

Governance and political economy analysis has gained increasing attention in the wider development community over the last decade (see DFID 2006; OECD 2010; SIDA 2006), though its operational application to the sector and project level,

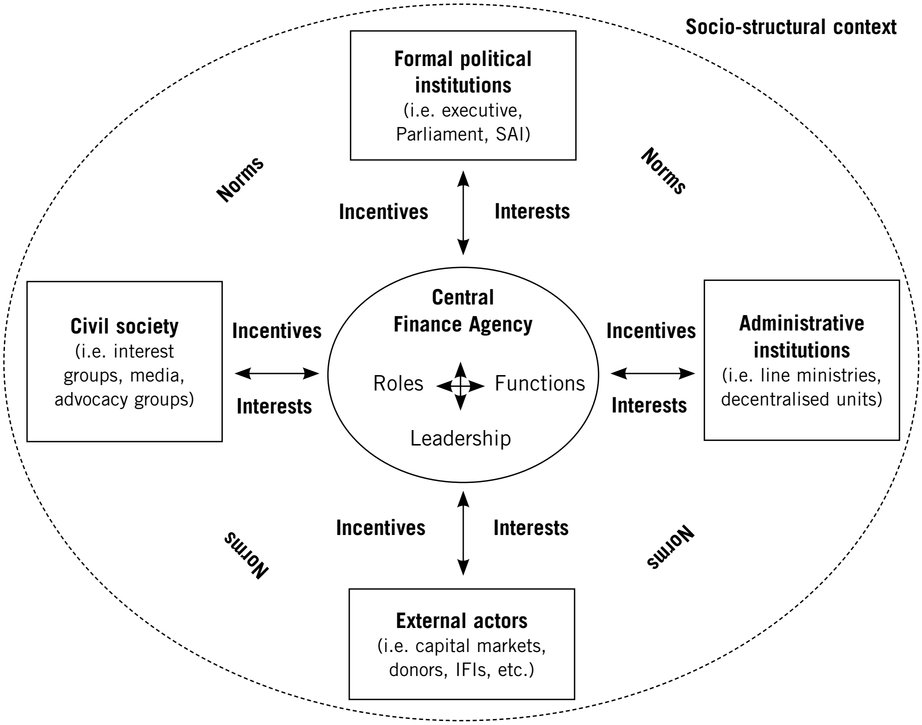
2 For simplicity's sake, 16 core functions can be identified: macroeconomic forecasting and analysis; tax policy; budget preparation and analysis; public investment management; aid and debt management; financial assets and liabilities; intergovernmental fiscal relations; treasury and cash management; accounting and reporting; internal audit; public procurement; civil service pay; financial sector regulations; financial framework for managing state-owned enterprises (SOEs); tax revenues and customs administration; and public financial management (PFM) reform co-ordination.

particularly in areas such as PFM, has remained limited (Hedger & Agha-Kizilbash 2007). Recent debates around *problem-driven* governance and political economy analysis have sought to address these shortcomings by urging a more problem-oriented approach that would take an existing problem or vulnerability as a start before 'drilling down' on issues by mapping out major institutional arrangements (i.e. institutions, laws, policy processes, etc.) and the underlying political economy drivers (i.e. actors, incentives and structural constraints) in order to understand why things are the way they are and to derive a set of actions that are fitting and feasible within the current context (see World Bank 2011).

Applied to the aforementioned context of CFA strengthening, the implications of such an approach are twofold. Firstly, when it comes to understanding existing vulnerabilities in CFA functioning, it is helpful to move away from the current focus on 'capacity' to a new analytical focus on 'capability' instead. Capacity and capability are used interchangeably at times, but are clearly distinguishable: the former refers to the volume or scope of CFA inputs of an appropriate quality (determined, for example, by the IT or human resource base), while the latter is about converting that volume into performance. The two are linked: where capacity is low, capabilities are also likely to be constrained. However, a weak configuration and/or organisation of inputs, and a high-cost operating environment, perhaps marked by a lack of authority, may mean that even when capacity is high, capability may be low. Conversely, there may be cases where a CFA has low capacity, but scarce resources have been put to effective use due to a supportive operating environment, thus creating considerable capabilities. In short, thinking about CFA strengthening requires, first and foremost, an analytical focus on capability rather than capacity, because it is the latter that ultimately determines the role and effectiveness of a CFA in the PFM process.

Secondly, seeking to enhance the capabilities of a CFA requires us to bring political economy analysis to the fore. More specifically, this involves a careful mapping of the key interfaces of a CFA with the wider institutional realm, including the formal political institutions (executive, legislature and judiciary), administrative institutions (line ministries and decentralised units) and civil society (interest groups, media, etc.), external actors (donors, international financial institutions and capital markets), as well as within the CFA itself. Combined with the broader socio-structural context that provides the boundaries for these institutional dynamics to unfold, such a view allows us to clearly understand the political economy dynamics that shape the functioning and ultimate capabilities of a CFA in respective areas of PFM (see Figure 3.1).

Figure 3.1: The political economy context of CFAs



Source: Dressel & Brumby (2009)

As this framework clearly indicates, strengthening capabilities is a complex endeavour. The capabilities that a CFA can bring to bear are not determined simply by existing technical capacities or resources, but rather are best understood as the outcome of the complex interplay between institutions, actors and structural constraints (Stevens 2004; Von Hagen 2005). It is precisely for this reason that a political economy approach is so valuable. It recognises and clarifies these complex external dynamics, while at the same time drawing attention to internal factors that traditionally have been neglected, such as: the culture, morale and incentives of the organisation; the quality and experience of its management and staff; the organisational structure; and the business processes that underpin the organisation and its information and human resource management system. In short, in providing a contextual and dynamic understanding of capability issues, a political economy approach is critical to the goal of CFA strengthening.

The World Bank CFA study: some preliminary findings

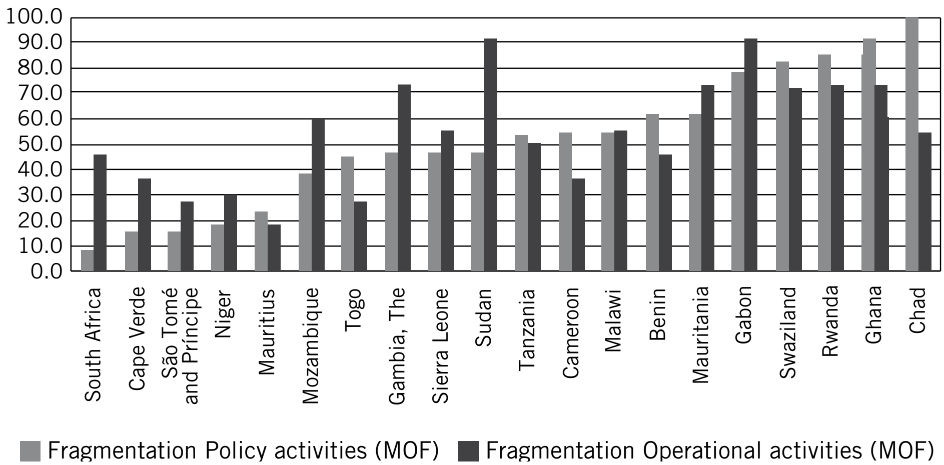
Guided by these broader theoretical assumptions, the World Bank launched an explorative study of CFAs in 2008. It combined a set of in-depth case studies of CFAs in low-income countries (six in sub-Saharan Africa, two in the East-Asia-Pacific region and two in Latin America) with the creation of a database (currently of 55 countries) containing information on the organisational structures, staffing and ICT systems of CFAs across a broad spectrum of countries. The full findings of the study are captured elsewhere, but a few points are highlighted below (see World Bank 2011).

As far as the CFA data-collection effort is concerned, the database has highlighted a number of interesting patterns, including:

- the wide variation in practices from country to country, including functional fragmentation (despite CFA activities mostly being carried out by the central finance ministry itself), staffing numbers (the average size of a ministry of finance is 1 100 members), gender (female managers representing less than 4 per cent of the sample) and ICT use (with 67 per cent having some form of Internet or electronic knowledge exchange);
- the tendency of policy functions to remain within the ministry of finance, while operational functions (e.g. revenue collection and public investment management) are often devolved to subordinate agencies and/or line ministries;
- a broader pattern, whereby in middle-income countries fragmentation tends to decrease as finance functions are consolidated within central ministries of finance, but to increase as countries develop further (as the automation of routine operations and the capabilities of line ministries grow) – perhaps best described in terms of a U-curve; and
- the trend of resource-rich countries being more prone to fragmentation (as other actors – such as an energy ministry or a national petroleum company – become powerful sources of financial influence), while fragile states are often less fragmented, given the unique opportunity to consolidate fiscal functions due to the emergency status of public finances, donor pressure and fragility of political claimants.

The sub-sample from sub-Saharan Africa is a good illustration of this. It shows not only a wide variation in patterns of fragmentation but also distinct differences in operational and policy fragmentation across countries from the region (see Figure 3.2).

Figure 3.2: Operational and policy fragmentation (sub-Saharan Africa sample)



In terms of some of the qualitative findings from CFAs in selected countries, the study also highlighted several distinct political economy aspects that interfere with the capabilities of CFAs, including:

- *the use (and misuse) of presidential power* (e.g. considerable interference of the executive in budget planning and execution, as well as distribution of material benefits through informal channels outside the control of the ministry of finance);
- *fragmenting the CFAs for political gain* (e.g. the deliberate fragmentation of CFA functions as part of a 'divide and rule' strategy aimed at serving political purposes, such as distribution of rents, accommodation of a transitional compact, etc.);
- *internal constraints of CFAs* (e.g. erosion of bureaucratic capacity due to persistence of informal structures that interfere with recruitment and performance systems); and
- *donor co-ordination of CFA reforms* (e.g. dysfunctionalities introduced by lack of donor co-ordination or bidding-up and slicing of programmes).

While reflecting the rather complex picture that emerged from the case studies, these points do provide interesting connections with a number of recent studies that have sought to expand the understanding of weaknesses in existing PFM systems reform efforts from a broader theoretical and empirical perspective, though clearly more work is required here (see Andrews 2009; De Renzio 2011).

Operational implications

As illustrated by these World Bank study findings, political economy analysis is highly relevant to the design and implementation of new initiatives to strengthen CFAs and their capabilities. A broader political economy analysis not only provides for understanding the existing vulnerabilities and bottlenecks in CFA operations but also helps clarify the prioritisation and sequencing of CFA and PFM reform, and facilitates the aim of fostering a greater CFA role in the countrywide development trajectory. That said, such analysis requires time and resources, and in many ways needs new modes of engagement for CFA staff as well as donors.

Indeed, two distinct implications might be drawn for these respective groups. Thus, CFA staff should:

- consider using political economy analysis to better understand the drivers and dynamics of the CFA/PFM reform process. More specifically, where there is a dynamic reform environment, CFAs should focus on what can actually be done within the limits of the political economy constraints, rather than attempting reforms to please the donor community. Where there is a stagnant reform environment, attempts should be made to build partnerships with groups that can exert effective pressure on governments to reform – whether civil society, reform-oriented political actors, or external oversight agencies, such as supreme audit institutions;
- focus on the mobilisation of internal 'capabilities' before seeking donor support in capacity building. This would include efforts to optimise internal workflow and resource use, to strengthen routes of accountability and transparency mechanisms, to emphasise leadership from within and to clarify and consolidate engagement with donors; and
- have realistic expectations. CFA transformation takes time, is often incremental and is hardly a linear process. Much ultimately depends on the ability to combine technical excellence with the ability to build and sustain reform coalitions.

Likewise, external actors (e.g. donors and international financial institutions) should make use of political economy analysis as a filter before launching new lending projects, and during the preparation and implementation of such projects. Moreover, a political economy approach would also urge external actors to:

- invest in the development of a continuing dialogue with political leaders and other stakeholders who can be instrumental in driving the reform effort;
- refocus CFA reform strategies on 'best-fit' solutions rather than 'best-practice' models;
- provide more intensive advice to clients on change management practices and efficient project management; and
- review the human resource management policies (including policies on rotation) in respective agencies to develop deep country and stakeholder knowledge of political economy aspects of reform.

In sum, applying political economy analysis in this manner entails a very different mode of operation – one, however, that is critical when seeking to enhance the capabilities of CFAs.

Moving forward: open questions and debate

Clearly, these are only the initial contours of a more distinct political economy approach to strengthening the capabilities of CFAs. More thinking is still required. For instance, as highlighted in discussions during the CABRI 2011 Annual Seminar, it is important to further qualify the characteristics of 'capabilities' versus 'capacities', perhaps by linking the former more clearly to the organisational literature.[3] Similarly, further research is required on the issue of functional fragmentation, not just among agencies but also within a particular ministry – an aspect only partially covered by the World Bank study. Indeed, fragmentation (policy or operational) of CFA functions might be manageable (or even desirable) as long as clear co-ordination, and monitoring and evaluation systems are in place, though there seems to be agreement that such arrangements would require a lead agency for enforcement purposes. Finally, more data collection regarding CFAs might be useful. The latter could support efforts to establish a basic baseline of CFA capabilities for future comparison, while also strengthening linkages to existing PEFA indicators, in order to start a

3 The literature on 'dynamic capabilities' provides an interesting starting point for this (see Pablo et al. 2007).

more informed debate about how to enhance CFA capabilities and to chart a reform trajectory that can claim ownership and wider stakeholder support.

These open questions aside, there are few doubts that political economy analysis, along the lines described here, can provide operationally useful insights for CFA strengthening efforts. Indeed, by providing a distinct toolkit of analysis and critical focus on CFA capabilities, such an approach offers a much needed new avenue for PFM reform efforts and CFA strengthening, one that deserves greater attention from scholars and practitioners alike.

3.3 The planning-budgeting link: split or merged?

Anke Braumann

Many CABRI countries have a history of alternating between an institutional structure that merges planning and budgeting in one ministry, and a structure that makes separate ministries responsible for these functions. This is no accident: there are costs and benefits to effective budgeting and public financial management (PFM) associated with either structure and, in practice, countries tend to revert to the one when the cost of the other becomes too high.

The heart of the problem is that whereas affordable, effective and efficient budgets require planning to be in terms of resource availability and budgeting in terms of plans, these two functions require different focuses and skills that can be hard to combine in one institution. Participants at the seminar recounted their countries' experiences in structuring the planning and budgeting functions to address this central dilemma.

In a separated structure, typically, a planning ministry would assume responsibility for long-range planning, public investment planning and co-ordination, and the direction of sector or spending agency planning, albeit through regulation, guidelines and/or the provision of support. Often, the planning ministry would take responsibility for allocating public investment funding through the development budget. The ministry of finance, then, would be free to focus on current and medium-term economic and fiscal policy, medium-term and annual recurrent budgeting, debt management, resource mobilisation, treasury functions, the regulation of budget execution, accounting and reporting, internal audit and monitoring of the finances of the wider public sector (see Schiavo-Campo 2007 for a discussion on the allocation of functions between ministries of finance and planning). Of course, as highlighted in the article by Björn Dressel, fragmentation can be multiple: the ministry of finance function set out here can be split further between a ministry of the economy and a ministry of finance. It can also be organised along different lines, with a finance ministry taking responsibility for planning and policy, and a Treasury or expenditure ministry taking charge of budget execution, monitoring and reporting functions.

A central premise of the discussion at the Annual Seminar was that both merged and split ministries have pros and cons. Ultimately, what matters is how well a ministry leverages the benefits and manages the drawbacks.

However, participants also pointed out that, in many cases, separation of the planning and budgeting function into two or more ministries is not necessarily driven by technical concerns; rather, it is the result of political imperatives, such as a desire to weaken the finance ministry or as part of a general increase in cabinet posts.

Managing fragmentation

Most of the represented countries have split the planning and budgeting function between two or more ministries. The strength of this system lies in the separate focus and equal importance that can be laid on the planning function and the budgeting function. Separating the planning and budgeting functions also prevents the accumulation of authority in one minister, while supporting the development of highly specialised agencies and staff responsible for the planning and budgeting of a country.

An important drawback of separating budgeting from planning is the loss of a resource-constrained approach to planning, which leads to very weak linkages between planning and budgeting when what is implemented in practice is guided by available resources and not the plan. A recent study on PFM in fragile and post-conflict states also found that separation can slow down the reform process (see Box 3.1).

Box 3.1: Fragmentation of CFA functions slows down PFM reform in fragile states

A study on PFM reform in fragile states, commissioned by the World Bank and undertaken by the Overseas Development Institute,[4] found that the reconfiguration of institutional arrangements for PFM to consolidate responsibility for budgeting and planning under a single CFA supported the technical reform process, while fragmentation undermined it. For example, the merger of the budget bureau with the finance ministry in Liberia in 2007/08 streamlined the budget process and addressed the bifurcation of reporting lines to the Presidency on budget policy. However, full integration in Liberia is still underway. Similar experiences were found in Kosovo and Afghanistan. In the Democratic Republic of the Congo, however, the split of the Ministry of Economy, Finance and Budget in 2002 into three separate ministries was detrimental to the reform process, because it removed the possibility of a single co-ordinated role for the minister of finance to lead reforms across PFM domains, and it created overlapping mandates.

The study, however, also found that efforts to consolidate and rationalise PFM functions and responsibilities can take a long time and can consume significant reform energy on account of vested interests on both government and donor sides. Integration threatens the power bases in governments that operate through ministerial portfolios and allow, for example, access to the president and direct separate engagement with donor agencies.

In fragile states, the link between recurrent and investment budgets has been a particularly challenging area, leading to significant inter-ministerial and inter-departmental co-ordination failures. In Sierra Leone and Kosovo, where the functions are located in the same ministry but still through separate units, planning and budgeting linked to the recurrent and investment budget continue to operate as semi-distinct processes. Efforts to address this issue were directed not at organisational merger, but rather at improved co-ordination, for example linking recurrent budgeting to investment expenditure.

Overall, the study found that there were two opposing pressures for concentration and fragmentation of CFA functions in fragile and post-conflict states. On the one hand, there was recognition of the need to concentrate responsibility for public financial management (ministers of finance enjoyed high levels of political support from the president in the post-conflict period). On the other hand, the need to secure political settlements could also drive the allocation of separate economic portfolios.

4 This box is based on notes provided by Edward Hedger, Head of the Centre for Aid and Public Expenditure at the Overseas Development Institute. For a summary of the study findings see Fritz, Hedger and Fialho Lopes (2011).

At the same time, separate ministries require more staff, which participants said was challenging as they contend with limited administrative capacity and skills' scarcity in the public sector. For line ministries, the 'double engagement' with both the planning and budgeting ministries can also represent a costly burden on their time. This is due to poor co-ordination between the two ministries, which do not always resolve differences in their approach or duplication and overlap in processes and information requested. The bigger cost of poor co-ordination, however, is the lack of integration between planning and budgeting, between the investment portion of spending and recurrent spending. Participants reported that where the planning ministry also does the investment budget, the finance ministry can struggle to get timely, comprehensive and reliable information on the investment budget. On the other hand, when the investment budget is drafted by the planning ministry, the finance ministry can be reluctant to take responsibility for it during budget execution.

In order to overcome these problems, participants reported that good use of information and communication technology is crucial for better co-ordination between ministries. Some countries have addressed co-ordination problems either by having only one minister responsible for both ministries, or by clearly designating the finance ministry as the co-ordinating ministry. While the ministry of planning, therefore, would be instrumental in putting together an investment budget, the finance ministry would present both budgets, with the execution of these budgets also resting with it. This solution also eases budget reform co-ordination, by enabling the finance ministry to play a leadership role. Lastly, co-ordination between fragmented ministries can also be built through the creation of inter-ministerial committees, such as a national budget committee.

The consolidated planning-budgeting function

A joined-up planning and budgeting function brings real benefits in terms of fiscal discipline, integrated planning and allocative efficiency. By having one ministry in charge, the planning/budgeting coherence at the centre translates into better coherence at spending agency and programme level. Problems in the full cycle can be identified more easily – as one ministry has a complete overview – and the reforms to address them approached more coherently.

The challenging aspect of the merged planning and budgeting function is that the planning function receives insufficient focus. This has several dimensions: long-term planning can fall by the wayside and, even in short and medium-term planning, the focus can be predominantly at the input-output level, and insufficiently at the outcome-impact level.

The concentration of all power in only one ministry can also result in some resistance by line ministries and can undermine co-operation in the budget process. Also, the plethora of tasks in a consolidated ministry can lead to overstretched human capacity.

Participants pointed out, however, that joining up planning and budgeting in one ministry does not necessarily resolve co-ordination challenges between budgeting for public investment and budgeting for the recurrent costs of the state. Even when the functions are joined in one ministry, but the separation of the investment and recurrent budgets continues, the co-ordination challenge remains.

Participants shared how their countries have addressed the challenges of consolidating the functions in one ministry. For instance, ministries create two divisions on the preparation side of the budget, one with responsibility for planning and the other for budgeting, but merge the execution of both budgets in one division. The planning function can be strengthened by raising the planning responsibility to a very senior level in the ministry in order to maintain the focus.

Some countries have a structure whereby planning and budgeting are merged at the centre, but remain apart at the line ministry level. This means that the centre can ensure proper co-ordination, and that planning occurs at the level where better information and knowledge exists for a sector. Other countries operate with a joined-up ministry, but create a planning authority or planning commission, which often advises the president.

3.4 The relationship between central finance agencies and line ministries

Anke Braumann

The relationship between the finance ministry and the line ministries of a country more often than not is characterised by tension. Whereas the ministry of finance has an interest in keeping spending within affordable levels and has to advise on trade-offs between line ministries' spending requests, the incentive for a line ministry is simply to maximise its share of available resources. This natural tension is often exacerbated by information asymmetry, which leads to mistrust.

At the same time, it is in the interest of overall good budgeting outcomes that the relationship between these two sets of actors is co-operative. Participants at the seminar identified four (interlinked) challenges that add to mistrust between the line and the centre:

- *Communication disconnect*: Instead of having institutionalised ways of information-sharing that render decision-making more transparent, there is a culture of mutual suspicion between the central finance agencies and their line ministries. For example, when during the fiscal year, finance ministries do not communicate fiscal constraints, and impose seemingly arbitrary cuts on appropriated funds, it leaves line ministries to address their own urgent expenditure needs including contractual obligations. Line ministries react by seeking to maximise their budget up front and not acknowledging where they can make savings to address their own underfunded priorities.

- *Undermining of priorities*: Participants reported that during budget execution, line ministries use various ways to undermine priorities and spend allocated funds differently. The methods used vary from the unauthorised shifting of funds between line items to faulty procurement processes for government contracts that have not been appropriated. Often, line ministries seek *ex post* approval on a political level, such as through the Cabinet or the council of ministers, thereby undermining Treasury functions.
- *Cash-flow management challenges*: Line ministries often overstate their fund requirements for the first two quarters, and then use surplus funds for ends other than those stated in their cash-flow projections. Other challenges for cash management include natural disasters, economic shocks and uncertainty about donor disbursements in budget support programmes (triggered often by line ministries not meeting indicators). These prevent finance ministries from giving line ministries certainty on forward available cash. Poor cash management systems are also a result of a lack of capacity to implement allocated budgets. A lack of capacity in finance ministries to monitor the implementation of programmes makes it more difficult to match available cash to expenditure needs efficiently.
- *Subverting financial management systems*: Even when integrated financial management systems are in use, line ministries still commit expenditure above their available budget lines in the system. At the end of the financial year, this practice adds to the stock of existing arrears.

Mechanisms to integrate line and centre

Participants shared the various mechanisms used to prevent or counteract 'budget wars' between finance and line ministries. Key to all these measures, however, is the capacity in the finance ministry to manage budget implementation.

- *Communication*: In order to enhance relationships, finance ministries need to become more participatory and transparent in their engagement with line ministries (for example, by instituting regular dialogue with line ministries to find joint solutions to budget challenges). A periodic dialogue with the Cabinet or the council of ministers to explain fiscal constraints and to engage them in developing solutions (such as reprioritising programmes) is one important action in this regard. Countries also establish dialogue mechanisms at the official level; for example, a regular dialogue can be achieved through the establishment in the finance ministry of focal points that are responsible for exchanges with a cluster of line ministries. Such clusters can strengthen relationships and knowledge management between central finance agencies and line ministries.

- *Undermining of authority*: As line ministries often undermine the authority of their finance ministry by seeking approval for expenditures on the political level, it is important that the finance minister does not allow this to happen without consultation with the finance ministry. Countries can formalise decision paths and enforce guidelines on the procedures line ministries should follow when seeking permission for expenditure that is not appropriated or not authorised in terms of in-year cash management. If these procedures apply to all ministries, peer pressure at Cabinet level can act as a disciplining measure when one ministry breaks ranks.
- *Cash-flow management*: Central finance agencies must build cash-flow management practices by developing clear rules for the allocation of available cash and by making timely and predictable cash disbursements in a transparent manner. The establishment or empowerment of cash management committees (with members of finance ministries, central banks and revenue authorities, for example) makes it easier to develop cash disbursement schedules, which can then be communicated regularly to line ministries.

  Line ministries, on the other hand, need to improve procurement and cash-planning systems in order to provide realistic estimates of their cash requirements to finance ministries.

  Cash management is also enhanced through mechanisms that monitor large state investment projects and identify ministries that are not able to spend large cash disbursements.

  The establishment of task teams to monitor progress towards the key performance indicators of budget-support performance-assessment frameworks and to ease the reporting process, coupled with ongoing dialogue with donors, contribute greatly to better predictability of budget support funds.
- *Building line ministry financial management capability*: Central finance agencies need to provide technical support and mentoring to line ministries so

that they are able to comply with regulations and enforce budget reforms. Countries have benefited from programmes that focus capacity-building efforts on accounting officers. Training should include building their capability to enforce financial management guidelines and accounting. Participants were clear that the key to improved control over public finances at the line ministry level is holding accounting officers to account, in line with their legal obligations. When accounting officers are not sanctioned, officials within line ministries are less likely to be sanctioned.

Seminar participants agreed that poor relations between the centre and the line detract from the quality of budgeting and spending. Primary responsibility for addressing these weaknesses rests with finance ministries, in the light of their role as custodians of public funds.

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4

The challenge of modernising country legal frameworks for public financial management

4.1 Introduction

The outcomes of the budget process strongly depend on whether there are clear rules for formulating, executing and reporting on the annual budget, as well as a clear statement of medium-term fiscal policy objectives (Lienert & Fainboim 2010). Usually, these rules are specified in a budget law or a set of laws that provide guidance for the different steps of the budget process. These formal rules articulate not only what the formal processes are but also who is responsible, when key processes should take place and how they should be implemented.

Internationally, there are significant differences in the degree to which countries capture rules, responsibilities and roles in formal law and legal instruments, and the degree to which the process is regulated by agreed practice. The extent to which primary public financial management (PFM) law should capture the set of rules depends on a country's legal tradition and the need to establish permanent rules, rather than temporary ones, the need to embody rules in formal law rather than more informal arrangements; and the perceived need to constrain abuse of power by different actors in the system (Lienert & Jung 2004).

It is in this light that many countries periodically review their PFM legal frameworks to ensure that: (a) adequate laws are in place; and (b) they are appropriate for and conducive to good financial governance and budgetary outcomes.

Another factor driving changes to PFM law over the last few decades is the alterations countries make to their budgeting system during budget reforms, which are then captured in law in order to imbed the changes in the system (Lienert & Jung 2004). Typically, the changes that are captured concern the modernisation of budgeting systems and the introduction of new approaches, such as budgeting based on programmes and performance.

As elsewhere in the world, legal frameworks in Africa vary in their development, and often embody legacy systems. How these systems are reformed, and the reforms imbedded in law, also varies depending on country context and objectives.

The 7th Annual Seminar of the Collaborative Africa Budget Reform Initiative (CABRI) examined the challenges in developing, implementing and enforcing PFM legal frameworks in Africa. The seminar also explored the incentives and commitment controls that can be put in place to enforce a legal framework.

Gert van der Linde, Lead Financial Management Specialist at the World Bank, gave an overview presentation on Legal Frameworks for Improved Public Financial Management. He stressed the importance of a legal framework that supports key areas of the PFM process, specifically: the accountability relationship (who is accountable and how he/she will be monitored and evaluated); the budgeting process (for example, appropriate laws and accountability systems); budget execution (for example, the control framework and risk management); accounting; and reporting. The vision underpinning the budget system, the legislative framework regulating it, and the standards, processes, systems and data requirements must be aligned with country-specific needs and capacity. Van der Linde highlighted the importance of getting the basics right in implementation, maintaining and protecting key stakeholder buy-in (inculcating change management processes) and, ultimately, showing results.

This introductory presentation was followed by presentations by Morocco, Rwanda and Zambia on recent changes to their PFM laws. Nana Boateng, GIZ advisor to CABRI, draws on the presentations made at the Annual Seminar to discuss how and why these three countries have recently reformed their legal frameworks. Rwanda and Morocco offer good examples of countries reforming their legal framework to capture a shift in their budget system to programme, performance-based budgeting. Morocco's case was presented by Mohammed Haddad, Deputy Budget Director Morocco, while Elias Baingana, Budget Director Rwanda, presented the Rwanda case. The adoption of new laws may also address specific budgetary problems, as was the Zambian case – presented by Pamela Chibonga, Chief Budget Analyst Zambia – where the lack of a legal framework in the budget process allowed for excessive discretionary practices and a lack of harmonisation between the budget process and national development planning.

4.2 Morocco's new Organic Budget Law captures budget process modernisation

Presentation by Mohammed Haddad

Introduction

In Morocco, the transition from a resource-based budget to a programme-based budget was founded on several considerations. The principal concern was that the resource-based budget did not provide answers for why expenses were to be incurred, what results the expenditures would achieve and whether the results would be achieved at lowest cost. The resource-based budget also did not highlight the strategic mandates and priorities of ministries or programmes through which it translates its public policy into goods and services. In Morocco, the notion of a 'programme' did not appear in the Organic Budget Law (the Constitutional by-law on Finance Acts of 1998). It, therefore, became necessary to make systemic changes in the PFM legal framework in order to improve the allocation of resources and attain the country’s economic and social development goals. At the time of the seminar, the new Organic Budget Law had been drafted and was to be submitted to the new government and Parliament after upcoming parliamentary elections.

The programme-based budget reform

The programme-based budget reform involved a change from a budget based on inputs (resources) to a results-based model built around a coherent set of initiatives and projects, and linked to performance indicators, all under a single ministry. The aim of introducing the performance approach in the public sector was to improve the effectiveness (delivering the expected outcomes at a set date and achieving the goals that were determined) and efficiency (reaching a target using the optimal amount of resources and delivering a quality service at a lower cost) of public sector management and the quality of public services within a resource framework. Such an approach would require: a clarification of public policy priorities; monitoring and evaluation of their effectiveness and efficiency; increasing transparency; and adapting internal management systems, programmes and policies according to the results obtained.

Changing over from a resource-based budget to a programme-based budget was a difficult exercise, requiring a great deal of commitment, perseverance, patience and hard work. All direct role-players in drafting, executing and monitoring a programme-based budget needed to be trained appropriately. It was essential to establish a monitoring and evaluation system for programme-based budgets. This would make it possible to implement the necessary adjustments and corrections. It was also important to analyse any divergences between what was envisaged and what was actually achieved in order to understand what was not working and be able to react before it was too late.

The implementation process

At the start of the reform, the Organic Budget Law was not revised; all the measures adopted were based on statutory texts such as decrees, orders and circulars. The implementation was rolled out according to the ‘GPP’ (gradual, participative and pragmatic) approach. A gradual and voluntary approach was important because it took into account the varying capacities of the departments. Pilots were undertaken in a few ministries before extending the reform to the administration as a whole. When this occurred, it operationalised a comprehensive, integrated approach involving the entire budgetary process. The participative approach was also key to the involvement of various departments in the design and implementation of reform mechanisms and in fostering ownership.

Various legal, institutional, administrative and capacity-building reforms were undertaken to support the reform process. Important statutory texts included the Prime Minister's Circular of 2001, which aimed at adapting the planning and execution of the state budget to the devolution framework, and the Prime Minister's Circular of 2003 on partnership. Key reform steps included: the introduction of a regional dimension into the state budget as from 2006; the merger from 2006 of the Kingdom's General Treasury and the General Inspectorate of Expenditure; the establishment of a medium-term expenditure framework (MTEF); the development of an integrated information system; the reform of the expenditure-monitoring system in 2008; the strengthening of performance audits; the introduction of training; and the development, communication and distribution of guides.

Reforming the legal framework

The experimental approach made it possible to identify a number of difficulties that would have to be managed. These included: the need to reform the classification system; the need to distinguish between a provisional classification and a classification for purposes of execution and budgetary devolution. Moreover, the Organic Budget Law of 1998 needed to be reviewed in order to entrench the performance approach and to integrate the relevant new concepts and tools. The reform of the Organic Budget Law (with the help of experts financed by the European Union) was based on benchmarking good international practice while taking into account the Moroccan context. All departments of the Ministry for Economic Affairs and Finance took part in the work to reform the Organic Budget Law and agreed on its content. However, the reform was not just technical; it affected, in addition, the fundamental balance between Parliament and the Executive. Therefore, the process also required political backing.

The main axes of legal change

The proposals for the reform of the Organic Budget Law were based on four main axes: (a) improving performance in public sector management; (b) increasing transparency; (c) strengthening the sustainability of public finances; and (d) extending the role of Parliament in the budget debate.

The process of improving performance in public sector management had several aspects. Firstly, it required instituting an obligation to formulate the annual Budget Law with reference to rolling multi-annual planning, in order to entrench the practice of an MTEF and the results-based approach. Secondly, procedures for the internal redeployment of appropriations had to be simplified to allow managers some room to manoeuvre. Thirdly, each ministry would have to draw up a Ministerial Performance

Project (MPP) to accompany the draft annual Budget Law, informing Parliament on the strategy, programmes, objectives and performance indicators for the following year. Fourthly, each ministry would have to prepare Ministerial Performance Reports (MPRs) to accompany the annual Budget Review Bill, detailing, for each programme, the performance targets met relative to the objectives set. Finally, the Minister of Finance would have to draft an Annual Performance Report to accompany the Budget Review Bill, consolidating the MPRs prepared by ministries and institutions.

Increasing budgetary transparency was benchmarked against good international standards. It included steps such as instituting general-accounting and cost-accounting systems in order to gain a better understanding of state assets and the overall costs of public services, and to monitor the efforts made to control expenditure. The new organic law had to: impose an obligation to table specific reports with the annual draft Budget Law (reports on the wage bill, repayments, government debt, public aid, etc.); set a specific time frame for the Budget Amendment Law and the Budget Review Law; and reform budget classification.

New financial rules were introduced to strengthen budgetary sustainability, including basing staff appropriations on limits instead of on evaluations, and restricting the use of medium- to long-term debt exclusively to financing capital investments. A proposal to introduce a fiscal rule into the Organic Budget Law limiting the budget deficit and Treasury debt was examined but eventually not adopted.

The new law also extends Parliament's role in the budget debate. From June 2011, Parliament has been involved in discussions on the policy guidelines that underpin the draft Budget Law. The voting procedure on expenditure has also been simplified, and Parliament's amendment rights have been revised to allow for amendments between programmes.

Conclusion

Despite many challenges, gains have been made in PFM reforms and the process is ongoing. The revision of the Organic Budget Law introduces new financial governance measures in order to improve the performance of public sector management. The reform makes it possible to give the budget a greater role in accelerating the pace of economic growth and improving social cohesion.

Enacting the new law, however, is not the end of the reform. Communication, awareness-raising initiatives and training are necessary on the content and benefits of the reform. Managers will need support to strengthen their management capacity, and their skills will have to be aligned to the new management methods.

4.3 Reform of archaic law underpins Rwandan public financial management improvements

Presentation by Elias Baingana

Introduction

On 12 September 2006, after a long period of debate on the objectives for reform, the government of Rwanda enacted a new public financial management (PFM) law covering the entire PFM cycle. While the scope of PFM is debatable, it is generally agreed that the components of budgeting and accounting comprise its core. The Organic Law on State Finances and Property covers the budgeting and accounting cycle in Rwanda, and has provisions that give rise to other legal instruments on procurement, treasury management, internal audit and external audit.

Before the enactment of the Organic Budget Law, the budgeting and accounting functions were guided by the 1979 Decree-Law No. 23/79. This law was deeplly problematic: it was not consistent with some key principles of modern PFM: it only focused on the annual budget and lacked elements of the medium-term framework; it allowed for line-item budgets based on inputs, and promoted a dual budgeting system with limited focus on policies and results; the principle of a unitary budget was not fully respected, since the Minister of Finance was allowed to open off-budget accounts – hence, there was lack of transparency in cash management; it was overly complex; and several of the envisaged administrative arrangements were not implemented.

Furthermore, the 1979 Decree-Law No. 23/79 never provided clarity on the respective roles of the executive and legislature with respect to budgetary decisions. There was no requirement for the executive to prepare and submit a draft finance law to Parliament. It was also unclear when Parliament should approve the draft finance law, and there were no rules for a reversionary budget (in other words, rules that would allow the government to operate in the event of Parliament not passing the budget on time for the start of the financial year). The 1979 law did not even require the publication of the budget and accounts.

With the enactment of a new Constitution and the adoption of Vision 2020, the emphasis shifted strongly to outcomes and results. The principles enshrined in these documents, such as decentralisation, accountability and efficiency, had to be reflected in the new PFM law.

The new Organic Budget Law laid down the fundamental principles for budget management under seven chapters: (a) General provisions; (b) Powers for budget management; (c) Preparation, presentation and approval of the budget; (d) Budget execution; (e) Government borrowing, debt management and banking arrangements; (f) Accounting, reporting and auditing; and (g) Special provisions.

Implementation of the new PFM law

The new law brought about fundamental changes in the PFM landscape. Programme budgeting and medium-term expenditure frameworks (MTEFs) were now fully captured under the law. The Office of the Accountant General, which reports directly to Parliament, replaced the old Cour des Comptes (Courts of Accounts). A comprehensive Internal Audit Charter and internal audit regulations were disseminated, and internal audit committees established in government institutions. Furthermore, the tax laws were simplified and the tax administration strengthened to enforce the laws.

The law also framed the country's budget reform programme. In 2007, the Public Expenditure and Financial Accountability (PEFA) assessment helped to identify gaps in the PFM cycle that would become the focus for reform. The PFM Reform Strategy for 2008–2012 was then designed, and included a number of reform actions across the PFM cycle. The first workshop for chief budget managers (CBMs) was conducted in 2006, and became standard practice in subsequent years. A consolidated financial report for the government was produced for the first time in 2007 for the 2006 fiscal year, and the Public Procurement Code was enacted in 2007 to replace fragmented procurement orders. The Chart of Accounts was revised, and accounting manuals were published.

Achievements of legal reform

Several gains have been made since the undertaking of the PFM legal reforms. The improvements in the 2010 PEFA over the 2007 scores underline the effectiveness of the framework and its implementation. Specifically, the aggregate expenditure out-turn compared to original approved budget changed from a 'B' score to an 'A' score; total expenditure variation exceeded 5 per cent in only one of the past three years, compared to twice for the 2007 PEFA. At the same time, the composition of expenditure out-turn compared to original approved budget changed from a 'D' to a 'C'. The comprehensiveness of information included in budget documentation changed from 'D' to 'A'; public access to key fiscal information changed from 'C' to 'A'; and the effectiveness of internal controls for non-salary expenditure changed from 'D+' to 'B+'.

Implementation challenges

Several challenges were encountered in the process. Key among these were the limited staff and institutional capacity to effectively execute the new PFM law and its associated laws, regulations and instructions, and the absence of critical statistical data for effective planning and monitoring. The implementation of the monitoring and evaluation system for non-financial performance information was weak and there was lack of a clearly documented process and procedure to facilitate implementation of the new PFM law. The management of external resources faced several challenges – often externally driven by donor practices – and lagged behind the requirements of the new PFM law. For example, donor requirements for numerous bank accounts did not fit easily with the provisions for banking arrangements in the new law, and complicated the accounting function.

Key Lessons

Sound leadership is essential in implementing a new PFM law. Equally important is creating awareness of the new PFM law and its requirements among all the stakeholders, including the legislature. Creating and sustaining a critical mass of technical skills at the centre to drive the reforms is key to the success of the reform, as is creating an ongoing capacity-building programme to compensate for staff turnover. It is important to institute a flexible and effective integrated financial system that facilitates recording and reporting of transactions. The establishment of a reform roadmap, continuous engagement and dialogue with donors on the reform strategy, and the establishment of effective horizontal and vertical co-ordination in the planning and budgeting process are also important steps.

Conclusion

In Rwanda, the PFM law that was inherited from the colonial era was archaic, complex and inconsistent with modern PFM practices. The new PFM law has helped to overcome these deficiencies, and remarkable progress has been made since its enactment. Nevertheless, several challenges remain, and these represent the focus areas for future reform. The lessons learnt point to the fact that there is no perfect reform process, and that perfection is approached through practice.

4.4 Underpinning better planning, budgeting and budget execution in PFM law

Presentation by Pamela Chibonga

Introduction

Zambia is currently undergoing a comprehensive reform of its PFM laws. These reforms were necessitated by the lack of a legal foundation for the country's national development planning framework and modern budgeting mechanisms, which meant that procedures and timetables were ad hoc and without legal basis.

In Zambia, only the spatial plans have a legal basis under the Town and Country Planning Act. Planning and stakeholder consultation structures and procedures such as the National, Provincial and District Development Co-ordinating Committees and Sector Advisory Groups are not legally established and have no legal mandate. Moreover, apart from scant detail in Article 117 of the 1991 Constitution (as amended), the annual medium-term expenditure framework (MTEF) and activity-based budgeting

(ABB) process have no legal basis, and the procedures and timetables vary each year. There is no legal requirement to produce the pre-budget Green Paper/MTEF and no legal requirement relating to the format of the budget and supporting documentation.

Despite efforts to introduce new mechanisms, Zambia's annual MTEF and budget procedures overall fall short of international standards of 'good PFM practice', particularly in respect of budget comprehensiveness, accountability, transparency in budget formulation and effective parliamentary oversight. The country's performance against the Public Expenditure and Financial Accountability (PEFA) assessment framework showed no improvement between 2005 and 2008, apart from in budget classification and public access to key fiscal information (which was not imbedded in law).

In 2009, a new Article 118A was inserted in the current (1996) Constitution, which states:

> Parliament shall enact budgeting and planning legislation which shall provide for matters that relate to the annual Budget and to medium term and long-term development plans.

The constitutional requirement for new budgeting and planning legislation provided an opportunity to address weaknesses identified in the current development planning and budgeting processes and to integrate these processes. An initiative to deepen the budget reforms had begun in 2003/04 by moving closer to international 'good practice' as regards budget transparency, stakeholder participation and greater performance orientation. There was now an opportunity to incorporate scheduled changes in the governance architecture into the PFM legal framework, in particular the devolution of functions to district-level councils and a strengthening of the oversight role of the National Assembly in the constitutional reforms.

The objectives of the PFM legal framework

A key objective was to create an institutional framework for integrating development planning with the annual budget process by providing a legal base for the National, Provincial and District Development Co-ordinating Committees. The reforms aimed at: facilitating sector devolution and harmonising the five-year development planning cycle with the electoral cycle; facilitating stakeholder participation in the development planning and MTEF/budget processes; integrating development planning and budgeting; enhancing parliamentary oversight of the national development plan and the MTEF/budget formulation process; and revising the budget estimates format by providing more narrative on objectives/outputs.

Challenges in developing the legislation

Challenges have been encountered in developing the legislation. Firstly, the legislation is being developed in the context of two key (related) processes, namely the constitutional reforms and devolution to district councils. Both processes have stalled, leading to uncertainty regarding the context for PFM legal reforms. Secondly, the consultative process involving the National Assembly and civil society, with its desire to see wider participation in the second phase of reforms, has also contributed to the stalling. In addition, managing institutional rivalries between spatial planners (in the Ministry of Local Government and Housing) and socio-economic planners (in the Ministry of Finance and National Planning) to ensure a legal framework for harmonised and integrated planning at district/sub-district levels has been a challenge.

At the same time, it is realised that while legislation may strengthen the formal rules governing National Development Plan (NDP) and budget formulation procedures, entrenched informal practices (for instance, spending public funds on programmes that have not passed through the formal approval process, and regularising the spending through the *ex post* approval of supplementary budgets) may persist. Therefore, there might be a risk that the introduction of a new law will amount to mere 'ritualistic' change.

Conclusion

In Zambia, the proposed 'second-generation' budget reforms encompass greater openness and transparency, stakeholder participation, and National Assembly scrutiny and oversight. Strengthening these areas in the PFM system will significantly enhance the checks and balances within the governance structure of the state and improve incentives within the executive to adhere to the procedures of the formal budget system. The new law is part of Zambia's efforts to reform the institutional context within which development plans and budgets are formulated and executed, so that the budget becomes a more effective vehicle for delivering prioritised public services and development. The proposed legislation, thus, provides for erring members of the executive (for example, in relation to generating unauthorised expenditure or excessive credit/payment arrears) to be summoned before the relevant parliamentary committee, with possible referral to a relevant law enforcement agency for prosecution.

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5

Fiscal decentralisation to support improved spending for service delivery

Compiled by Alta Fölscher

5.1 Introduction

The decentralisation of government functions from national to sub-national level is argued to be a critical mechanism for the translation of public resources into responsive, effective and efficient public services. This proposition is based on two central arguments. Firstly, local governments are closer to the citizens they serve and, therefore, are better placed to provide services in line with local preferences, based on local information. Secondly, because decentralised government is closer to citizens, it is more likely to be accountable, thus changing the incentives for better performance.

However, these benefits of decentralisation do not emerge automatically. They depend on the degree of autonomy afforded sub-national governments in practice, the quality of public financial management (PFM) systems and technical and managerial capacity at the sub-national level and, critically, on the design and transparency of intergovernmental fiscal transfers.

The fourth session of the 7th Annual Seminar looked at two of these aspects, focusing on the actions required from central government. In the first sub-session, participants looked at intergovernmental fiscal transfer design and access to borrowing as important determinants of sub-national budget effectiveness and adequacy. François Paul Yatta, an independent researcher from Niger and co-author of the Africa chapter in the Second Global Report on Decentralisation and Local Democracy (see UCLG 2010), presented on the challenges and practice of fiscal decentralisation in Africa.

His presentation, elaborated on below, pointed to not only weak design of grant systems, but also the implementation of legal provisions for fiscal decentralisation and poor local capacity as key issues that hinder local governments in delivering on their developmental potential.

In the second sub-session, participants engaged with the necessary transparency requirements in respect of fiscal decentralisation to enable local accountability for local service delivery and national accountability for the management of fiscal decentralisation. Jason Lakin, programme officer and research fellow at the International Budget Partnership (IBP), set out six draft transparency and participation principles developed by the IBP and its partners for transparency, participation and financial management at the sub-national level. His presentation is also captured below.

5.2 Practices and challenges of fiscal decentralisation in Africa

In the last 20 years, many countries in Africa have decentralised expenditure responsibilities to sub-national government. Recently, countries like Algeria, Cameroon, Kenya, Morocco, Mauritania, South Africa, Zambia and Zimbabwe have introduced various reforms aimed at establishing functional government closer to the citizens. Decentralisation can take many forms (see Box 5.1), but the type of decentralisation dealt with here is the establishment of local authorities with legal authority and financial autonomy, and which are managed by locally elected bodies.

Within this type of decentralisation, the financing of sub-national governments' expenditure responsibilities (expenditure assignment) through fiscal transfers or own revenue sources (revenue assignment) is critical in ensuring local accountability and the delivery of services.

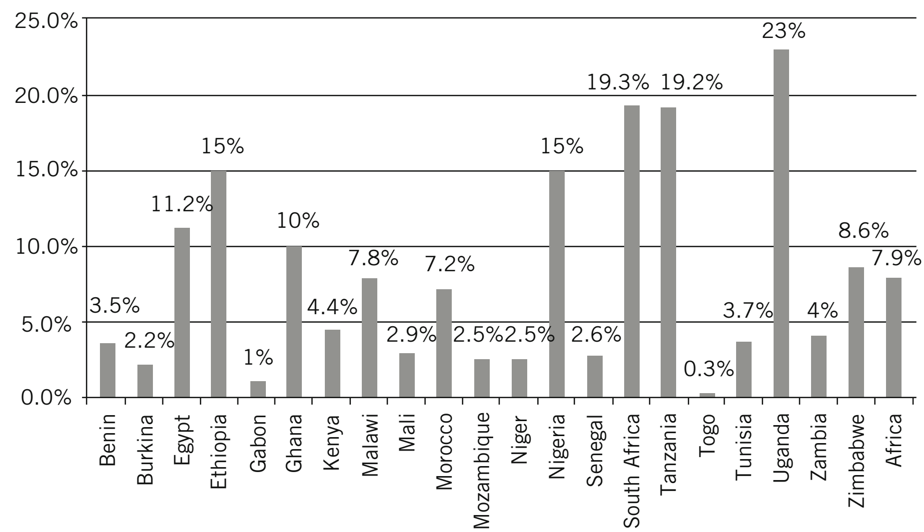
There are no standard patterns for fiscal decentralisation in Africa. Different countries have different configurations of revenue and expenditure assignment across differently structured levels of government. Fiscal decentralisation can be based on various combinations of assigning sufficient own resources to sub-national government (the tax-based model) or funding local services through a share of nationally collected revenue (the fund-transfer model). Within the fund-transfer model, there is wide variety in how transfers are structured (e.g. whether they are conditional or unconditional), calculated and made. The types of local authorities and degree of political decentralisation can also differ according to how territories are assigned.

Box 5.1: Decentralisation unpacked

Decentralisation is defined differently by different writers, and is often used as distinct from terms such as devolution and deconcentration. Here, decentralisation refers to political and budgetary decentralisation, as defined by the World Bank (see World Bank 2011), which distinguishes between four types of decentralisation: (a) administrative decentralisation, which places local authorities under the supervision of a central authority; (b) political decentralisation, which assumes that local authorities are independent of central government power; (c) budgetary (or fiscal) decentralisation, which entails the transfer of resources required for the exercise of transferred competencies; and (d) market decentralisation, which implies the outsourcing of certain public sector activities to the private sector.

The degree and distribution of decentralisation – as measured by the relative share of sub-national authorities in consolidated public expenditure – also differs across countries. As shown in Figure 5.1, for local government authorities, this may be as much as 23 per cent of expenditure (in Uganda) to as little as 0.3 per cent (in Togo).

Figure 5.1: Share of local government authorities in public expenditure, selected African countries



Source: Yatta (2011)

However, as identified in the Gold 2010 report on decentralisation and local democracy, local governments in Africa overall have limited spending authority (the non-weighted average of local government expenditure to public expenditure is 8 per cent across countries) (Yatta & Vaillancourt 2010).

The legal framework for decentralisation often also does not make expenditure assignment sufficiently clear; and, even if it does, budget controls exerted by national governments weaken local-level accountability, as local governments are able to argue that their expenditure mandates have remained unfunded, or that they have insufficient control over the funding to be accountable.

External financing modalities – and the nature of aid agreements between central governments or central government and multilateral agencies – further undermine local government autonomy. Modern aid modalities (for example, budget-support and sector-wide modalities) result in the recentralisation of policies and functions in key decentralised sectors such as education, health, water and sanitation. Local government implementing agencies end up being more accountable to central government structures, rather than to local assemblies and citizens (Yatta & Vaillancourt 2010).

The design of revenue-assignment and fiscal-transfer systems, therefore, is critical for the benefits of decentralisation be realised. For Africa as a whole, local government's own revenue is approximately half of total local government revenue (see Box 5.2), with the remainder comprising fiscal transfers from higher levels of government.

Box 5.2: Local taxes and service charges

Yatta and Vaillancourt (2010) found that across Africa local governments have weak powers to raise taxes and, where they do have the powers, tax collection challenges place a limit on the level of own resources. In most Francophone countries, for example, local governments have no power to raise taxes. In Anglophone countries, even where they have the power, their ability to set taxes and change tax rates may be constrained in terms of national legislation. User charges for electricity, water and sanitation services, in principle, offer separate sources of revenue for local governments, but in Africa this option is often not fully exploited. The high incidence of informal settlements, illegal access to services and poor capacity to collect revenues are factors that keep collections from this source low in many countries. In some regions and countries, however, practices are more developed. In West Africa, incomes from services and the use of public properties accounted for nearly 20 per cent of local revenue between 2004 and 2007. In South Africa, revenues from services (water, sanitation, electricity) are responsible for almost half of the income of local governments in metropolitan and medium-size cities, but less than 10 per cent in small cities and rural municipalities (Yatta & Vaillancourt 2010).

Fiscal transfers in Africa take various forms, across and within countries. Key parameters are whether grants are an unconditional share of nationally collected revenue/national resources or whether they are conditional, usually upon terms derived from national policy interests at sub-national level. The distribution of both conditional and unconditional grants can be calculated on the basis of a formula, or can be driven by estimated or actual costs. Fiscal transfers can be paid upfront, or can be a reimbursement for costs incurred. Finally, fiscal transfers can occur as a statutory requirement in law, removing the discretion of the national government as to whether and when they will be granted, or they can be based on ad hoc decisions by national agencies. The following are examples of fiscal transfers by type:

- *Formula-driven as a share of resources or revenue*: Development Grants Facility (Côte d'Ivoire); District Assemblies Common Fund (Ghana); Equitable Share (South Africa); and the Local Authorities Trust Fund (Kenya).
- *Cost-driven*: Sub-national grants in Mali, Zimbabwe and Tunisia.
- *Conditional grants*: Such as those employed in Uganda and South Africa.
- *Grants by ad hoc decision*: Decentralisation Allocation Fund (Senegal); National Investment Agency for Municipalities (Mali); Fonds Commun des Collectivités Locales (Tunisia); grants from value added tax and custom revenues in Benin; and Local Government Capital Fund (Senegal).

The prevalence of ad hoc decision-making underpins some of the key challenges associated with intergovernmental fiscal transfers in Africa. Whereas there can be some predictability in the total amount of transfers (when it is determined as a fixed percentage of government revenue or even when determined annually in finance laws, but within a medium-term framework), the factors determining transfer formulas are often not explicitly set out (Yatta & Vaillancourt 2010).

In principle, transfers can be structured so that better, more accountable spending occurs at local level. A grant can incentivise local government revenue collection, for example, in which case the greater the improvement in resources, the higher the grant. It can also reward improvements in infrastructure and service delivery, with greater improvements in facilities rewarded with bigger grants. Grants can also incentivise local accountability mechanisms, increasing transfers when the quality of local management improves.

However, transfers that are structured to reward performance at the local level can result in a deepening of inequalities between jurisdictions. International experience on grant design offers various options for fiscal equalisation through intergovernmental transfers. In Africa, however, it is rare to find formulas that promote equalisation of fiscal revenues. Many financing formulas are based on pre-decentralisation expenditures, which reflect choices made by the national government in the past, and not the current needs as defined by the assignment of expenditure responsibilities (UCLG 2010). A lack of information on the real unit cost of transferred responsibilities prevents improved distribution of resources. This means that in practice local authorities with smaller populations may receive relatively more money, and that local authorities with a lower level of facilities are never able to catch up as the level of facilities of the local authority is the determining factor in the amount of the grant. In some countries, distance from the capital city is negatively correlated with the grant levels.

The implementation of allocated intergovernmental fiscal transfers in Africa is equally ridden with problems. According the Yatta and Vaillancourt (2010) a pressing issue is the irregularity and unpredictability of actual transfers. In some cases, national transfers – even if allocated – never occur.

In principle, autonomous local governments could expand their fiscal capacity by borrowing. However, in Africa access to borrowing for local governments is very limited. Of the more than US$2 000 billion in municipal bonds in circulation throughout the world, barely 1 per cent are issued by African local governments, and then mainly by municipalities in South Africa and Morocco.

Yatta and Vaillancourt (2010) set out three main constraints on the development of local governments' capacity for borrowing: (a) legal framework limits on local borrowing, either constitutionally imposed, or imposed through central government legislation and regulation; (b) limits on local government resources, preventing access to capital markets at affordable rates; and (c) lack of adequate budgetary tools at the local level to allow responsible borrowing. Local capital markets for local government borrowing are also very poorly developed in Africa.

In many African countries, financial intermediaries enable borrowing by local governments. These include the Development Bank of Southern Africa (DBSA), Infrastructure Finance Corporation (INCA) of South Africa, Fonds de Développement Communautaire (FDC) in Rwanda, Fonds d'Equipement Communal (FEC) in Marocco, Fonds Special d'Equipement et d'Intervention Intercommunale (FEICOM) in Cameroon, Agence Nationale d'Investissement des Collectivités Territoriale (ANICT) in Mali, Agence de Développement Municipal (ADM) in Senegal, Fonds de Prêt aux Collectivités Locales (FPCL) in Côte d'Ivoire, Caisse de Prêts aux Collectivités Territoriales (CPCT) in Niger and Caisse de Prêts et de Soutien aux Collectivités Locales (CPSCL) in Tunisia. Table 5.1 sets out functions provided by selected intermediaries in their countries. According the Yatta and Vaillancourt (2010), the use of financial intermediaries has produced mixed results.

Table 5.1: Financial intermediaries and functions in selected African countries

	Grants	Loans	Interest rebate	Security	Institutional support
Tunisia (CPSCL)	X	X	X		X
Morocco (FEC)		X			X
Senegal (ADM)	X	X	X		X
Rwanda (FDC)		X		X	
South Africa (DBSA)		X			X
Côte d'Ivoire (FPCL)		X			
South Africa (INCA)		X			
Cameroon (FEICOM)	X	X			X
Niger (CPCT)		X			
Mali (ANICT)	X			X	X

Besides lack of access to stable, transparent and adequate financing, the ability of local governments in Africa to convert budgetary resources into quality services in line with citizen preferences is also impaired by generally weak local capacity and accountability. The dearth of qualified staff, in particular in small local governments and rural areas, makes using even available resources difficult (Yatta & Vaillancourt 2010). Poor fiscal transparency at the local level and weak mechanisms for local citizens to exercise their right of oversight also mean that incentives to improve services are weak.

In conclusion, the tax capacity of local governments, key problems in intergovernmental fiscal transfer design and practice and poor access to borrowing impose constraints on the capacity of local governments to fulfil their decentralisation promise. Besides poor compliance by national governments with the legal provisions for the transfer of responsibilities and financing, the weak institutional capacity of local governments to implement development programmes is a key challenge.

5.3 Principles for sub-national transparency

The decentralisation of expenditure responsibilities to sub-national governments will only lead to better expenditure outcomes: if these governments are sufficiently autonomous and have access to resources to finance their expenditure mandates; if local technical and managerial capacity is in place; and, importantly, if they are held accountable by their constituents for their fiscal and spending decisions (UCLG 2010).

In the second part of the session on decentralisation, Jason Lakin, programme officer and research fellow at the International Budget Partnership (IBP), highlighted experiences in Africa of how social accountability mechanisms at the local level help create positive incentives for better performance by sub-national government. He shared draft principles the IBP and partners are working on for transparency and participation at sub-national level.

Many of the IBPs partners in Ghana, Mali, Uganda, Tanzania, Kenya, Zambia, Mozambique and South Africa work at the sub-national, local or community level monitoring policy, tracking financial flows to the local or sub-local level, tracking the funding of core mandates and working with local leaders to influence expenditure choices and implement budgets effectively. While the work of civil society organisations at this level can facilitate improved spending, it is a common experience of the IBP and partners that even where countries are highly or reasonably transparent at the central level, budgets at the local level tend to be far more opaque (see Box 5.3 on experiences in Ghana). Even where sub-national budgets are available, they are often neither comprehensive nor unified. This impairs civil society work at the sub-national level.

Box 5.3: SEND Ghana monitors use of special-purpose transfers from national government

District Assemblies (DAs) have been created by the government in Ghana to provide social amenities, economic opportunities and security for the people in the districts for which they are responsible. One group for which funding is provided to DAs by the central government is persons with disabilities. In order to access and use these funds properly, districts must follow certain procedures. However, in practice, these procedures are often not followed and DAs draw on the central government funding, but deliver fewer services or no services at all. SEND Ghana, an NGO established in August 1998, began collecting information on this problem and engaging with policy-makers at different levels of government. This has resulted in some districts following procedures and using the fund properly. However, SEND's work is hampered by difficulty in obtaining sub-national budgets and spending information. In Ghana, too, there is no comprehensive source on spending at district level, as different revenue sources for a function have their own separate budgets.

Source: Lakin (2011)

In response to this common state of affairs, the IBP formed a working group on sub-national advocacy in 2010, with partners from Uganda, India, South Africa, Kenya, Indonesia and Ghana, among others. The group has elaborated six principles of sub-national budget transparency, participation and financial management, and is in the process of refining the principles and writing them up with rationales and examples. These principles are outlined below.

1. Sub-national governments should provide fully transparent and comprehensive information to the public regarding both budgeted and actual revenues and expenditures, through all four stages of the budget process (formulation, approval, implementation and evaluation).

Sub-national revenues covered by this principle include funds generated internally by sub-national governments, as well as transfers from central government in any form (conditional, block grants and so on). The formats for reporting on revenues should be consistent across phases of the budget process and levels of government, allowing for a clear picture of all fund flows to sub-national units, and comparability across units. The reporting should be timely, sufficiently disaggregated and in accessible (understandable) formats, to ensure that it is usable. All reports should contain an executive summary in simple language, with minimal technical jargon. Information should be made freely available both online and in public places.

2. Sub-national governments, like national governments, should be audited internally and externally, and external audit findings should be made available to the public within a reasonable time frame.

Since not all sub-national units are audited externally every year, internal audit reports should also be made available on a regular basis. Where concerns have been identified by the auditors, government officials should be allowed a reasonable period of time to respond to audit findings, after which provision should be made for appropriate action to be taken to hold officials accountable for misuse of public funds where this has occurred, and recovery of those funds where possible. A report detailing actions taken should be published within a set time frame (laid down in regulations or law) by the auditor describing responses from officials and sanctions applied where necessary. This report should include information on the aggregate number and type of disciplinary proceedings that are in progress, but where no action has yet been taken. These reports should also begin with a summary in simple language.

3. Where sub-national governments have discretion over the use of funds that have been transferred to them from other levels of government, or funds collected through their own revenue sources, opportunities should be provided for local assemblies (where these exist) and citizens to give input into the budget process at multiple points from allocation to implementation and evaluation.

The government should explain the specific issues upon which citizens are being asked to comment and the reasons why citizen inputs are being requested. These inputs should be acknowledged explicitly by the government, and explanations should be made available as to how these inputs were handled (for example, input accepted, input accepted but modified with reasons, input rejected with reasons, etc.). Where participatory processes exist at local level for citizens to contribute to the planning or budget process, clear regulations should explain what those contributions are intended to be used for, and how they will be accounted for in the central and provincial budget process, so that local participation has a concrete impact on national planning and budgeting. Legal protection should exist for minorities and disadvantaged groups to protect them from discrimination and to ensure that they have genuine opportunities to participate.

4. The executive's budget at central and sub-national level should contain detailed information (quantitative and narrative) related to intergovernmental transfers, including, at least, their size, all rules for receiving and spending them, their distribution, the rationale for this distribution, and, where applicable, the formula by which the distribution is calculated.
Where that formula is based on inputs derived from other sources, those inputs should also be made available so that the public may verify the formula. Where states or provinces distribute funds to district levels, the same should apply. To the extent possible, information should be provided on a multi-year basis to facilitate planning at sub-national level.

Many sub-national governments depend heavily on resources from the central government, but it is often not clear to citizens why their local government has received the resources that it has, and how they compare with other areas. Furthermore, because revenues that come from the central government are not raised through visible taxes, they can weaken the sense that citizens should hold the government accountable for these resources. It is, therefore, necessary to ensure that citizens understand how these flows work, why they are entitled to them and what they can expect from them.

This principle states that such information should be easily available to citizens both at the local level and at the central level, where it should be in an easily usable format so that citizens can compare distributions across sub-national units. They should also be able to understand and verify any formulas. Making this information and the rationale for decisions public encourages wider discussion and ensures that the reasons provided are reasonable.

The central government has an important role to play in ensuring uniformity of reporting across levels of government, and in building the capacity of local governments to follow reporting formats.

The following are examples of good practice in this regard:

- South Africa has an extensive 'Explanatory memorandum to the division of revenue', which includes a detailed explanation of the rationale for and the inputs to the formulas used to calculate provinces' shares in the provincial equitable share of nationally collected revenue. Furthermore, the Division of Revenue Act 6 of 2011 details conditional grants in an annexure, by province and by transferring and recipient departments.

- In India, the Finance Commission establishes clear guidelines for the distribution of transfers across states, discusses rationales, such as needs, cost disabilities and efficiency, and provides detail on criteria and weights for formula-based sharing of revenues.

5. The distribution of resources across sub-national units should take account of equity considerations, and should be driven by the need/demand for services, rather than exclusively by 'supply-side considerations', such as the existing supply of infrastructure and personnel.
The budget should contain narrative and quantitative information explaining how the need/demand for services is measured and its relationship to the distribution of resources. Where other factors also influence the distribution of funds, a rationale for the use of these factors should also be included.

Most countries have substantial inequality across sub-national jurisdictions, and most countries also have a system of transfers from central government to sub-national governments. In many developing countries, these transfers constitute the bulk of sub-national government revenues. In principle, therefore, they are a public instrument for the reduction of inequalities. However, if the demand for services is a focus in grant design, better service delivery outcomes can ensue, which contributes not only to equity but also to improved efficiency of spending.

In Mexico, the 2004 health financing reform shifted financing away from opaque, supply-driven allocation to a demand-driven, transparent formula. In both South Africa and India, the division of revenue among governments at sub-national level is governed by demand-driven formulas.

6. Where funds are decentralised, the executive budget proposal or other publicly available, easily accessible central government documents should contain narrative information detailing the responsibilities of each level of government for the delivery of the decentralised services, the public offices or public officials within each level of government that are responsible for specific services, and the fund flows associated with those responsibilities.
A common concern in cases of financial decentralisation is that there is not a clear relationship between the funds that have been decentralised and the functions that the sub-national unit is expected to carry out. The functions of each level of government should be set out in appropriate laws and regulations, so that these can be compared to the financial resources available at each level.

The government should be clear about the expectations of service delivery and other responsibilities at each level of government. This allows citizens to make an assessment of what they should expect from each level of government, and what it should cost to provide those services. It also protects citizens from attempts to shift responsibility for providing services between levels of government, where laws or regulations are not clear about who is responsible. By demanding clarity of roles, citizens have the information they need to demand accountability.

This principle is particularly important where service delivery responsibilities are shared across levels of government. This often occurs when services are decentralised, because the central and provincial governments may maintain some role in the decentralised system. This is the case for the health systems in India and Ghana, for example: in India, the central and state levels have joint responsibility for the health system; in Ghana, central, regional and district levels share responsibility.

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