Working Paper 141

Aid and Public Expenditure: A Guide

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Contents

Acronyms

CWIQ	Community Welfare Indicator Surverys
DAC	Development Assistance Committee
DFID	Department for International Development
GDP	Gross Domestic Product
HIPC	Highly Indepted Poor Countries
IDT	International Development Target
IMF	International Monetary Fund
LDC	Less Developed Countries
MOFPED	Ministry of Finance Planning and Economic Development (Uganda)
MOH	Ministry of Health
MRALG	Ministry for Regional Administration and Local Government
MTEF	Medium Term Expenditure Framework
NGO	Non Governamental Organisation
OECD	Organisation for Economic Cooperation and Development
PEAP	Poverty Eradication Action Plan
PIP	Public Investment Programme
PPA	Participatory Poverty Assessments
UPE	Ugandan Primary Education
UPPAP	Ugandan Participatory Poverty Assessment
SWAP	Sector Wide Approach

1. Introduction

1.1 Objectives and structure

This working paper was originally produced for DFID economists, and aims to provide practical guidance on the budget process in developing countries, and the role of aid within it. Though aimed primarily at development agencies, the paper should be of wider interest to anyone involved in the budget process, or seeking to influence it. Though written for economists, the treatment of the issues aims to be largely non–technical, and should be accessible to anyone with a general interest in development and the aid relationship.

Sections 2 and 3 aim to equip readers to make intelligent assessments of the quality of public expenditure planning and management. This is an enormous subject area, in which a number of major guidance manuals are available. The main emphasis will be placed on diagnosis, and on drawing the implications for the appropriate form of financial support. Section 4 includes brief lessons of experience from integrating poverty elimination, gender sensitivity and participation into the budgetary process. Comprehensive treatment of these issues, each a chapter in themselves, can not be attempted, but the chapter will provide diagnostic advice, and signposts to further material.

Sections 5–8 discuss the relationship between public expenditure and forms of aid which support it, directly or indirectly. It discusses the experience with attempts to co–ordinate aid flows and debt relief with the budget process. It aims to equip economists to make judgements on when different types of aid are appropriate, including the choice between interventions at macro, sectoral or project level. It also provides more detailed guidance on issues to consider in the design and appraisal of programme aid, sector support, and support to budget reform.

The working paper covers an enormous amount of material, and the depth of treatment reflects that: it is not sufficient in isolation, and readers are encouraged to also consult the sources of additional material and advice which are referenced. For Budget appraisal, the World Bank Public Expenditure Management Handbook should definitely be on the bookshelf.[1]

1.2 Relevance of Budget Issues to Development Co–operation Policy and Practice

An understanding of budgets and public expenditure is necessary in a range of different contexts, from global policy to the appraisal of specific aid interventions:

- **Global discussion of aid policy**. The aid effectiveness debate has revolved in part around issues of fungibility, and has resulted in discussion of the case for retreating from ‘earmarking’ aid or debt relief to specific purposes, towards increasingly comprehensive approaches, based around Comprehensive Development Frameworks or Poverty Reduction Strategies. The debate on the International Development Targets has also focused attention on the effectiveness of Government action in moving towards achieving them. Donor co–ordination increasingly focuses on how donors interact with Government led budget processes. The development of new aid instruments has progressed towards budget support at

[1] World Bank (1998), PREM network, Public Expenditure Management Handbook

increasingly macro levels, with the World Bank having developed ideas for a Public Expenditure Reform Credit. Debt relief under HIPC has been linked to budget reforms.

- **Aid policy and implementation instruments**, including the issues to be addressed in considering how best to support poverty reducing public expenditure. The paper argues that the design of programme aid, sector support, and project aid needs to be pursued in a wider context of budgetary policy which assesses longer term sustainability and medium term accountability issues within the Government budget system. More technical issues, relating to the design of financial management procedures may also have to be addressed.

- **Advice on country policy**, including Country Strategy Papers, advice on aid levels, and assessments of which aid instruments to use in differing country circumstances.

- **Identification, design, appraisal, monitoring and evaluation of programme aid, sector programmes and budget reform programmes**, and indeed any project which involves support disbursed to a public sector body.

Even where the main focus of support is on facilitating private sector led growth, the Government to Government nature of the aid relationship comes down to understanding how Government interacts with the wider economy. Public expenditure analysis asks questions which are central:

- Are the roles which Government proposes to play in the economy appropriate?
- Are they adequately financed, in ways which are consistent with healthy growth of the private sector?
- Are priorities consistent with poverty reduction?
- Are standards replicable across the country and sustainable through time?
- Are there pressures to improve equity and effectiveness, including sufficient attention to ensuring that Government is accountable, in the widest sense, to those intended to benefit?
- Is there a credible programme for improving performance over time?
- How should donor support be provided?

Time spent in understanding the flow of funds and accounting systems within the budget system will be amply repaid in far sounder understanding of problems of economic management at every level from macro to project interventions. Key sources of information on the public expenditure management process include: the budget framework or organic law, which sets out the basic principles and institutional responsibilities within the system; Ministry of Finance budget manuals, which set out information systems and procedures; and, of course, the budget and final accounts as presented and approved by parliament. Attention is also drawn to a selection of the extensive literature on public expenditure management, which may elucidate the principles applied in a specific country context[2].

[2] Key Reference Sources: World Bank PREM Network, Public Expenditure Management Handbook; Guidelines for Public Expenditure Management, Barry Potter and Jack Diamond, IMF,1999. A rich source of information on public expenditures is the World Bank Public Sector Group's web site at www.worldbank.org/publicsector/pe.

2. Understanding Budgets

2.1 Functions of the budget process

In essence, the budget is a document which, once approved by parliament, authorises the government to raise revenues, incur debts and effect expenditures in order to achieve certain goals. Since the budget determines the origin and application of public financial resources, it plays a central role in the process of government, fulfilling economic, political, legal and managerial functions:

- **Economic**

  The budget is the state's financial plan. As a tool of economic policy, the budget is the means by which the government seeks to achieve three key economic policy goals: firstly, fiscal discipline, by controlling aggregate expenditure in line with macroeconomic constraints; secondly, the allocation of resources in line with the government's policy priorities; and thirdly, the economic, efficient and effective use of resources in achieving its policy goals[3].

- **Political**

  The budget process ensures the people's representatives scrutinise and approve the raising of taxes, the contracting of debts and the application of public funds by government. This is achieved through a formal separation of powers: government proposes the budget, which is approved by parliament, then executed by government, and finally subject to monitoring and appraisal by parliament to ensure compliance.

- **Legal**

  Enactment of the budget in law by parliament limits the powers of government, since the government may not raise taxes that have not been approved by parliament and may not exceed parliament's expenditure appropriations. An auditor, usually accountable to parliament, scrutinises the budget to ensure compliance with parliamentary authorisations. Institutions and individual managers who fail to comply, by, for instance, spending in excess of parliamentary appropriations, are accountable before the law.

- **Managerial**

  The budget communicates government policy to public institutions by informing them how much may be spent for what purpose, thereby guiding policy implementation. In some budgeting systems, this function may be reinforced by the inclusion of specific service performance targets within the budget document.

These functions are interdependent: the government is unlikely to implement successful economic policies (economic function) as approved by parliament (political function) if the budget does not effectively communicate its policies to public agencies (managerial function) and compliance with approved policy is not verified (legal function).

[3] Potter and Diamond (199, p. 12).

2.2 Budgetary principles

In order to adequately fulfil these functions, the budget should be comprehensive and transparent, following clear rules and procedures which establish the relationship between the key institutions in the budget process. In many OECD countries, and an increasing number of developing countries, these goals are achieved by establishing budgetary principles and procedures in a budget framework law.

The application of the budgetary principles is illustrated below using the example of Mozambique's Budget Framework Law, promulgated in 1997. Six budgetary principles are defined:

- **Annuality**

  The budget is prepared annually and executed over a period of one year. In common with some European budgets, Mozambique's budget has a complimentary period of three months after the end of the budget year, to allow the liquidation of payments for goods and services received during the budget year. Consequently, Mozambique's public accounts are closed on 31st March rather than 31st December.

  The principle of annuality is almost universal – some States in the USA operate on biannual budgets – and applied even when longer term expenditure forecasts are presented to parliament (see Section 3.2). In such cases, the first year of the forecast is considered for the purposes of budget appropriation and the remaining years are indicative, being subject to change by the executive or parliament in the following year.

- **Universality**

  All state revenues and expenditures should be presented in the budget. In Mozambique's case a clear distinction is made between the state budget and those of autonomous public institutions, including public enterprises, special development funds and local government. Only the transfers between the state budget and the autonomous bodies are registered in the budget. However, the autonomous bodies are required to present their financial situation to parliament in an annexe to the state budget.

  Poor coverage is a common weakness of state budgets, making it difficult for policy makers to control aggregate expenditure and allocate resources between priority programmes. The budgets of autonomous bodies and funds are often excluded altogether, registered only as net (expenditures minus receipts) or present only fiscal transfers from central government, as in the Mozambican case. In some countries these extra–budgetary funds, financed from earmarked revenues, such as oil funds and petrol taxes, can account for a substantial part of public expenditure yet fail to be captured by the budget process. It should be noted that the existence of extrabugetary funds allows revenues and expenditures to escape parliamentary scrutiny unless special arrangements have been made for parliamentary supervision.

- **Unity**

  All revenues and expenditures, and financing requirements, should be presented within the same budget. In some countries the revenue estimates and expenditures appropriations are presented to parliament and voted separately, as was formerly the case in the UK. This practice prevents parliament from assessing the compatibility of expenditure and revenue plans and is generally discouraged.

- **Pooling of resources**

  Revenues should be directed to the common fund for the financing of all expenditures rather than earmarked for the financing of a particular institution, programme or expenditure item. The principle of separating revenue from expenditure decisions is generally sound. A part of Government which happens to be in a position to earn revenues should not as a consequence face a lower scrutiny of the justification for incurring expenditure, but should normally surrender the revenue to the common fund and compete for budgetary allocations in the same way as all other spending departments.

  However, most countries (including Mozambique) have agreed exceptions to this principle for a range of reasons. The long history of inadequate road maintenance has encouraged the creation of road funds in many countries, financed from fuel taxes. Other special funds exist for fisheries development (revenues from fishing licences) and irrigation (revenues from water licences) amongst others. The most widespread example is the use of user fees in health, education and water supply, with revenues often retained to defray costs at the point of payment.

  There is both a pragmatic and a theoretical case for allowing user fees to be retained. The theoretical justification is that provision of a service on a cost recovery basis is not public expenditure if costs and revenues vary directly with volume. The public expenditure is limited to the subsidy. This argument is strongest where the calculation of the budget to be provided takes account of the expected level of user fees. The pragmatic case is that user fees can be a reliable, timely, and flexible source of non–salary recurrent revenues in budget systems which frequently fail to ensure that budget provision reaches the periphery on time. They can be used to respond flexibly to changing local perceptions of need. Collection of fees provides evidence of the existence of customer demand for the services offered. Allowing them to be spent where they are collected avoids the transmission costs, delays, and leakage which can result in both directions when revenues are surrendered and budget resources have to be provided from the centre. Together with public involvement in management, they can support greater ownership and responsiveness of services. Provided they are properly accounted for, and there are mechanisms for compensating poor areas for their lower ability to generate such funds, it makes sense to support decentralised management of these funds.

  The retention of user fees and hypothecation of revenues to specific uses does however risk making the budget fragmented and inflexible. There is a risk that earmarked funds can become entrenched and difficult to dismantle, long after the original budget purpose which gave rise to them has ceased to be a priority of Government.

- **Gross registration**

  Revenues must be registered as charged, without the deduction of the costs of collection, and the full costs of the provision of services should be registered, without deduction of revenues generated by sales or user charges. In this way, the budget figures capture the full cost of public services and aggregate public expenditure. Service agencies may resist a move from a net to gross registration, since this will require the registration of all expenditures and revenues, bringing them under the scrutiny of the Ministry of Finance and parliament and, possibly, reducing management discretion in their application.

  Exception may be made to this rule in the case of autonomous government agencies, who will have discretion over the application of revenues. Government financing of these institutions will generally be registered on budget as transfers or subsidies, thereby effectively net, and the agency will present separate accounts, often in a commercial format.

Recent developments in public sector reform may require some rethinking of this principle of gross registration. Cost recovery and the use of intermediate agencies to deliver services is becoming increasingly common and is being applied to new areas. The definition of public expenditure can become increasingly elusive as similar services are provided through multiple channels with slightly different definitions, e.g. Mission hospitals may be funded net of user fees, Government services gross. The approach adopted in the audited Financial Statements of the Ministry of Health in Ghana may provide a useful model: a matrix presentation shows total public sector health expenditure and how it is financed, with Government revenues, internally generated funds (user fees), and donor flows separately identified as sources of funding.

- **Classification of financial operations**

Mozambique's Budget Framework Law requires that public financial operations should be discriminated by institutional, territorial, functional and economic classifiers (see Box 1, and Section 2.9 for a more detailed analysis of the economic classification). Traditionally, budgets have distinguished expenditures by department or votes, further disaggregated by expenditure heads and line items. This is adequate for control purposes, but contributes little to the analysis of public expenditures in terms of its economic impact, the purpose for which funds are voted or the activities that are financed.

Box 1 Budget Classification Systems

Line Item Classification: structures expenditure by object according to the categories used for administrative control, for instance: salaries, travel allowances, telephone, and office materials.

Functional Classification: structures government activities and expenditures according to their purpose, for instance: policing, defence, education, health, transportation and communication. The United Nations standard functional classification, used in the preparation of national accounts and government Financial Statistics distinguishes 14 major groups, 61 groups and 127 sub–groups.

Economic Classification: structures government financial operations according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments: and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.

Administrative Classification: structures expenditure by the institution responsible for the management of funds. The structure of administrative classification will vary from country to country, as will the number and administrative level of the budget holder.

Programme Classification: structures expenditures according to programmes, considered as a set of activities undertaken to meet the same objectives. The programme classification may correspond to a disaggreation of the administrative classification or may cross administrative units.

Territorial classification: structures revenues and expenditure by the geographical area of impact of the financial operation.

Source: Based on Schiavo–Campo and Tommasi (1998), Chapter 2.

While such multi–dimensional budget classifications may support analysis, improving effectiveness and transparency, they are difficult to implement, requiring the cross referencing of expenditure items in the budget and subsequent accounts. Consequently, most budget systems continue to use administrative and line item classifications – usually structured so as to be compatible with the economic classification – complemented by estimates of expenditure by their functional and, in some cases, programme structure.

There is further trade–off to be made between the detail of the classification used for control purposes and the degree of flexibility given to budget holders in managing resources. Even for administrative control purposes, a very detailed budget presentation can be unhelpful. Budgets are often presented to a level of detail which obscures whether or not expenditure patterns and trends are appropriate, and which gives little insight into why and to what end expenditure is being incurred. Mozambique's line item classification, for instance, is extremely detailed, with more than thirty expenditure categories on the standard budget form, giving managers little flexibility to SWAP (vire) funds from, for example, transport costs to the contracting of services. It is not evident that any useful purpose is served by preparing or scrutinising budgets in this level of detail. On the other hand, broad administrative classifications can also be undesirable since they allow managers to divert appropriations originally intended for field service units to higher level administrative units: from schools, for instance, to district or provincial administrative departments. As discussed later, the trend in the literature and to some extent in recent reform programmes is towards giving managers increased discretion over how they use their budgets, but holding them accountable for what they achieve with them.

2.3 The Budget cycle

Figure 1 describes an idealised annual budget cycle. Steps 1 to 7 in this cycle are discussed in detail in Section 2.4 Budget Preparation and steps 8 to 11 in Section 2.5 Budget Execution. A number of general points are made here.

Firstly, it should be noted that the cycle is not unidirectional: the steps during the preparation process tend to be iterative, with proposals for the key outputs, such as overall resource envelope, sector limits and sector budget proposals, being subject to review and revision. During execution too, the budget is reviewed and altered in order to adapt to unforeseen circumstances (see Section 2.6 Budget Alterations).

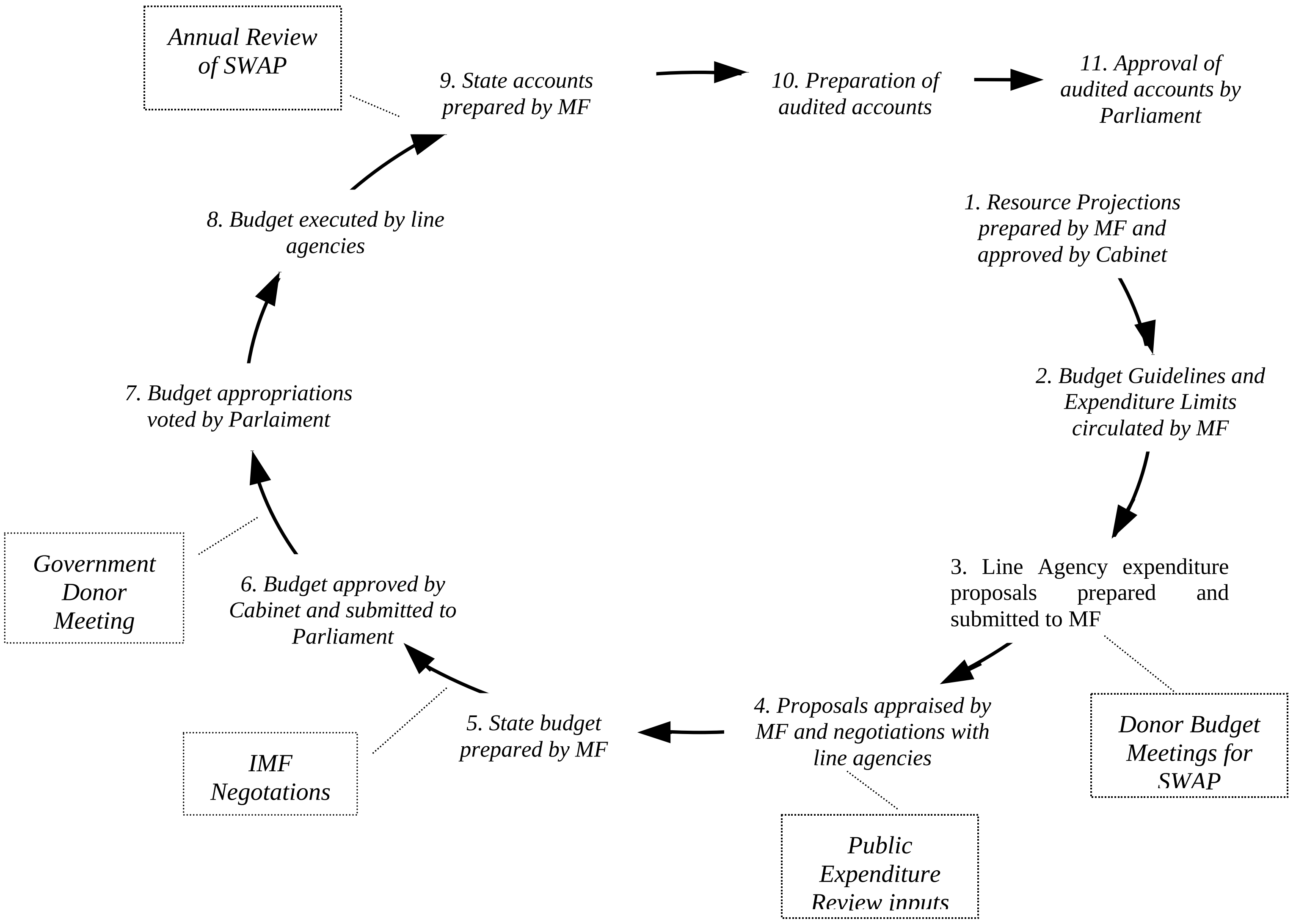
Secondly, the time frame for the budget preparation, execution and the finalising of accounts is typically three years: budget preparation may start a year or more before the budget year, execution lasts a year (annuality principle) and it takes a further year to prepare and audit the final accounts. This may seem like a long time: it is not. Lack of time, given human resource constraints, is often the cause of the superficial analysis that leads to incremental and unrealistic budgets. Pushing preparation back further from the start of the budget year may not be a practical solution to this problem since this will require even more distant, and therefore potentially less accurate, forecasts. These human resource and information constraints are compounded by the staggering of the budget cycles so that, at any one point of time three or more budgets will be in various stages of preparation, approval, execution and auditing.

Thirdly, an annual budget is too short a time frame for addressing development priorities, which require sustained implementation of policies and reforms over a medium to long term period. The budget cycle needs to be nested within a longer term policy and planning process, which provides a clear link from planning to the allocation of resources. In countries where the responsibility for planning and for the budget are separated, there are dangers of poor co–ordination between the two. This can lead to the dual problems of unplanned budgets which do not reflect policy choices, and unbudgeted plans which can not be implemented. The introduction of a medium term expenditure framework, providing indicative budget allocations for three or more years as a strategic framework to the budget, is one response to this problem.

Fourthly, the key stages in the budget cycle are, usually, the responsibility of different departments: budgets are usually prepared by a budget department in the line agencies and the Ministry of Finance, hopefully with contributions from planners; they may be altered by Cabinet or Parliament, often without time for consultation with those who prepared the initial budgets; substantial influence over how the budget is executed is held by accounts or administration departments in line agencies with oversight from an accounts department in the Ministry of Finance; and the budget is audited by an independent auditor. As a result it is difficult for any one agency or individual to have overview of the whole process. Typically, information flows between departments are poor so that, for instance, the departments responsible for execution may be unaware of the policies underlying budget allocations and so fail to take them into account when authorising budget alterations. Issues that arise during execution are, moreover, unlikely to filter back to those responsible for budget preparation.

Finally, the characteristics of the budget cycle, as described above, make it extremely difficult to close the feedback loop. The budget cycle is, purportedly, a planning cycle in which monitoring and evaluation inform formulation. This is only imperfectly so: in practise the most recent final out turn data available at the start of the budget preparation will generally be for two years before the actual execution period. Consequently, analysts usually have to make do with incomplete provisional estimates of expenditure out turns. It should be pointed out, moreover, that accounting information is prepared to verify compliance and so lacks the analytical content needed to support budget preparation. For these reasons, policy makers tend to place more reliance on periodic in–depth studies of public expenditure, such as Public Expenditure Reviews, than routine ‘monitoring’ information.

Figure 1: The Budget Cycle



2.4 Budget preparation

Budget preparation usually starts with an assessment by the Ministry of Finance of the macro–economic framework for the coming period, at least the coming budget year, the next three years if a medium term budget framework is in place (Step 1 in Figure 1). This will include assessments of GDP growth, and of the growth of domestic revenue, and of those external financial flows which support the budget. It will consider the scope for domestic financing of any budget deficit. The Ministry will also consider the non–discretionary spending which it will have to meet, i.e. those inescapable commitments which Government cannot vary by policy, such as debt servicing and pension obligations. Government may also consider the volume of the resources that should be held back in a contingency reserve. In most countries, public sector wage bargaining is centralised, and the contingency reserve will normally include an element to meet the cost of any civil service wage increase to be negotiated during the year. After subtracting the contingencies and the non–discretionary spending, the Ministry is able to forecast the resources available for allocation to Ministries and other spending departments.

An informed analysis of the resource needs of the various spending agencies should take into consideration actual expenditures. This is usually based on out turns from previous budgets and provisional estimates for the on–going budget exercise. Such information allows the Ministry of Finance to identify areas where existing limits are tight – constraining services or leading to overspending – or loose. Ideally, data on financial execution will be compared with performance targets for the delivery of services in order to appraise the efficiency of spending. In practise, the scope of analysis of prior years' results is often severely constrained by both the lack of data and time.

On the basis of the macro–economic forecasts, the Ministry of Finance will then issue a Budget Guidelines paper, setting out the basis on which spending departments should prepare their budget bids for the coming year (Step 2). This usually includes indicative ceilings for each department, though departments are free to contest these in subsequent budget discussions. Ceilings are often based on crude adjustments to the previous year's figures, taking account of the overall change in resources available for allocation. They may also take account at this stage of previous out turn figures or known policy commitments. Where a medium term expenditure framework is in place, the ceiling are taken from the second year of the previous forecasts, adjusted as necessary in the light of changes in resources available and the experience of budget execution (see Section 3.2). In most cases, however, the main influence is the agreed budget for the previous year. In some countries, Departments may be asked to prepare budgets based on both a high case and a low case scenario.

Each spending department and agency prepares a budget submission to the Ministry of Finance (Step 3). The format for these budget proposals or bids is usually determined by the Ministry of Finance in order to ensure that they can be aggregated using common classifiers and budget categories. While the content of budget format varies from country to country, they usually also contain some text setting out some justification for the overall level of the bid, and the priority expenditure programmes within it. The Ministry of Finance has the job of seeking to reconcile the bids from individual spending departments and the overall resources available. This may be done by correspondence, or there may be provision for specific budget hearings within the Ministry of Finance (Step 4). Contentious issues may be taken to the political level to be resolved by Ministers.

Following discussion of the budget bids, the Ministry of Finance puts together the overall budget consistent with the resource envelope as revised during the year, and submits it to Cabinet (Step 5). These provide the basis for Cabinet discussion, which may result in further revisions (Step 6). The

Budget is then presented and debated in Parliament, and then published, together with the detailed Estimates, setting out expenditures by department in whatever detail the procedures prescribe. The formal authority to spend in Commonwealth countries depends on Parliament voting for the funds through approval of the Finance Bill, hence the terminology of 'votes', the specific ceilings for expenditure voted by Parliament (Step 7).

2.5 Budget execution

When the budget appropriations are approved, resources may be released to the spending agencies, initiating budget execution (Step 8). The Central Bank normally holds Government funds within a single treasury account (albeit with sub–accounts) or general fund, known in Commonwealth Countries as the Consolidated Fund. Procedures for the release of funds from the general fund to the spending agencies account, usually held at a delegation of the central bank or a commercial bank, differ from country to country. In many LDCs funds are released in equal instalments either monthly or quarterly, the first release establishes an imprest account which is replenished against the submission of accounts. In most Commonwealth countries, the release of funds is controlled by formal warrants, which may specify the line items against which the agency may incur expenditure.

Spending agencies are usually responsible for the disbursement of funds to suppliers and contractors, following a series of steps designed to ensure that procurement procedures are applied and the limits set by parliamentary appropriations are respected. These steps are:

- **Commitment of funds:** Spending proposals are initiated by the department which will use the goods or services. These proposals are subject to a pre–audit by the chief accounting office of the spending agency to ensure that government procurement procedures have been followed, the decision to commit funds has been taken at the appropriate level of delegated authority, and the expenditure is covered by the appropriation. Once approved, the spending agency signs a contract or places an order for the delivery of goods and services.

- **Acquisition of goods and services:** The supplier or contractor presents the spending agency with an invoice for the goods and services delivered. The department which initiated the order confirms that the goods or services were received, in compliance with the terms and conditions, and requests that the accounts department makes payment.

- **Payment:** Payment is made by the accounts department of the spending agency by cheque or bank transfer. Cash payments are extremely rare and discouraged. However, in countries with sparse banking networks, there may be arrangements whereby, for example, the head teacher picks up the salary cheque on behalf of all staff, and makes payment in cash.

- **Accounting:** The transaction is registered as complete in the accounts once the payment has been made, immediately following the issue of a payment order.

Some variation on this procedure can be expected where commitment or accrual accounting systems are used (see Box 2) and where payment systems are centralised. In Tanzania, for example, all cheques are written centrally by the Treasury, which enables the Ministry of Finance to issue up to date 'flash reports' on expenditure. The spending agency will submit supporting documentation including the original order or contract, the invoice, and evidence of receipt of the goods or services. Finance will ensure that the documentation is complete and there are funds available in the relevant 'vote', and then issue the cheque or ask Central Bank to make payment direct to the creditor's account. In order to facilitate these operations in the regions, each region may have sub–Treasury, with outposted Treasury staff responsible for managing Government funds.

Box 2 The Basis of Accounting in Government

Virtually all developing countries operate a cash accounting system, that is transactions are registered once payment has been made, as indicated in the figure below. While this has the advantage of simplicity, it makes it difficult for the spending agency and for the Ministry of Finance to get a clear picture of the outstanding liabilities and payments arrears at any given point in time. Ideally, the spending agency would register commitments when orders are placed or contracts signed and communicate this information to the Ministry of Finance. Unfortunately, such information is rarely collected systematically.

It should be noted that the cash accounting system applied by most governments differs from the accrual accounting applied by the private sector and in the preparation of National Income Accounts. Under an accrual system, financial transactions are registered when the activities that generate them occur. Thus, expenditures are accounted when goods and services are delivered, even if payment has not yet been made, and revenues are accounted when a tax falls due or goods and services are sold, even if payment has not been received. From an economist's perspective, the principal advantage of the accrual method is that it captures the full costs of activities, including overheads such as physical assets used in the production of services. This is particularly important where, through, for example, contracting out or the charging of user fees, services may be put on a more commercial footing. Such systems are more complex than traditional cash accounting and, while many OECD countries may be introducing accrual systems, their application in most developing countries may not always be practical in the short–term.

Stage in budget execution	Action	Basis of Accounting
Budgetary Appropriations Released		
Commitment of Funds	Contracts signed and orders placed	Obligations or Encumbrance
Acquisition of Goods and Services	Goods and services received and invoiced	Accrual
Payment for Goods and Services	Payment order prepared and check issued.	Cash

Source: Based on Premchand (1995).

Disbursement mechanisms may also be centralised for certain kinds of transactions. In many countries the payroll is managed by a central agency, particularly where payroll is computerised. Arrangements may be made for the bulk purchase of commonly used goods, such as fuel. Foreign exchange transactions, for the import of goods and services, may also be restricted to Ministry of Finance and, in some cases, purchases for certain goods, such as cars, may be made centrally in order to avoid abuse by the spending agencies.

Requests for a release of funds by line agencies will normally be supported by statements of expenditure and bank statements showing the balance of funds. Since expenditures are usually registered on a cheques issued basis, bank reconciliation will require the deduction of a 'float' of cheques issued which have yet to be cashed. The line agency's account will be subject to audit, and documentation such as invoices and receipts will be retained by the spending agency to permit reconciliation of the bank statement with evidence of the underlying transactions.

Difficulties often arise in compiling and reconciling accounts owing to lags in the presentation of data by line agencies and regional authorities, particularly in decentralised systems, and arrears in payments, resulting from delays in the processing of payment orders by the line agencies, which are difficult to detect without an audit of unpaid bills. The timely compilation and reconciliation of accounts is particularly difficult where manual systems are still in use.

On completion of the budget year, the Ministry of Finance or Treasury will prepare final Government Accounts (Step 9) which are then audited by the Comptroller and Auditor General or equivalent (Step 10). To ensure independence, the Auditor is usually responsible to Parliament rather than to the executive, and Audit reports are laid before Parliament, and discussed by a Public Accounts or Budget committee (Step 11). While this process may appear relatively straightforward, since accounts will generally be closed on a monthly or quarterly basis throughout the year, many countries face considerable difficulties in finalising their accounts on time, if at all.

2.6 Budget alterations

While a hard budget constraint is an essential discipline on managers and an essential safeguard of parliamentary oversight, some flexibility is usually built into the budget system through contingency reserves and authorisations for the virement of expenditures from one budget line to another. Contingency reserves may be included within the spending agency appropriation or, more often, held centrally at the discretion of the Ministry of Finance. The scope for virement is usually fixed by law: in most countries it is not possible to vire between the salary and non–salary recurrent budget; nor between the recurrent budget and the investment or development budget, to which different approval rules usually apply. Where there is a significant divergence between the budget and actual expenditures, the government may be forced to revise the budget or request supplementary appropriations from parliament.

Frequent virement of expenditures may be an indicator of poor budget planning and management. It can also be an indicator of an over–detailed and inflexible line item classification and of lack of delegation of budget authority. Excessively detailed budgets, together with inappropriate definition of ceilings for line items, combined with a bureaucratic and time consuming process for re–allocation, can lead to inefficiency and prevent managers taking responsibility for programme objectives. Managers may find themselves unable to utilise their budgets sensibly because a ceiling on the maintenance budget, for example, prevents them from repairing vehicles needed for service delivery, even though there are funds in other budget lines.

Ideally the structure of the budget should protect resources flowing to priority budget objectives, while giving the responsible managers the flexibility to achieve those objectives. If improving the availability of books in primary schools is a key priority for improving the quality of primary education, then there are good reasons to discourage diversion of that budget in favour of salaries and allowances, or new school construction, or books and materials for higher education.

Major changes to the budget are often required to accommodate cuts or lower than anticipated growth in revenues or financing. There is a tendency for such cuts to be applied across the board, on the grounds that this is ‘fairer’ to the various spending agencies and easier to apply. Unfortunately, such indiscriminate cuts ignore spending priorities and the differing composition of expenditure, particularly as regards non–discretionary items. Where a substantial proportion of sector expenditure is dedicated to payroll, as is in the social sectors, cuts on discretionary items are likely to be more severe than in sector with a smaller payroll component. In all sectors, cuts will be directed at consumables. In some cases this will mean that staff continue to be paid although they lack the basic materials necessary to deliver services. Investment projects are another common target of cuts in expenditure, leading to the postponement of projects or the failure to meet commitments with donors for the financing of internal contributions.

Evidently, budget cuts require careful planning to avoid unnecessary distortions of expenditure and disruption of services. This is rarely possible when urgent cuts are required to tame a burgeoning deficit. Consequently, priority should be given to improved budgeting and forecasting in order to reduce the need for and scope of in–year budget alterations.

2.7 Cash planning and management

In many countries, reductions in the availability of resources are accommodated by restrictions on the flow of funds to the spending agencies rather than formal budget alterations. In these circumstances, managers will prioritise expenditures according to their own criteria – which may mean, for instance, that headquarter's administrative personnel are paid before those in the field – or continue to enter into commitments in the hope that funds will be made available at a later date. This can lead to the growth of substantial arrears, particularly to state owned utilities and suppliers, though the burden is likely to be particularly heavy on small–scale private companies. Where payments are frequently made in arrears, suppliers will tend to factor risk and financing costs into their prices or insist on payment in whole or part upon the delivery of goods and services. Both these practices raise procurement costs for government.

Improved cash planning and management is, therefore, often the key to the budget being executed as originally approved by parliament, preventing the build up of arrears – forced lending by suppliers – and minimising borrowing. To this end the government should have a clear picture of the cash resources at its disposal, prepare regular cash plans that forecast resource availability and ensure that the release of funds is predictable.

All Government receipts are, in principle, paid into and all Government payments are made from the Consolidated Fund. The Central Bank and the Ministry of Finance will keep a close eye on the cash balances within the Consolidated Fund, on a daily basis, and will plan the Government borrowing strategy on the basis of actual and expected movements in the cash balances relative to expected calls on them. There are usually strict rules calling for revenues to be returned to the Consolidated Fund. However, the number of special accounts has tended to multiply in recent years, owing to the retention of user fees by, for example, health sector facilities, the introduction of special road funds, and the creation of project and programmes accounts managed by line agencies. While a strong case may be made for the retention of revenues from user charges at service delivery units level (see Box 3), as a rule the resulting proliferation of other special accounts should be discouraged because it undermines treasury management. Government can find itself having to borrow to meet shortfalls on one account, despite having a positive balance in other accounts possibly in the same bank, so that Government is in effect paying interest charges to a Bank for borrowing its own money. Evidently, the concentration of Government cash within a single account will help minimise borrowing costs.

Government should forecast the pattern of spending across the financial year, in order to plan for Government cash flow and minimise borrowing requirements. In mature systems, each Ministry or Agency forecasts the profile of future expenditure and cash needs over the year. The Ministry of Finance will advise Ministries and Departments of spending and commitment limits by quarter, based on a review of the forecasts submitted. Revenue streams are relatively stable, owing to substantial contributions from sales and income taxes settled on a monthly basis. Where shortfalls occur, Governments in countries with well developed capital markets can raise funds through issues of short–term bonds and thereby stabilise the flow of funds.

Many developing countries, however, face seasonal peaks in revenues – often linked to the agricultural calendar, poorly developed capital markets and macro–economic constraints on their ability to borrow. Consequently, it is difficult to ensure a smooth the flow of resources during the course of the year. In these circumstances, short–term budgetary stabilisation is often achieved by restricting the release of funds and expenditure. In some cases, release of funds depends on revenue collection in the previous period, less non–discretionary payments such as debt service and the salary bill. Where this practice results in considerable fluctuation in cash flow it is seriously disruptive, making operational planning impossible and leading to an inefficient stop–start pattern of spending. Such drastic measures should only to be adopted in crisis conditions. Uganda has modified this approach, basing budget releases on revenue progress to date and regularly updated revenue forecasts.

2.8 Investment budgets and programmes

Many countries operate dual budget systems – even though the budget may be presented to parliament in a unified format – distinguishing: a recurrent budget which presents continuous expenditure such as payroll, operating and maintenance expenses, broken down by institution and line item; and an investment or development budget which presents – in theory at least – one–off capital expenditures, usually presented by project or programme. Responsibility for the preparation of the recurrent budget invariably rests with the Ministry of Finance, while the investment budget is usually prepared by a Planning Ministry or Commission in order to ensure a close link between the

Box 3 A special case for user fees?

The retention of user charges by service delivery units can provide a valuable incentive for improved performance, tends to enhance levels of collection and offers a cushion against irregular release of funds by treasury and, as is often the case, the retention of funds by administrative departments. Tracking studies in Uganda and Tanzania have shown that up to half the budget appropriations never reach the service delivery units for which they were intended, being retained and used by administrative units higher up the chain.

However, the retention of user fees at delivery unit level presents a number of challenges:

- there is a need for the clear legal authority for the collection of charges and information for users as to the rates to be charged, in order to reduce the risk of informal supplementary ‘fees’;
- services should be fully costed and budgeted at gross in order to present total public expenditure on the services provided;
- communities should be involved in the management of user fees, accounts should be publicly available and these should be subject to audit;
- care should be taken to ensure equity by allowing differential rates or exemptions from charges. Exemption schemes are, in practice, extremely difficult to make work. There is a substantial literature on this topic.

government's investment programme and its development plans.

Investment or development budgets can serve a useful function, particularly where these have been given a multi–year framework in a rolling Public Investment Programme (PIP). A well managed PIP allows the Government to:

- apply specific criteria for the appraisal and approval of investment projects, thereby ensuring that projects and programmes, including those initiated by donors, are consistent with government priorities, are technically and economically viable and that the contingent recurrent expenditures have been taken into account and foreseen by the relevant agency;
- establish the project or programme as a budgetary and management unit, making a clear link between project expenditures and performance;
- schedule project and programme financing, where this is derived from various internal and external sources, providing a bridge between the internal financing on the budget, which is based on the first year of the PIP, and aid financing that may be off budget (see Section 5.1).

Unfortunately, most PIPs are poorly managed. Screening procedures are not rigorously applied, allowing non–priority and poorly formulated projects onto the PIP often simply because external financing is available. Indeed, many projects may be included in the PIP solely for the purpose of attracting donor funding, leading to confusion between the projects that will be implemented and a 'wish–list' of projects that are unlikely to get off the ground. The distinction between the recurrent and investment expenditures is rarely clear–cut, allowing agencies to hide recurrent expenditures in the PIP and thereby get round tight recurrent expenditure limits. Consequently, PIPs often include 'projects' for doctors and extension workers salaries, once paid by donors and now financed by the government. Co–ordination between the PIP and recurrent budgets is generally poor, particularly where they are prepared using incompatible classification systems and macro–economic assumptions. This problem is aggravated by the institutional division of responsibility between recurrent budget, prepared by administrative departments, and the investment programme, prepared by planning departments: a distinction that often continues in line agencies even after Planning and Finance Ministries have been merged, as in Uganda and Mozambique. A frequent complaint is that investment decisions are not matched by the provision of adequate funds for operation and maintenance so that, for instance, recently built schools have no budget for teachers or teaching materials. In heavily aid dependent countries, where the investment budget may be almost entirely financed – 80% in the case of Mozambique – by development assistance, the need to ensure the provision of counterpart financing for projects and programmes may divert funds from higher priority expenditures.

In many countries the costs of poor PIP management far outweigh the benefits, leading some analysts to suggest that it would better scrapped and replaced by a truly unified budget[4]. Certainly, where a Medium Term Expenditure Framework is in place (see Section 3.2), there is little sense in retaining the PIP as a separate programming instrument for investment. Where a MTEF has yet to be developed, however, the PIP may, when properly managed, provide a useful transitional instrument, allowing the programming of aid expenditures that would otherwise remain off budget.

2.9 Interpreting government financial statistics

For the purposes of most economic analysis, DFID Economists will use aggregate budgetary data presented in the form of Government Financial Statistics. Box 4 shows how this aggregate data is

[4] IMF, 1999, page 6.

presented following IMF conventions, following an economic classification of government financial operations (see Section 2.2).

The top half of the table – 'above the line' – shows revenues and expenditures. The bottom half of the table – 'below the line' – shows how any overall surplus or deficit is funded. The IMF presentation treats grants from donors as an above the line item (an unrequited transfer) rather than as part of the financing of any deficit. For the purpose of discussing aid requirements, this practice is unhelpful, and it is usual to also present a line showing the budget deficit 'before grants'.

Interest payments and other service charges are shown above the line as expenditures – since these represent the cost of borrowing money – whereas the principle repayment or any new borrowing will be shown below the line as part of financing. The primary surplus or deficit excludes both grants and debt service, in order to show to what extent domestic revenue covers Government expenditure other than debt service.

Financing of the deficit ('below the line') will be by a combination of domestic and foreign borrowing, and changes in payment arrears (which constitute a form of borrowing). Domestic bank financing of any deficit leads to money creation. Where there is an IMF programme in place, there will normally be ceilings on net credit to Government, which constrain the use of this form of finance. However, borrowing ceilings may have a seasonal component, recognising that the pattern of receipts and expenditures varies across the year.

When analysing such data it is worth questioning how it was compiled. It is particularly important to ascertain the data coverage, noting the existence extrabudgetary funds and the treatment of autonomous agencies, local government and development assistance, which may or may not be fully accounted. Large residual items may be a signal of deficiencies or inconsistencies in the data, as are abrupt or unexplained changes in the pattern of spending. Be advised that Governments may massage budget information to present their policies and financial situation in a more favourable light. Since defence and presidential expenditures may not be regarded as high priority by the donors, there are examples of such spending being hidden elsewhere. The Fund may raise these issues privately with the Government, but may not feel able to breach confidentiality by discussing them directly with donors.

Box 4 Presenting Government Financial Statistics

A	**Total Revenue and Grants**	**876.6**	**15.8**	
A1	**Revenue**	**627.2**	**11.3**	
	Tax	588.8		
	Nontax	38.4		
A2	**Grants**	**249.4**	**4.5**	
	Import Support	87.4		
	Project Grants	162.0		
B	**Expenditures and Net Lending**	**991.1**	**17.8**	
B1	**Current expenditures**	**554.0**	**10.0**	
	Wages and salaries	167.4		
	Interest Payments	59.0		
	Domestic	13.6		
	External	45.4		
	Transfers to the Revenue Authority	19.7		
	Defense	88.3		
	Priority Program Areas	87.4		
	Statutory	34.7		
	Other	97.5		
B2	**Development expenditures**	**429.9**	**7.7**	
	External	360.0	6.5	
	Domestic	69.9	1.3	
B3	**Net lending and investment**	**7.2**		
B4	**Contingency**	**0.0**		
C	**Overall balance, including grants**	**-114.5**	**-2.1**	**= A-B**
C1	Excluding grants	-363.9	-6.5	= A1-B
C2	Domestic balance /3	41.6	0.7	
D	**Financing**	**-114.4**	**2.1**	
D1	**External financing (net)**	**195.4**	**3.5**	
	Disbursement	248.5		
	Import support	50.5		
	Project loans	198.0		
	Amortization (-)	-66.8		
	Payment of external arrears	-11.1		
	Payment of nondebt arrears	0.0		
	Exceptional financing	24.8		
D2	**Domestic financing (net)**	**-81.0**	**-1.4**	
	Bank Financing	-29.6	-0.5	
	Central Bank	-67.2		
	Commercial Banks	37.6		
	Non bank financing	-51.4	-0.9	
	Check Float	-28.8		
	Payment of domestic arrears	-23.1		
	Promissory notes (net)	…..		
	Other	0.5		
E	**Errors and omissions/financing gap**	**0.0**		**= C-D**

Source: Based on IMF, Government Financial Statistics.

3. Improving Effectiveness and Accountability

3.1 Common problems

Most budgets are prepared using the annual bidding system described in Section 2. This has the advantage of decentralising responsibility for budget preparation to the agency responsible for budget execution, whilst ensuring that the Ministry of Finance has final say on the overall budget allocations, thereby ensuring their consistency with global expenditure targets. However, the bidding system has been criticised extensively on the following grounds:

- **Failure to review the base budget.** Departmental bids generally take the previous year's budget as the base and request additional increments, ideally on the basis of an expansion of the services to be provided, more often as percentage increase. Negotiations with the Ministry of Finance focus on the increment, giving little consideration to the bulk of expenditure. Consequently, the bid system gives little scope to review of the relevance, efficiency and effectiveness of existing programmes or administrative overheads.

- **Failure to relate expenditure to resource availability.** Since base expenditures are taken as fixed, they can become the starting point for the whole budget process. This effectively turns budget planning process on its head, so that additional resource requirements are determined as a residual of expenditure minus guaranteed finance rather than determining additional expenditures on the basis of resource availability. The problem may be aggravated by unrealistic revenue projections, especially if Cabinet is reluctant to face up to the need for expenditure cuts for macro–economic reasons. A budget that is known to be unrealistic from the outset establishes a web of perverse incentives. Spending agencies will tend to commit funds as quickly as possible, for fear that later cuts will be imposed. If sanctions are weak, this may include taking on commitments beyond the official limits, and building up payment arrears to suppliers.

- **Departmental rather than programme or output orientation.** Budgets are prepared by and for administrative units rather than on the basis of the Government's objectives, programmes and activities. Emphasis is placed on the inputs required to ensure that the administrative machinery operates smoothly, with little attempt to relate inputs to activities or performance as measured by the services provided (outputs) or their impact on the public (outcomes). In resource constrained economies, this can result in divergence between the functions fulfilled by institutions on paper and reality. Where funds are scarce they will tend to be channelled into payroll expenses, leaving inadequate resources for activities, resulting in schools without books, extension services without fuel to visit farmers, and clinics without drugs.

- **Inadequate timeframe for analysis of expenditure.** An annual time frame will not capture the long–term implications of expenditure decisions: for example, the recurrent cost implications of on–going capital expenditures, such as road or hospital construction, will not be reflected in the budget until they become operational. Similarly, the short–term focus is likely to subordinate longer–term development priorities to immediate needs.

- **Encouragement of a cynical attitude.** Spending agencies will tend to bid high because they expect their proposals to be cut back. As a result, Ministries of Finance will be faced with overall spending proposals that greatly exceed the overall targets and, under pressure of time, impose arbitrary cuts on agency proposals. Since the spending agency does not feel directly responsible for the final budget figures it has little commitment to the limits imposed. There is, moreover, an incentive for the agency to fully spend its budget, since the Ministry of Finance will generally take execution rates into consideration when setting the following year's budget limit. To avoid under spending, there is often a surge in agency spending in the last quarter, often on frivolous items. Moreover, spending agencies have no incentive to proffer savings which they fear will be clawed back to the centre, and hence continue to plan budgets which feature a range of activities, facilities and staff which can not feasibly be funded at efficient levels of activity.

Awareness of these problems is nothing new. There is a long history of attempts at budgetary reform, most of which were initiated in the United States and Europe and subsequently filtered down to developing countries, such as Programme Budgets of the 1960s and Zero–Based Budgeting of the 1970s. These top–down reforms met with little success, largely because they sought to address technical problems and failed to improve managerial capacity at operating levels. More recent reforms have, in contrast, sought to combine technical innovation with managerial reform by increasing the autonomy and accountability of government agencies, giving them greater flexibility in the use of resources whilst holding them responsible for results. Sections 3.2 and 3.3 will illustrate how more effective budgeting is linked to wider issues of public management reform in developing countries by analysing the application of two new budget management tools: the Medium Term Expenditure Framework and Performance Budgets.

3.2 Medium term expenditure frameworks

The Medium Term Expenditure Framework (MTEF) is a planning tool that seeks to:

- **match expenditures with overall resource availability**, thereby ensuring budgetary stabilisation in the short term and define sustainable expenditure levels for the longer–term;
- **guide the sectoral allocation of expenditures** in line with government's development priorities, on the basis of a comprehensive review of resources, policy options and their cost;
- **facilitate strategic sector planning** by ensuring a more predictable flow of resources on the basis of indicative limits over a three to five year period and the simultaneous programming of recurrent and investment expenditures and both internal and external financing; and
- **improve the efficiency of expenditure**, by requiring line agencies to define their mission, objectives and activities and, where possible, link expenditure to measures of performance in terms of outputs and outcomes.

Although many countries have used resource forecasting tools for some time, the MTEF represents a significant innovation in its emphasis on the sectoral allocation of expenditure and the linkage between expenditure and performance. In the past, resource forecasting has generally been restricted to the preparation of expenditure aggregates in order to define a hard budget constraint. Consequently, it has failed to provide decision–makers with a sound basis for the inter–sectoral allocation of the resources available. Similarly, while planning systems may routinely generate statistical information on sectoral performance, these have rarely been used as an input to the budgeting process.

In essence, the MTEF consists of a 'top–down' resource envelope consistent with macro–economic stability, a 'bottom–up' estimate of the current and medium term cost of existing national priorities, and a framework which matches these costs with available resources through an iterative decision making process. Box 5 demonstrates how this process unfolds.

Preparation of a MTEF is by no means straightforward. There are no hard and fast rules to guide the inter–sectoral allocation of resources that lies at the very heart of the MTEF process. Since most Government's already allocate their resources broadly in line with priorities, the MTEF may apply an incremental approach rather than a fundamental restructuring of public expenditure. A time frame of three years may, moreover, be inadequate to demonstrate the effects of new policies which may take several years to come on stream – an expansion in the number of teachers, for instance, will take many years, since teachers have to be recruited and trained. Consequently, the temporal perspective of the MTEF, while much better than that of the budget, may not be sufficient to evaluate the relative cost of policy options.

Most line agencies are poorly equipped to cost existing or new programmes. This reflects, in part, the departmental structure of most budgets, whereby it is practically impossible to disaggregate the total cost of activities, leaving a substantial administrative overhead unallocated to any particular programme. Even where new budget classifications have been introduced, as in Ghana, this problem has yet to satisfactorily resolved. Besides, government agencies may be unsure of their mission and have poorly defined objectives and programmes. In Mozambique, the MTEF exercise focussed on those sectors that embarked on a sector programming exercise, since only these institutions had clearly defined objectives and preliminary costings for their programmes. For the remaining sectors, the Ministry of Planning and Finance was forced to extrapolate existing budget allocations, in some cases using the population growth rate as the basis for annual increments.

Where local government is responsible for a substantial range of public services and transfers are determined by statute, as in South Africa, the scope of the MTEF process to influence the structure of expenditure is severely constrained, since the integration of local government within the MTEF process is impractical for logistical reasons. Even where the structure local government expenditures are largely defined by central government, as in Mozambique, a territorial dimension to the MTEF has yet to be achieved owing to the difficulties in defining a multidimensional agency, programme and provincial matrix.

Box 5 Steps in the preparation of a MTEF

1. **Preparation of the resource envelope.** This is based on forecasts of economic performance during a three to five year period, from which revenue estimates may be derived, and forecasts of development assistance flows. In Ghana and Mozambique macroeconomic models are being developed in order to generate more realistic resource projections.

2. **Definition of the three to five year sectoral resource limits.** The resources available for allocation are determined by deducting funds committed by contract or agreement (such as counterpart financing of aid and debt service obligations) and statutory expenditures (such as pensions and inter–governmental transfers) from the overall resource envelope. Sectoral expenditure limits are then defined on the basis of government priorities and submitted to Cabinet for approval, usually several months before the beginning of the annual budget cycle.

3. **Preparation of Sector Programmes.** The sector ministries prepare medium–term strategic plans that set out their key objectives, outputs and activities, together with expenditure forecasts within the spending limits agreed by cabinet. These plans should take into consideration the cost of both on–going and new programmes, relating the expenditures to the performance targets to be met. Expenditures are generally presented by programme, with broad classifications of expenditure categories. In Ghana and South Africa these correspond to the final budget classifications. In Mozambique, the MTEF expenditure categories are simplified in order to facilitate preparation and analysis of the forecasts.

4. **Review of the Sector Programmes by Ministry of Finance.** The Ministry of Finance analyses the sector programmes to verify their consistency with the government priorities and the expenditure limits, focusing on broad strategic issues rather than the detailed structure of the proposed budgets. Where the sector forecasts exceed the limits, the Ministry of Finance may assist the sector agency in trimming expenditures or require request additional information in order to revise the limits.

5. **Submission of Revised Limits to Cabinet.** On the basis of this review, the Ministry of Finance will propose revised multi–year limits for sector expenditure for approval by Cabinet.

6. **Finalisation of Budget and presentation to Parliament** In South Africa and Ghana, the three year forecasts are presented to parliament in the government's budget proposal, the first year of the programme being subject to parliamentary approval while the second and third years are indicative spending forecasts. In Mozambique and Uganda, on the other hand, the MTEF multi–year forecasts are internal government working documents used to set the annual budget limits. The annual budget is then prepared by the line agencies, submitted to the Ministry of Finance for aggregation and presented to parliament.

7. **Review and Rollover**. The following year, the expenditure estimates are reviewed in relation to performance and preliminary budget out–turn data, where available. These provide an input to sectoral resource limits in step 2 of the next MTEF process, together with an analysis of policy changes and their budgetary implications.

Source: Based on Muggeridge (1999)

Most MTEF exercises – such as those of South Africa, Malawi, Tanzania, Ghana, Ethiopia and Mozambique – are still at an early stage of development. A preliminary appraisal suggests that they have already proved effective as a means of bringing expenditures in line with resource availability and providing a basis for the inter–sectoral allocation of these resources. However, this is only the case where politicians are willing to make the difficult decisions needed if resources are to be allocated in line with priorities, and to stick with them. In Uganda, for instance, the MTEF has been used to identify specific high priority expenditure items within the poverty eradication action plan for specific protection from any cuts which prove necessary. Where ad hoc reallocations and inconsistent macro management continue, then the process will lack real content. The validity of the MTEF process also depends on the level of coverage of government resources, including aid flows, within the budget framework. In many countries coverage continues to be poor.

The extent to which an MTEF process can, in itself, bring about improvements in the efficiency and effectiveness of public expenditure at sectoral level is less clear. Even where sectoral performance indicators are prepared and presented to Cabinet, spending limits are often determined by the perceived need for future expenditure rather than the historical performance. Existing budgetary structures generally do not provide decision–makers with a clear link between programmes, their outputs and outcomes, and expenditures that would inform such decisions. Besides, line agency managers may lack the autonomy necessary to bring about changes in performance even where this information is available. These issues, and their implications for budgetary reform, are discussed in following section.

The MTEF provides an important link between the budget and the political process, both at Cabinet and, where forecasts are published, Parliamentary level. Consequently, the MTEF is a useful entry point for budget reform initiatives. Ultimately, however, the MTEF will only be as effective as the weakest link in the public expenditure management system: the effort in preparing medium–term forecasts of expenditure, for instance, is likely to be lost where funds are not released to spending agencies as programmed. In these circumstances, it is essential that the introduction of expenditure programming instruments be considered in the context of wider public financial management reform programme (see Section 6).

3.3 Performance management and budgets

Public finance management systems have traditionally emphasised control over achievement. Budgets have often been allocated on a historic basis, not linked to objectives. Highly centralised decision making and control systems have left many public servants unable to take initiatives to secure improved results even if they should wish to do so. The size and all–encompassing nature of the state is seen as a further source of inefficiency. As public choice economics gained acceptance at a political level in the OECD countries and in the Bretton Woods institutions, it was argued that the bureaucracy existed, to a large extent, to serve its own interests and would expand inexorably unless curtailed by politicians or the international financial institutions. At a micro level, patronage systems or outright corruption were seen as inherent weaknesses of public institutions, controlling access to public sector jobs, creating alternative incentive systems in which the purpose of the job may be seen as supporting the patron or recouping the personal investment, rather than a conventional public service rationale. The public service may settle into a low level equilibrium, in which the lack of financial incentives and low expectations combine to generate low performance.

From this perspective, a clearly defined and realistic mission and managerial autonomy, supported by appropriate performance measures and incentives, are seen as requirements of an effective and efficient public sector and public expenditure management system. These issues are addressed in the following subsections:

An appropriate role for public institutions

For economists, the rationale for the public sector lies in addressing market failure and the concern for equity (see Chapter on Micro Economics). However, an institution's mission should also reflect its capacity to deliver, considering both the financial and human resources at its disposal. On this basis, the World Bank[5] has proposed a hierarchy of functions for the state which may also be applied to individual institutions. This distinguishes:

- Minimal Functions: restricted to the provision of pure public goods (law and order, defence, macro–economic management and public health) and protecting the poor (anti–poverty programmes and disaster relief);
- Intermediate Functions: which aim to address externalities (basic education and environmental protection), regulate monopolies, overcome imperfect information (financial regulation and consumer protection) and provide social insurance (redistributive pensions, family allowances and unemployment insurance); and
- Activist Functions: which seek to co–ordinate private activity and redistribute assets.

Institutions often seek to fill a much broader mission than they are able manage or adequately resource. While this may be patently obvious to service users, politicians are usually reluctant to trim back public agencies' functions to more realistic levels. Such policies may be encouraged by public debate over the mission of key service delivery institutions and the identification of alternative, often private sector or non–governmental, service delivery agencies who can take up part of the burden. In Mozambique, such discussions formed the starting point for the development of sector programmes, paving the way for private sector service delivery in education, health water and agricultural services.

Agency management

There is widespread recognition that centralised top–down planning and control – as in traditional budgeting systems –can be highly inefficient, leading to institutions that are inflexible and unresponsive to changing needs and demands. At the same time, central departments and the political leadership wish to ensure that key policy priorities are fully reflected in the expenditure programmes of line agencies. Moves towards performance management and performance (or programme) budgets in some OECD countries, and in increasing numbers of low income countries, are a response to this dilemma. The central idea is that line ministries are given more autonomy over how they manage their budgets, but have to agree performance targets, which they are accountable for achieving with the resources voted to them.

One mechanism that has gained popularity in this context is the performance contract, which sets out the performance targets and standards which the budget holder agrees to achieve. This mechanism was used extensively in the reforms in New Zealand (see Box 6), and remains a central feature of the management of 'next steps' agencies in the UK. Ghana is also making extensive use of performance contracts, not only between the central finance ministry and line ministries, but between line ministries themselves and budget holders down to district level. Though not called performance contracts, the Tanzania education sector programme is based around district education plans with specific targets, with each year's release of funds based on a review of implementation performance.

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[5] World Bank (1997,p. 27).

Box 6 Giving autonomy to line agencies

The example of Public Sector Management Reform in New Zealand is particularly interesting because managerial autonomy has been achieved within the framework of the departmental or ministerial structure of the state rather than through the creation of autonomous agencies. The table below shows how this autonomy has been achieved, comparing the situation after reform with that before the reforms took place, when New Zealand's public sector applied the centrally controlled civil service model prevalent in most developing countries.

After Reform	Before Reform
• Chief Executives appointed on fixed term contracts	• Managers hold permanent contracts within civil service
• Chief Executives negotiate annual performance agreements for themselves and their departments which are subject to appraisal	• No explicit requirement for departments to meet performance targets and no formal appraisal process
• Ministers purchase and departments provide services, allowing contestability with the private sector	• All services are provided by departments, there is no competition with private providers
• Ministers responsible for the achievement of outcomes and chief executives responsible for outputs	• Division of responsibilities between Ministers and managers unclear.
• Chief Executives have authority to manage departments, contract and dismiss staff and negotiate collective agreements	• Civil Service Commission regulates employment of civil servants, their salaries and working conditions
• Departments manage their own funds and bank accounts, paying or earning interest depending on size of cash balance	• Treasury manages funds and regulations determine how departments will administer expenditures
• Appropriations voted on the basis of outputs rather than inputs, giving managers freedom to alter the composition of inputs	• Appropriations prepared on the basis of inputs, which subsequently determine what departments may purchase
• Where services are contestable, trading revenues may be budgeted net and departments may spend all of their revenue	• All appropriations are presented as gross and revenues are usually surrendered to Treasury
• Accounts prepared on an accrual basis and departments pay capital charge for assets	• Accounts prepared on a cash basis and capital assets treated as "free"

Source: Based on OECD (1997: 75–98)

Measuring performance

One of the major problems faced in the introduction of performance management and budget systems is the definition of appropriate **measures of performance**. Schiavo–Campo and Tommasi (1999) distinguish the following performance measures, as illustrated by the examples presented in Box 7:

- **Inputs:** the resources used to produce services, whose social value is measured by their cost. The performance criterion corresponding to inputs is compliance, defined as adherence to budgetary limits.

- **Outputs:** the services provided, whose social value may be approximated by market cost of the closest equivalent service. The performance criterion corresponding to outputs is efficiency, that is, minimising the total input cost per unit of output.
- **Outcome:** the purpose that achieved by providing the service. The social value of outcomes is generally revealed by public reaction in the political arena. The performance criterion is effectiveness, that is, maximising the outcomes in relation to the outputs produced.
- **Impact:** the value added from the output, the gross income minus the contribution from other activities. This takes into consideration the contribution of other services to the achievement of outcomes but is, in practise, impossible to measure.
- **Process:** the manner in which inputs are procured, outputs produced and outcomes achieved. Although such indicators are usually qualitative they may be given a quantitative dimension through the use of service user surveys. These measures can provide a useful proxy for outcomes.

Box 7 Levels of performance indicators

Sector	**Type of Indicator**			
	Input	**Output**	**Outcome**	**Process**
Administration	No. Staff	No. Policy Papers	Better Decisions	Openness of debate
Education	Student/teacher ratio	Retention Rates	Higher literacy	Encouraging expression
Health	Nurses/ Population	No. Vaccinations	Lower morbitity	Caring for patients
Social Welfar	Social workers	Persons assisted	Exists from system	Dignified treatment
Police	No. Police Cars	No. Arrests	Decline in crime rate	Respect for rights

Source: Schiavo–Campo and Tommasi (1999: Chapter 15) Web Version

One of the challenges of performance management is to link the responsibilities of various levels of an institution, and levels of personnel, to an appropriate performance measure. The director of a village clinic may be held responsible for the coverage of vaccinations achieved, for example, but he cannot be held responsible for the overall health status of the population. Consequently, performance management systems generally match a hierarchy of measures to a hierarchy of responsibility and accountability.

Performance measures should also be carefully formulated to ensure that they do not distract attention from more fundamental goals. For example, targets for the percentage of children achieving a given literacy standard can lead to unwelcome concentration of teaching effort on those close to the borderline, ignoring the needs of those with very low or very high attainment.

Performance measures should also be sufficiently precise – not necessarily quantifiable – so as to permit verification. So–called ‘strategic objectives’ which are so general as to rule nothing out, and are consequently devoid of operational relevance, are of no use.

Holding managers accountable

The second requirement of the performance budgeting system is a mechanism for linking resources to targets and holding institutions and managers accountable for performance. Performance appraisals are particularly useful where these allow peer comparisons and benchmarking. This can work very powerfully at district level, enabling managers to compare and contrast their performance with other districts, can help to build a spirit of emulation and healthy competition. Closer research can also help the centre to identify the characteristics of better performing districts, and can help in the design of programmes to help poor performers improve. At national level, comparisons with other countries can be a powerful spur to politicians to allocate funds and support reforms aimed at achieving standards no worse than their neighbours, especially where a free press is able to access transparent information on relative performance.

Creating an environment conducive to performance

These initiatives are only likely to succeed where managers operate in an environment conducive to improving performance: where they enjoy autonomy for operational matters, are held personally responsible for their performance and there are adequate incentives for all personnel to increase the efficiency and effectiveness of service delivery. The New Zealand example demonstrates how institutional reform can liberate managers from public sector wide – ‘one size fits all’ – rules and regulations. Incentives can be introduced for institutions and for personnel. Allowing agencies to carry forward a proportion of undisbursed funds, for instance, creates an incentive for managers to achieve efficiency savings. Performance related bonuses and salary supplements for personnel working in rural areas or strategic posts can have a significant impact on both the performance and continuity of personnel.

Ultimately, however, institutional and budgetary reform can only provide management with the tools for improving public sector performance. Where there is no culture of performance – where poor management is no criticised and good performance is not praised – changes in behaviour are unlikely to follow. The following two sections illustrates some of the means by which this culture can be instilled within the public sector.

3.4 Improving transparency and accountability

In recent years, transparency has come to fore as a key criterion in the appraisal of public financial management systems. The IMF has recently issued a ‘Code of Good Practice on Fiscal Transparency’[6] and supporting manual which seeks to assist governments in meeting the five key objectives, namely:

- Clarity of the role and responsibilities of government and public financial management institutions, which should be reflected in a clear legal and administrative framework for fiscal management;
- Public availability of information on government’s fiscal activity, through the publication of historical series on budgets and timely publication of budgets and accounts;
- Open budget preparation, execution and reporting, as reflected in budget documentation that specifies the policy basis for the budget and identifies major fiscal risks, a classification

[6] See http://www.imf.org/external/np/fad/trans/summary/summary.htm

system that facilitates analysis, clear procedures for execution and monitoring, and timely and comprehensive budget reporting systems; and

- Public and independent assurances of the integrity of fiscal information, through, most importantly, an independent national audit body.

The technical and procedural measures proposed by the IMF are designed to ensure the accountability of the public financial management system to: senior managers and politicians responsible for the management of the system; and parliament, through its oversight and approval of fiscal management instruments, such as the budget, state accounts and auditors reports. Although the effective functioning of such accountability mechanisms is an important safeguard for the public, they are, all too often, far removed from the public's day to day to day experience of public institutions and do little to empower citizens in the management of a key resource: public money.

To address these concerns, some governments have sought to foster greater involvement of the public in the budgetary process and make the decision makers directly accountable to the public. It is hoped that, by involving those who are supposed to benefit from Government services in decision making, the efficiency and effectiveness of public expenditure will be improved and fraud reduced.

There is a wide spectrum of possible involvement, from simply consulting the users for views on priorities and performance, through to the users having an important role in managing the Government funded service. The choice of mechanism will depend on the purpose of involving the wider public, distinguishing:

- **Consultation on priorities**, through Participatory Poverty Assessments (PPAs) and national consultation exercises. These may be one–off exercises, often intended to identify priority projects, though in Zambia PPAs have been carried out on a regular basis and provided an input to budgetary decision making, providing support for sectoral allocations on rural roads amongst others.
- **Appraisal of performance**, through service delivery surveys and CWIQ surveys. Such surveys may also include an assessment of the honesty of public servants, measuring informal user fees and demands for bribes, through an integrity survey as carried out in Uganda. In Bangalore, India, 'report cards' have been used to allow citizens and businesses to rate the quality of services, providing a spur to improved performance in the weakest institutions.
- **Improving transparency** by publishing and informing the public of budgets, transfers and staffing complements at facility and district level, as is now the practise in Uganda. Similarly, public information may be extended to cover service delivery standards and customer 'rights'.
- **Providing redress** through channels for complaint, independent mechanisms for investigation and follow–up, as applied in the Indonesia social safety net.
- **Involving communities in the management of facilities**, this may include the setting up of co–ordinating bodies, such as parents committees at schools, as a mechanism for raising the community's concerns or the creation of governing bodies with authority to approve budgets and accounts and select, promote and dismiss staff. Community representatives may also be asked to manage user contributions and exemptions from user–charges.
- **Involving the public at a policy level**, through broad consultative exercises in the media and through public meetings or by the inclusion of Community Based Organisations in national management and policy bodies.
- **Advocacy groups**, which seek to defend and promote the interests of particular groups by improving access to public services. However, these groups more often represent powerful 'lobbies' than the poor and marginalised, who tend to be less well organised.

Box 8 illustrates how these instruments have been used to improve transparency and accountability in Uganda’s education system. Experience from elsewhere in Africa tends to confirm that the community involvement is most effective in the management of village level service delivery units, since villagers have an incentive to ensure that an adequate level of performance is maintained and can clearly identify where it is not – if, for example, teachers are absent or drunk. Efforts to promote district councils as a representative body with authority over the allocation of resources have often foundered because the district may appear as distant and alien as the capital when seen from a village. Particular difficulties are encountered in trying to build in participatory management for services that cover a wide area, access is competitive and asymmetric knowledge makes it difficult for users to judge quality. Nevertheless, it can still be worth attempting to design involvement in ways which confront these difficulties.

It should not be assumed that more transparent, accountable and participatory public sector management and budgeting is always the result of administrative fiat and the product of top down reforms. Experience from Brazil demonstrates that Community Based Organisations have effectively used the budget process at municipal level as a means of empowerment, by presenting proposals for approval by Council and ‘naming’ councillors who have voted against them. This has required a considerable investment in improving awareness and understanding of the budget process and resource allocations through public education. As might be expected, public interest in the budget has not always been welcomed by councillors[7].

[7] Scanlon, Ted (Undated).

Box 8 Improving transparency and accountability in Uganda's education system

Conditional Grants are paid by Ministry of Finance (MOFPEP) to Districts, who are required to pass the full amount on to schools at a standard rate per pupil enrolled, with 9 monthly releases. Guidelines to schools advise how the grant should be spent. The District provides a return recording the releases made. Each school provides termly accounts of amounts received and expenditures made to sub–county and district. A School Management Committee and School Finance Sub Committee (SFSC), with teachers and non–teachers, approves the school budget, signs the school accounts. One non–teaching member of SFSC is a signatory on the school bank account.

For transparency and accountability to parents, there is a requirement to publish and display to the public details of all fund releases and how they are spent at all levels down to the school. A June 98 sample survey found that over 90% of schools and districts do display this information. Government also publishes details of releases, the schools they are intended for, and the use to be made of them, in national and local media.

Although these measures have undoubtedly improved the transparency and accountability in the use of funds, an independent audit and National Integrity Survey revealed a number of problems:

- Delays in receipt of funds. It can take 2–4 months for funds to get from MOFPED to schools. Funds are received late in the term (or after it finishes), due to bureaucracy, banking inefficiency and district delays.
- Some funds are retained at local government level when intended for Conditional Grants to schools (6%), and there are problems in monitoring of fund use, but these were not as serious as might have been expected (given the results of earlier fund tracking studies).
- Up to 9% of payroll data was of doubtful accuracy. Further system strengthening, and independent audits, were planned under economic management project:
- 10% of parents were still paying school fees for education which should be free. However, the education service has the lowest level and incidence of bribes.
- Overall monitoring of compliance with financial management and accounting requirements was judged to be weak.

Source: Ministry of Education and Sports Uganda, DFID (EA) (98)41, 24/9/98

4. Poverty and Public Expenditure

4.1 Key issues

Poverty reduction is becoming the central objective of development co–operation. This is not only true for DFID, as set out in the 1997 White Paper, but is also the underlying objective of the International Development Targets to which DAC donors have committed themselves. The World Bank and the IMF have also embraced poverty reduction as the main objective of their programmes in low income countries, and have called for Poverty Reduction Strategies to be prepared by all IDA countries. The poverty reduction strategy process will involve an annual assessment of the success with which Government policy addresses poverty issues, an assessment which will be discussed by the Bank and Fund Boards. One key issue for the poverty reduction strategy and the Bank/Fund assessment of it will be the effectiveness with which Government expenditure, and the way in which it is financed, seeks to enhance the welfare of the poor.

Economic theory is unable to tell us with any precision how best to allocate resources between sectors in order to have the maximum impact on poverty reduction. There is legitimate room for disagreement on aspects of poverty strategy, and the legitimate forum in which that disagreement should mainly be played out is the domestic political arena. However, although it is difficult to be confident of what is the ‘best’ poverty strategy, it is rather easier to detect aspects of budget policy which are clearly not aimed at poverty reduction, or which are plainly ineffective or counter–productive. Although, in most countries, we may be uncertain as to the precise location of the destination we wish to reach, the general direction in which we must travel is clear.

In assessing expenditure policies from a poverty perspective, the key questions are:

- Is there a plausible diagnosis of the problems of the poor and how Government action may help to move them out of poverty?
- Is Government expenditure being directed towards the priorities that are consistent with that diagnosis of problems and solutions?
- Are there good feedback mechanisms for monitoring the effect of Government policies and programmes and for taking corrective action where necessary?

4.2 Defining the target population

In a poor country, up to 80% of the population may be below the internationally defined poverty line of $1 per day. The Government may have no realistic prospect of reaching the whole population with basic services unless and until it can generate economic growth to raise living standards and the tax capacity of the economy. Since the poorest within a poor population are likely to be the most costly to reach with Government services, it may be preferable to give priority to helping the majority who are poor rather than specifically targeting of the minority who are deeply poor. Following this strategy Government would focus on broad– based growth and the extension of services to unserved populations in a sequence determined by their relative cost–effectiveness. This is not a defence of manifestly unjust distributions of expenditure which exclude certain regions or ethnic groups; and it reinforces the case for a tight definition of the essential services which Government should finance, in order to permit as broad a coverage as possible. Nevertheless, there are important issues of sequencing and of trade offs which can not be ignored, and should be made explicit.

In middle–income countries, in contrast, a focus on improving the welfare of the poorest may be a more feasible objective, and the main rationale for development co–operation.

4.3 Diagnosis

Household surveys enable the location and sources of income of the poor to be identified, together with other socio–economic characteristics including gender, age, and household composition. Such data should be supplemented by information on the perceptions and priorities of the poor, collected via participatory poverty assessments. Information is also needed on their access to public services, and experience of trying to use them, including views on the quality of what is offered, and experience on such things as informal user charging.

Exercises to identify the priorities of the poor are not an infallible guide, but they can be useful provided they are used with judgement. When they do not expect to have to pay for services, for instance, communities will tend to prefer the expensive over the cost–effective. They may lack knowledge of the costs and benefits of the various options, particularly when they do not have access to the service they are asked to judge. Responses may be over–influenced by past experiences of successful (or failed) interventions, or by perceptions of what the investigators are able to offer. Priorities will differ between men and women, between the better off and worse off, and between landed and landless, and so studies should be carefully differentiated.

Participatory exercises can be particularly useful in revealing the main problems faced by the poor. African PPAs have emphasised the importance of improved road access, convenient water supplies and personal security. They have also revealed marked differences in priorities between service providers and service users. In Zambia, for instance, health staff gave prioritised physical improvements to facilities, whereas the poor identified high and uncertain fees, lack of drugs, and staff attitudes as factors influencing whether they used Government services.[8] In Tanzania, education staff once again emphasised poor quality physical facilities, whereas parents stressed high fees for poor quality teaching.[9] PPAs have confirmed the importance of hospital access for the poor, as well as preventative and primary healthcare, given the consequences of work time lost by sick breadwinners. These studies have influenced the priorities of health sector programmes, which invariably include at least first level curative care within the essential services package. In Bangladesh, for instance, the design of social health insurance schemes was modified to include curative care in recognition that this was essential if the poor were expected to pay.

Other useful tools for diagnosis and monitoring purposes include Community Welfare Indicators Surveys (CWIQ), as used in Ghana;[10] and Service Delivery Surveys, as used in Uganda, Tanzania and Bangladesh[11]. Both approaches involve obtaining quick and reliable information on the access which people have to Government services, and views on the quality of those services. The CWIQ surveys also gather data on a range of other indicators correlated with poverty. Uganda and Tanzania have used expenditure tracking studies to detect fraud and diversion of funds,[12] while

[8] Booth (1998)
[9] Chigoriga et al. (1999).
[10] Strode (1999) .
[11] CIETcanada (1999)
[12] Price Waterhouse Coopers (1999); Economic Policy Research Centre and Management Systems and Economic Consultants Ltd (1996).

Uganda has undertaken integrity surveys to ascertain the incidence of bribes being sought by public servants within different parts of the public sector.

4.4 The policy response

Geographical targeting

One of the most difficult policy judgements is whether funds should flow to where the poor population is located, or to areas of higher economic potential to which the poor have links, or can be encouraged to develop them. Within poor regions, there are choices between investing to develop people to become more mobile, or investing to develop unpromising locations with problems of low returns and doubtful environmental sustainability. There is room for reasoned debate, though major disparities in the per capita spend between regions should be questioned, with a general presumption that less well endowed regions should expect to receive extra help from central Government.

Within decentralised systems, equalisation grants are often proposed in order to compensate poor districts that have lower revenue capacity but greater needs. The process of agreeing a formula for such grants often becomes highly politicised and it is often difficult to apply a simple and equitable formula based on population and equity. There is a moral hazard, especially if revenue raising is brought into the equation. It may be possible to achieve the same ends by less contentious means using specific grants, such as Uganda's universal primary education grant. These are based simply on primary school enrolments and proved strongly equalising once UPE had opened access to all children.

Poverty and coverage of services

The critical question concerns the relationship between the future resource envelope, the services to be provided from Government funds, and the coverage which Government can afford. A common problem of public expenditure in poor countries is a commitment in principle to provide a range of services to everyone which, given available funds, can in practice only be afforded for the few. If the package of health services costs $12 per head, but Government can only afford $5, there will be a financing gap. Consequently, the coverage of Government services will be lower than planned (which in practice is most likely to exclude the poor and remote communities) or the services provided will be under–resourced, leading to ineffective services (which will tend to be deserted by those who can afford to go elsewhere). Where Governments seek to close the financing gap by cost recovery measures, the poor may be excluded. For this reason it is important to understand the level of access enjoyed by the poor at present and the implications of future plans. It is not sufficient to argue from first principles that primary healthcare services are pro poor if the present and future coverage will, in practice, lead to their exclusion or ineffective service provision.

In principle, programmes should be designed on the basis of *per capita* spending levels which represent a realistic medium to long–term target for access by the entire population. In a country with a growing per capita income, and constraints over the speed at which coverage can be expanded, it may be ten to fifteen years before reasonably full coverage can be achieved and sustained. Where current coverage is low, it is all the more important to define service standards that are consistent with rapid expansion of services to near universal coverage over a reasonable time frame, whilst ensuring that the majority of the population at least have access to minimum services. A medium term budget framework should help determine the resource envelope within which each sector must plan.

Resource availability forecasts should be complimented by costing the package of services which Government claims to offer at present and intends to offer in the future. This will help identify inefficiencies and spending on activities not related to the core mission of the Ministry. It will also indicate the extent to which the marginal costs of the extension of services to new areas may differ from current average costs, thereby allowing more informed analysis of the costs of achieving coverage targets.

Cost studies and resource projections will provide the basis for discussion on whether Government's stated targets are consistent with the resources allocated for achieving them, and how any gap can be narrowed. It will often be clear that Government has little hope of funding any meaningful level of universal access within the per capita ceiling. This dilemma can be addressed in various ways, including a narrower definition of the role of Government, more focused on a tighter core of services that the private and NGO sectors are unable or unwilling to provide, sequencing of future development of services, and broader application of service and community charges with suitable safeguards. Decisions of this nature are at the core of the public expenditure policy debate.

Who benefits and who pays?

It is useful to apply incidence analysis to explore the pattern of who benefits from expenditure in each sector, allowing us to make statements of the type that x% of the benefits of Government education spending are enjoyed by the top 10% of the income distribution, whereas y% are enjoyed by the poorest 10%. Incidence analysis requires information on the use made of Government services by income level, together with information on expenditure on services. The method is easier to apply to services where the benefits are readily attributable to individual households, such as education, health, and agricultural extension; it is more difficult to apply to genuine public goods, such as police and defence services. However, even where formal incidence analysis is not feasible, it is usually possible to compare the proportion of expenditure on tertiary level services used by small numbers of mainly non–poor people – for instance spending on university within education systems – with spending on services enjoyed by the population at large.

A more sophisticated analysis would attempt to look at who pays as well as who benefits from public expenditure. Tax incidence is inherently more difficult to apply. Direct taxation has limited reach in low income countries, while analysis of the incidence of taxes on goods and services requires estimation of second round effects, and would require formal economic modelling based around a social accounting matrix. Experience in low income countries suggests that efforts to target taxes for specific policy purposes have often failed, while inviting fraud and corruption and higher transactions costs. Smuggling across porous borders is rife where the prices of goods diverge markedly from those in neighbouring countries. In general, there are strong arguments in favour of a tax system which aims at minimising tax induced distortions while keeping administration costs low. There may nevertheless be potential for excluding from taxation goods and services consumed predominantly by the poor.

Charges for services

Formal and informal service charges for health, education, water and sanitation, are a major burden on the poor in many countries. Though user fees may formally be a small percentage of public expenditure, household surveys consistently show very high household expenditures supplementing

Government spending. Spending by households often exceeds spending by Government and donors. In education for example, this includes not only formal school fees, but quasi–formal contributions to schools funds in cash or in kind, uniforms (a major cost), exam fees, books and materials, and payments to teachers for additional tutoring. In health, informal fees for services are widespread, and drugs and other consumables may have to be bought by the patient because they are unavailable in the public sector. The non–Government sector often includes significant reliance on treatments bought directly from pharmacies, and on traditional healers and birth attendants in addition to modern services available from private and NGO providers. These additional charges for services are not recorded in the overall sector expenditures.

Attempts to protect the access of the poor by exemption schemes have often failed to do so. Communities may in principle be better able to identify the poor among them, but whether local knowledge leads to actual exemption or alternative payment schedules will depend on the extent to which there is a sense of community responsibility for weaker members, which can vary greatly. In some countries, exemptions have mainly benefited those who do not need them. In some circumstances, self targeting through differentiation of services may be the only option, in others credit and insurance schemes may be feasible. Further discussion of this issue can be found in references listed at the end of this chapter. [13]

Gendered budgets

The DAC gender guidelines[14] call for gender equality concerns to be mainstreamed within all policy areas, and for policy analysis to cover the differential impact on men and women. It calls for both men and women to participate and express their views in the policy process and the inclusion of indicators on the gender impact of policies within monitoring systems (see Box 9).

Some countries have sought to implement a degree of gender mainstreaming. South Africa has gone furthest, with a formal ‘women’s budget’ in which gender disaggregated expenditure data has been presented. Other countries lack the data systems to go this far, though other measures are possible. Tanzania’s budget guidelines explicitly call for accounting officers to make thorough analysis of all submitted expenditure proposals to see how they benefit both men and women; to identify priority gender concerns and allocate budgets to facilitate reduced gender inequality; formulate gender objectives with associated action plans; set gender monitoring indicators (quantitative and qualitative); and utilise gender disaggregated data to monitor progress.

Turning the rhetoric into reality can be more difficult. Incidence analysis can in principle be applied to look at the distribution of expenditure from a gender perspective, and Manchester University have attempted to apply this technique in low income countries. Unfortunately, line item budget classification systems impede meaningful gender analysis and so analysis of the gender implications of spending decisions often requires sophisticated judgements which can not be readily supported by the budget information system.

A more productive approach may be via the gender disaggregated diagnosis of spending priorities, and of the experience of trying to access Government services. It is usually possible to obtain gender disaggregated information on who uses Government services such as health and education from administratively collected data. It may be more difficult to obtain information on who benefits most from expenditures with stronger ‘public good’ characteristics, such as transport services, though it is important to obtain gender differentiated views on spending priorities. Where utilisation

[13] See World Bank (1995); Sanjay and Van de Moortele (1996); ECA–CEA (1999);
[14] OECD (1998).

and access differs between men and women, participatory poverty assessments and service delivery surveys can help in developing understanding of the nature of the gender specific constraints, and hence help in finding solutions. Box 6 provides some illustrative examples of gender differences in public expenditure priorities and access, but circumstances differ widely and specific diagnosis is required.

The advocacy role of women's representative institutions within the budget process, and in helping women to obtain their entitlements is also of central importance: advice from social development advisers should be sought.

Box 9 Gender issues in public expenditure

Time use: Where women collect water and work longer hours on multiple roles, they may give more priority to convenient water supplies, certainty over times when Government facilities are open, thereby reducing queuing time. Facilities need to open at times convenient to those who use them, may have gender dimensions.

Security: Freedom from harassment may be a bigger issue for women than men in determining access to education, health and other facilities, and ability to pursue economic activities. Double shift schools may have gender implications if girls return after dark, or unescorted by siblings. Many societies prohibit or discourage girls being taught in the same classroom as boys or by male teachers. In others, parents are concerned, often with good reason, that young girls may be the targets of sexual blackmail by men in positions of responsibility.

User fees: Service charges may impact more heavily on women/girls access to health, education if men control cash income decisions. Women may be less mobile and hence perceived private returns to education of girls may be lower, leading to lower girls enrolment. This is a classic justification for differential subsidy. Lack of control over cash may discourage timely attention to women's health problems.

Economic activity: Crops grown by women may receive less attention in agricultural research. Extension services dominated by men may not reach women and may be based on poor understanding of the impact of time constraints on the to adoption of practices and crops. Priority is often given to the employment of men, on the grounds that they are the family breadwinner, ignoring evidence in many countries that this is patently not the case.

Sanitation: poor sanitation facilities in public facilities more of a barrier to women using them than to men.

Safety nets: women headed households may be more dependent on support from food for work and other schemes in bad times.

5. Donor Support to Public Expenditure

5.1 Recording and forecasting aid flows

Governments require information on flows of development assistance in order to assess overall resource availability and allocate these resources in line with its policy priorities. In order to achieve these goals, aid flows should be integrated within the budget and programmed alongside resources from internal sources.

While aid given as budgetary support and loans is easily captured in the budget process – since these instruments are channelled through special accounts managed by the central bank or by treasury – grant financed project or programme aid is more elusive for a number of reasons. Even when project aid is used to support local expenditures, it is often disbursed directly to special accounts managed by the line agency. Consequently, information on projected and actual aid flows has to be provided by the line agency, usually through the budget process or through the PIP (see Section 2.8). Since these project accounts follow budgeting and accounting procedures stipulated by the donor, with differing classification systems and budget calendars, the line agency may be unable to provide detailed information on anticipated donor financing. Foreign currency payments, such as those for technical assistance and major contracts, may be made directly by the donor's head office and consequently the line agency may be ignorant of the total cost of the projects for which it is nominally responsible. Besides, line agencies may be unwilling to divulge complete information on the aid financing received, since this may be used as grounds for reducing the domestic contribution to sectoral spending. They are particularly reluctant to present the full cost of some high–cost items, such as technical assistance, since this may be considered as distorting the overall picture of resource allocation to the sector. Although project is the main problem area, some donors (especially those that earmark counterpart funds) cause similar problems in relation to their programme support.

In order to improve the coverage of aid registration and forecasting, many countries have established a dedicated aid management information system, fed by information provided by the donors rather than line agencies. These systems are often geared to the registration of financing pledges at donor conferences, such as Consultative Group meetings, and subsequently tracking disbursements against the commitments. Ideally, this information should feed into the MTEF, in order to support the preparation of aggregate and sectoral resource envelopes and provide a cross–check against information on aid flows channelled directly through the line agencies, as reported in the budget submissions. Unfortunately, the information provided by donors is often incomplete and presented in a format that is incompatible with internal government systems.

DFID economists can help host country governments by ensuring that they provide comprehensive and timely information on British aid flows. The appropriate structure and calendar used for the presentation of financial information should be discussed with Government. Subsequent publications should be monitored to ensure that British aid is correctly recorded.

5.2 Aid in the macro–economic framework

Since the links between the macro–economic framework and public expenditure are considered in depth in the macro–economic chapter, this section is limited to a few points worth highlighting on the relation between aid and the budget in the context of macro–economic stabilisation programmes.

Budget stability depends on macro–stability. The prospects for realising the levels of real spending implied in the budget forecasts depend on whether the growth, inflation, exchange rate, revenue, and expenditure control assumptions underlying the budget presentation are realistic, and the degree of uncertainty around them. The underlying assumptions, and the past forecasting record, should be critically reviewed.

The IMF programme, where one exists, will impose constraints on the levels of expenditure which a country can undertake, and the way in which that expenditure is financed. This is true even if the financing is grant funded, and applies especially to above the line financing of the recurrent budget. This can mean that unanticipated support via the Government budget can not actually be spent, but has to be 'saved' via an offsetting reduction of net Government borrowing.[15] It is entirely appropriate that windfall gains should not automatically be spent, and there are good reasons for caution before using aid grants which may not be sustained in order to expand recurrent spending obligations which are difficult to reverse. The main point however is that these judgements need to be understood by country economists. They are not only relevant when briefing on an IMF or World Bank supported reform programme, they are also highly relevant to aid co–ordination discussions, and to the appraisal of how programme aid or sector programmes impact on the economy. The judgements on the role of aid flows in the budget should be explicit, and open to discussion on the alternatives and the trade–offs. The IMF has accepted this argument in principle, but there may still be occasional problems in applying it in practice.

In assessing the relationship between the budget and the need for aid, the fundamental macro–economic judgements concern future growth prospects, the revenue effort relative to GDP, and the revenues per capita which are left to fund expenditure programmes after non–discretionary commitments (basically debt service) have been accounted for.

The revenue effort can be compared with countries with similar per capita income and structure to the economy. The HIPC debt initiative has taken a benchmark threshold figure of revenue: GDP of around 20% as representing a reasonable effort by low income countries. This rule of thumb needs to be adapted to country circumstances, however. A country with a large mining sector, which is usually easier to tax – with the exception of alluvial diamonds because of ease of smuggling – ought to achieve higher than average revenue levels and, given that it is depleting a non–sustainable resource, should be expected to save and/or invest a larger proportion of the proceeds. Countries with relatively larger modern or formal sectors will also find it easier to raise tax revenues through non–distortionary means such as value added tax, than countries where the small–scale agricultural sector is dominant. Economic reform programmes have, for good development reasons, removed or reduced many of the traditional tax levers, both high trade taxes and recourse to taxing via state owned marketing boards. The speed at which low tax takes can be raised is also a consideration: Uganda experience suggests that attempts to sustain increases of ½% of GDP per annum can seriously strain both tax administration and tax compliance. A judgement therefore needs to be made of whether sufficient tax effort is being made and planned for given the specific structural circumstances of the country.

For countries making equivalent efforts, and facing similar per capita income prospects, with similar quality of economic policies, other things being equal the level of development finance offered should seek to narrow the gap in resources available for per capita discretionary

[15] Foster and Thomas (1998).

expenditure. It is the resources available after meeting debt service which will determine how effectively a Government is able to tackle its problems.

5.3 Aid co–ordination and the budget

Access to external assistance enables Governments to spend more, tax less, or borrow less. Where external flows are significant their distribution can significantly alter the overall pattern of Government expenditure, geographically, sectorally, between capital and recurrent spending, and in terms of the design of expenditure programmes. Where Government has not taken a lead in co–ordinating donor and domestic resources, this can result in uneven provision of services and a lack of sustainability. In the worst cases, Governments may not know how much donors spend on what or the time frame for support. Implementation of government programmes may be constrained by a proliferation of donor fiefdoms in which differing standards and approaches are applied.

In order to overcome these problems, a key requirement is for a process to co–ordinate donor activity around a broad based medium term budget framework, which captures both Government and donor resources. Making progress towards poverty reduction and the achievement of the IDTs will require Governments to set out a policy framework and plans for medium to long term progress towards the targets. This will require clarity on the role of the state relative to other actors, and prioritisation of expenditures within tight resource constraints. A medium term budget planning process involving Government and other donor partners will be a necessary vehicle for achieving systematic progress which can be sustained. DFID has had a role in promoting this approach to dialogue, and will continue to be involved in operationalising it at country level.

One major benefit of the MTEF approach is that it can put the Government more in control by bringing donor resources within a clear framework of prioritisation. This implies that co–ordinated efforts by Government and donors to implement an MTEF will only be successful if there is strong domestic backing for the policy. This section provides some examples of how donor actions can support or undermine government ownership.

Government ownership matters. Donors should support the Government in establishing overall national priorities. They should also respect these priorities once agreed rather than seeking to push their own project ideas outside that framework. Care should be taken to avoid the pressures applied by line agencies trying to escape fiscal disciplines by seeking additional donor support. This problem often arises in sectors in need of reform, faced with a declining share of internal resources, such as agriculture[16], where more is being left to the private sector. Where possible, donors should keep the Ministry of Finance fully informed of negotiations with line agencies and provide accurate and timely information on their own financing intentions and disbursements. Efforts should be made to ensure that the process of programme design and approval is fully integrated with the budget system.

Donor support is more likely to be forthcoming if national expenditure priorities can be shown to be the outcome of a transparent, accountable and participatory process for reaching agreement on objectives, linked to the resources needed to achieve them. In Uganda and Tanzania efforts have been made to bring donor funding more into the budget process. Both countries have established sector working groups, which co–ordinate between centre and line agencies, and which in future will prepare draft sector frameworks for the MTEF. Ideally, Government should lead the groups, with donors providing technical advice where needed. In Mozambique, the sector working groups were originally created by donors and co–ordinated by a ‘lead donor’. One of the tasks of the lead donor was to lobby the Government on behalf of the wider donor community, giving many

[16] See, for example, Jones (1997) on the particular difficulties in agriculture.

government officials the impression that the donor groups were a means of ‘ganging up’ on the Government. Recently, the donors have sought to reassure by encouraging the participation of ministry officials in the sector groups, thereby creating a forum for dialogue – rather than confrontation – with government.

Donor commitment to Government policies is also strengthened where Government demonstrates its openness to evaluation. In Tanzania, the Public Expenditure Review (PER) used to be a donor driven exercise divorced from the Government’s decision–making process. In 1998, however, the PER took the form of co–ordinated budget workshops which were focused on preparing and discussing medium–term budget submissions. Donors and consultants were encouraged to act as facilitators and advisors of a process fully integrated with the budget cycle, rather than as lobbyist for particular sectors or projects. As a result the workshops raised the awareness of all parties of broader intersectoral allocation issues[17]. The intention is to involve both partners in a process which leads to expenditure programmes which secure Government and donor support, thereby avoiding the proliferation of donor–driven projects inconsistent with the framework[18].

By this means the Government cedes some influence to the donors in return for authority over its budget. The jury is still out on whether Governments can succeed in disciplining the donors in this way: Uganda’s experience is encouraging, Tanzania’s less so. Clearly, it is in the Government’s interests to bring all donors in line with government policy, reducing the transaction costs and improving co–ordination through joint negotiations and, where possible, unified financing and reporting mechanisms. On the other hand, a unified donor community has considerably more power to exert conditionally on government than the individual, isolated donor agencies. Most Governments are aware of and sensitive to these risks, having seen – and perhaps experienced – cases where the refusal to submit to donors’ policy prescriptions led to reductions in aid. While the language of aid coordination is one of empowerment, donors should be aware that many governments view this rhetoric with scepticism. In these circumstances, confidence must be built on the basis of collaboration and a willingness to accept and work through errors of policy and practise.

5.4 Choosing aid instruments

There is a wide spectrum of alternative mechanisms for providing aid for public sector expenditures, ranging from pure financial transfers with no strings attached, through to the most restricted forms of donor managed projects where all important decisions and responsibilities remain with the donor.

Different aid modalities can be distinguished by the extent to which they attach conditions to the use made of the donor funds and to the policies and programmes which the Government agrees to implement. Programme aid attaches few if any conditions to how the aid funds are used, but commonly links their release to implementation of an agreed programme of policy measures. For DFID, this will invariably include implementation of sound macro–economic policies endorsed by the IMF, together with policies to address sustained poverty reduction. Project aid specifies the objectives and the expenditures to be financed in more detail, but will not be linked to overall macro policy conditions. The donor is more likely to be directly involved in aspects of the management and implementation of project activities.

[17] Moon (1998: 15)
[18] See Joekes (1999) for a discussion of Benin, where high aid dependency and the lack of donor co–ordination undermines the budget process.

In practice, there is a wide range of alternatives and hybrid aid forms between these two extremes. Restrictions on the use of funds can range from none at all (IMF), through nominal accounting against categories of expenditure on a reimbursement basis, to requiring prior agreement on how funds will be spent, through, for instance, the 'no–objections' endorsed by World Bank task managers. Disbursement may take place through existing Government procedures, or may require adaptation to meet donor requirements, or may be entirely controlled by the donor who procures and spends on behalf of Government. Policy conditionality may also range from none at all, through macro–economic conditions, through overall reforms in economic policy or in Governance, to sector and project level conditions. Conditions can be precise and time–bound, or based on general and more subjective assessments. They may relate to conditions to be met prior to disbursement, or require actions during implementation.

The recent literature on fungibility has resulted in increased scepticism about the effectiveness of earmarking of donor funds to specific projects or uses, because Governments may simply divert their own funding elsewhere. Similarly, much recent literature has demonstrated that policy conditions are unlikely to be rigorously applied where the government is not committed to policy reform. Consequently, donors are now less preoccupied with the restrictions which they can impose in order to raise aid effectiveness and more concerned with positive steps to promote commitment to sound policies for poverty reduction, providing flexible support where it exists, and finding ways to help build it where it does not.

Figure 2 seeks to demonstrate the diversity of aid modalities in country situations distinguished according to the quality of macro–economic and budget management, degree of aid dependence, quality of sector level policies (importantly including whether they are realistic given available resources), and quality of sector level management. This yields a 4*4 matrix with 16 possibilities.

Working across the rows from the top left, an aid dependent country with good policies and good sector management (Cell 1) should be supported with general programme aid, the main purpose of which would be to finance a higher level of expenditure on priority programmes than could otherwise be achieved. If both policy and management are sound, there are strong grounds for favouring programme support, which enables Government to prioritise the use of all of the resources available to it. This is the situation in which the World Bank proposed Public Expenditure Reform Credit would seem to be most appropriate, with the aid relationship simplified to a single annual commitment to support the overall budget. In this way Government budget priorities will not be distorted by divergent donor policies, and the transaction costs of dealing with donors are minimised. However, it is difficult to think of states which meet all of the criteria.

A more common situation in aid dependent countries is one in which macro management and sector policy are relatively good, but civil service management capacity is weak (Cell 2). Most of the sector programmes in Africa are operating in this kind of environment. Here the case for a programme approach, at macro or sector level, does not rest on the need for policy dialogue and conditionality but on the need to improve planning and management by minimising the problems caused by uncertain donor support using multiple donor projects with different approaches and procedures. However, in an environment of weak capacity, donors may be concerned about the loss of direct control which a movement away from projects implies. The country needs financial transfers, but also needs capacity building support to enable effective services to be delivered and resources properly accounted for. The suggested approach is to provide programme support at sector level, but with extra support for capacity building, additional safeguards on accountability, and close attention to monitoring and evaluation. The transition to using Government procedures to disburse the aid may be gradual, as capacity and confidence are built, though there are advantages to early commitment to disburse some funds in this way. The Ghana health case, where districts had to meet specific criteria before they could manage donor funding, provides an example where access to donor funds gave staff an incentive to improve financial management. Most sector programmes are at present still hybrids: some donor money flows using common procedures, especially support to local level services, often with additional financial checks, while some flows, especially technical assistance and off–shore procurement, may continue for the present to rely on donor procedures.

Where sector policies are weak but macro–economic and sector management is stronger (Cell 3), there is a case for donor technical support and policy dialogue, working with Ministry of Finance and sector officials to facilitate sector policy

development. In these circumstances a medium–term budget framework approach can be helpful in clarifying policy choices and bringing aspirations in line with available resources. There may be a case for support to pilot projects which can demonstrate the potential of reformed approaches to service delivery. Programme support could follow the development of a coherent policy package, but would depend on a judgement as to whether the pro–reform forces within the sector are strong enough to implement improved policies. The Pakistan Social Action Programme, supported by a consortium of donors including World Bank and DFID, arguably represents an example of this kind of intervention. Development of the programme was, in part, an attempt by donors to promote improved Government policies, with the donor funds conditional on additional Government spending, thereby avoiding the risk of fungibility of donor support. However, it may be difficult to commitment to reform where the poor policies of the past reflected political pressures or the influence of corruption.

If both sector policy and sector management capacity is weak (Cell 4), significant sector finance of any kind, whether programme or project, is unlikely to yield sustainable benefits, even where the macro framework is sound. Limited development assistance, mainly as TC, might be used to facilitate policy and capacity development.

Where policy and management are good but aid dependency is low (Cell 5), Government may nevertheless welcome general programme aid linked to an agreed policy programme, because, in addition to the direct value of the finance provided, the endorsement of the Bank and Fund may help to restore the confidence of private sector investors following a financial crisis. This is in part the explanation for the massive increase in programme lending to countries affected by the Asian financial crisis.

Other than in crisis conditions, countries with low aid dependence are likely to prefer project aid to policy conditional programme aid. Arguments for programme aid based on the distorting effect of project support are less likely to be significant where aid is low relative to the size of the budget, while Government is more readily able to resist unwelcome donor influence on policy. China is a good example of a country which makes excellent use of project aid to pilot new activities which are then taken up with local finance. If aid dependence is low but sector policy or management is weak (Cells 6–8), project support and TC are still likely to be the most appropriate instruments to facilitate policy development and pilot new approaches, possibly working with overall civil service and budget reform processes where they exist.

Figure 2 Framework for choosing between aid instruments

		Good sector policies linked to resources		Weak sector policies not linked to resources	
		High sector management capacity	**Low sector management capacity**	**High sector management capacity**	**Low sector management capacity**
Good overall macro–economic and budget management	**High aid dependence**	1. Government owned SWAP, using Govt procedures, aid role mainly finance. No examples.	2.SWAP with extra safeguards on accountability, support for capacity building, close attention to monitoring and evaluation, transition to using Govt procedures. E.g. Uganda, Ghana.	3. Work with Ministry of Finance and Sector officials to facilitate policy development, possibly linked to MTEF, to force policy choices. Finance SWAP if enough change agents are present for realistic prospect of success.	4. Sector–wide thinking:– support Ministry of Finance, MTEF, explore interests in debate on direction, support donor co–ordination around the budget, use aid to facilitate policy and capacity development. Defer major sector finance, whether SWAP or Project.
	Low aid dependence	5. General program aid to restore private sector confidence by endorsing policies, e.g. E Asia crisis. In non–crisis situations, aid provides project support, managed by Government using its own procedures, possible aid role in underwriting innovation, promoting stronger poverty focus. E.g. China.	6. Potential aid role for T.C. support to build capacity, within a framework set by Ministry policy–makers.	7.No case for SWAP but possibly T.C. to facilitate national consultation on policy, project support to demonstrate new approaches and support drivers of change within the sector. Support reform processes led by Ministry of Finance.	8.Absence of sector leadership or capacity suggest support for central economic ministry reform processes is the best option:– build sector policy and capacity via T.C. support to MTEF and Civil Service Reform processes.
Weak overall macro–economic and budget management	**High aid dependence**	9. Sustainability of SWAP requires policy dialogue on macro frameworks and budget shares, conservative view of SWAP resources available, general programme aid a likely instrument. Long term donor commitments, possible support to cost–recovery from non–poor to preserve good sector performance despite weak macro framework.	10.Capacity constraints not likely to be solved without macro level reform to ensure predictable budgets, staff incentives. SWAP requires both macro and sector reform process to be in place. Cost recovery from non–poor is an option if quality of services is high enough.	11. Weak Sector Policies, despite high sector capacity may be caused by a macro framework which does not provide secure budgets or impose priorities. No SWAP unless commitment to a credible programme can be built, including Ministry of Finance ability and willingness to finance it. Support macro reform process, facilitate policy development at macro and sector level, possibly support increased sector autonomy via cost recovery	12.No sector support is likely to yield sustainable benefits, in whatever form it is given, T.C., project. or SWAP, Donor role limited to policy dialogue and analysis.
	Low aid dependence	13.Most useful donor role will be for T.C support to overall reform process, not sector level. Possible T.C. role to support cost–recovery , reduce dependence on macro policies	14.Weak capacity at sector level is probably a symptom of overall budget and macro policies, not possible to achieve much with sector level T.C, unless linked to increased autonomy including financial resources and personal policies. Macro–level T.C. the priority	15.Possible case for modest T.C. to facilitate policy development at macro and sector level. Support increased autonomy at sector level.	16.No case for aid at any level, other than policy dialogue.

Where the overall macro–economic and budget management framework is weak, the most useful donor intervention may well be to support the overall macro–economic reform process with general programme aid, possibly including reaching agreement with the Government on the share of budget resources to be spent on specific sectors. In practice, good sector performance (Cell 9) is unlikely to be sustained in a weak macro environment (Cell 10 and 11). Policy is unlikely to be effective where fund releases are unpredictable, while capacity will be eroded by falling real salaries and personnel policies which do not reward effort. The sustainability of sector programmes will depend on the budget resources which Government is able to commit. In situations where the macro–economic policy environment is weak, it will be especially important for sector programmes to take a conservative view of the future growth of budget resources. Over–optimism on the Government contribution was one of the problems which affected sector programmes in Zambia, one of the early leaders in developing the approach.

If support is to be provided to the sector despite the weak macro context, the sector programme will need to make optimal use of limited resources, which argues for the flexibility of programme support, preferably in the form of longer term commitments. It may also argue for support to developing approaches to increasing the budget autonomy of the sector, by supporting clarity on the role which the public sector should play, and supporting increased cost recovery where it can be done without excluding access by the poor.

If both the macro and the sector level policies and management are weak (Cells 12 and 16), no support is likely to yield sustainable benefits, in whatever form it is given, and the donor role should be limited to policy dialogue and analysis.

Summarising the analysis of Box 11: programme aid with few restrictions will be the most appropriate form of support where Government is committed to sound policies, capacity to implement them is strong, and aid is a significant proportion of public expenditure. Where the extent of commitment to sound policies is unclear, donors may wish to strengthen the position of reformers, and protect the benefits from their own support, by attaching policy conditions, while recognising the limitations of conditionality if ownership is entirely absent. Donors may also wish to be more interventionist in seeking to build commitment by the demonstration effect of project interventions. Where capacity is weak, programme support may need to be accompanied by interventions to support the building of sound institutions, though these could be undertaken as part of a multi–donor programme under Government control. Where aid dependence is high, the case for reducing transactions costs by increased use of programme aid forms will be higher than where a less significant role for aid means that project interventions can be readily managed.

Analysis of the effectiveness of budget plans and performance in reducing poverty and making progress towards the IDTs should be a key factor in DFID decisions on the amount of aid which a country should receive and the modalities by which it should be made available. Aid co–ordination, at macro, sector, and project level needs to be informed by the total public expenditure picture. The pattern of overall spending is also critical to informing the policy dialogue with our developing country partners, as well as the DFID voice in discussions with other donors.

6. Programme Aid

6.1 The scope of programme aid

Programme aid is the term used to describe general financial assistance given to help to finance the balance of payments and the Government budget. Programme aid focuses on improving the overall level of resources available to an economy and the effectiveness with which they are used to achieve development goals. The emphasis of appraisal is on whether the overall thrust of Government policies and expenditure programmes are worth supporting, rather than on the specific use of the DFID funds. Programme aid is almost always conditional on a country reaching agreement on a macro–economic reform programme supported by the IMF. It also usually accompanies a programme of structural reforms agreed with the World Bank.

Annex 1 sets out proposals for the design and appraisal of programme aid, in the form of a proposed revised format for Part 1 of the OI guidance on PRC submissions, from Section 3 to the end. This combines the previous format and accompanying notes for the sake of brevity, and also reduces the number of sections to cut down repetition. This section amplifies on a few issues, but the Annex is intended to stand alone as guidance for those preparing programme aid proposals.

6.2 The rationale for programme aid

Evidence of the fungibility of aid tends to justify the increased use programme aid. If Government is able to adjust the pattern of its own spending to offset donor project preferences, there is little point in earmarking donor support to specific projects. It becomes more logical to appraise the overall pattern of policy and expenditure priorities, seek to influence both in directions which are thought to be more effective in reaching donor objectives, and provide flexible programme support for the agreed package of reforms and policy measures. Rather than seeking to provide a rationale for programme aid, it may make more sense to approach the issue from the other direction: what is the rationale for imposing restrictions on the use of the aid transfer?

It is also important to consider the specific rationale for using DFID bilateral funds. It could be argued that programme aid is given in support of economic reform programmes negotiated with the World Bank and the IMF, and we should therefore leave those institutions to provide the financial resources necessary to implement the reforms, concentrating our bilateral funds on project and sector programmes. The reason for not doing this is that the economic reform process is fundamental to the prospects for successful development in countries in receipt of programme aid, and DFID has therefore attached importance to being able to influence the process at a number of levels, including the policies of the Bank, the IMF, the other donors, and the Governments of the countries themselves. It is because DFID is a significant financier of the adjustment effort that it is listened to by the World Bank and IMF, by the other donors, and by our partner Governments. Project aid alone fails to give us the breadth of vision, influence, and access to be serious participants in the policy dialogue.

There is also a burden sharing argument for providing some aid in programme form. In heavily aid dependent countries, Government domestic revenue is insufficient to provide adequately for staffing and operating costs, and needs to be supplemented by programme resources from donors if all of the project aid is to be sustainably used. The alternative of donors directly paying the recurrent costs of their own projects escapes normal budget disciplines and leads to donor enclaves with inconsistent standards of provision and no Government ownership. Programme aid is one aid instrument which provides the kind of general budget support which is needed: general sector support programmes, currently being developed in a number of countries, can perform the same role.

This structural argument for programme aid rests on the proportion of the budget that is financed from external sources. Where external assistance is a substantial part of the Government investment budget - over 80% in Mozambique, for instance - it becomes difficult to package into discrete projects without distorting the pattern of spending. The development budget will tend to expand to absorb donor funds, while the recurrent budget becomes increasingly strained. Structural arguments for budget or programme support can be deduced from examination of the structure of the budget, and from evidence of budget execution. Key questions include:

- Is the implementation of the investment or development budget slow, and hampered by inadequate Government counterpart resources, poor staffing, lack of operating budgets?
- Is the recurrent budget dominated by salaries, are salaries too low to motivate staff, are maintenance expenditures too low to maintain the capital stock, are operating expenditures too low for staff to be fully effective in delivering services?
- Is project aid already paying in an ad hoc way for recurrent costs in order to overcome problems and shortfalls in access to Government recurrent funding?

These structural arguments could be addressed through programme support at programme or sector level.

6.3 Assessing government policy

Programme aid provides general support to enable Government to implement the policies and expenditure programmes to which it is committed. A significant part of the appraisal task is therefore to assess the overall thrust of policy and the quality of implementation, in order to assess the level and the nature of the support which should be offered. DFID may also be able to influence the policy process through dialogue with senior policymakers in Government, by participating alongside the World Bank in the appraisal of policy reforms, or through technical assistance. Where problems or potential for improvements are identified, it is part of the job of the Country Economist to advise how the issues may be put on the agenda of key decision makers in Government.

It is beyond the scope of this chapter to provide guidance on how to assess the content of economic policy reforms which may range over all aspects of Government activity. Annex 1 proposes a checklist of questions which may be helpful in ensuring a systematic approach to making an assessment of a reform programme. More detailed material on aspects of economic policy may be found elsewhere in this manual. The higher level strategy questions include:

- Does Government have a plausible strategy for poverty reduction, based on evidence and analysis?
- Does Government policy cover all of the major issues, long medium and short–term? If there are significant gaps, do they imperil the objectives of the reforms which are being implemented? What is being done to enable them to be addressed in future?
- Is there a programme, endorsed by the IMF, for securing sound macro–economic management consistent with broad based economic growth?
- Is there an appropriate role for Government and private sector, with Government objectives clear, and appropriately resourced?

- What evidence is there that the reform programme will be implemented? What was the Government role in initiating and design of the reforms? What is the former track record of implementation, what policy actions have been taken up–front, have senior Government politicians been involved in consultation and advocacy of the reforms, what evidence is there of the power and influence of pro–reform factions?
- How will the progress of the reforms, and their effects be monitored? How transparent and accountable is the policy process to local constituencies?

6.4 The financing gap

Programme aid normally supports both the balance of payments and the budget, and the financing needs of both the budget and the balance of payments need to be examined. This is true even if programme aid is used to finance private sector imports, as was traditionally the case. The importers pay for the imports, or the foreign exchange with which to buy them, in local currency, and these payments accrue to Government as counterpart funds for application in the budget. The macroeconomic impact of providing balance of payments support is therefore identical to that of providing budgetary support. In both cases, donors provide foreign exchange in a way which increases the resources potentially available for financing the budget by the equivalent sum in local currency. This does not necessarily mean that the donor flows are used to increase public spending, nor is an increased focus on the budget inconsistent with the objective of supporting private sector development as the main priority of adjustment. The extra resources are transmitted to the economy via the budget, but the revenues could be used to benefit the private sector by lowering taxes, or by reducing public sector borrowing and hence easing credit conditions for private sector borrowers.

The key point is that it is Government budget decisions which determine how the donor resources are used, and it is therefore the budget and its financing on which donor appraisal should primarily focus. To achieve better results and reduce dependence on adjustment finance, donors need to ensure that the public savings effort improves over time, and that public resources are sensibly prioritised and efficiently used. The material elsewhere in this chapter can help economists make these assessments.

6.5 Policy conditionality

There is considerable evidence that better policies lead to better outcomes, but little evidence that conditionality has been associated with better policies. One of the policy implications to draw from this observation is that donors should concentrate their support on willing partners who are committed to sound policies for their own reasons.

This complex issue needs further unpacking, however, and alternative interpretations are possible. ‘Ownership’ is impossible to confirm ex ante, and is rarely universal within a Government. Conditionality may help to support reformers who face domestic opposition (it can also be unhelpful if it makes reformers appear to be in the hands of the Washington institutions.) Reforms which are initially unpopular can quickly gather support if they are shown to work. Conversely, ownership can soon erode in the face of poor immediate results making challenging but necessary policy reforms impossible to sustain. The democratic process means that reforms are subject to reversal via the ballot box. Another factor is that conditions which are imposed by donors may be viewed by the private sector as less likely to be sustained, and may rob the Government of the ability to signal to would be investors their intention of creating and sustaining a suitable environment for investment.

In the search for more effective commitment to implementing agreed reforms, donors prefer fewer but more focused conditions, particularly those that place emphasis on:

- **A process of national debate**, in which the political leadership has explicitly committed itself to the reform process.
- **Assessment of the government's track record,** where there is a history of poor compliance, increased emphasis on transparency and completion of policy actions before money is released.
- **Flexibility over timing**. Tranched operations with multiple unrelated conditions and set timetables place pressure on both sides to fudge. Floating tranches, where funds are released when groups of related reforms are completed, give more flexibility to manage the local political process.
- **Conditions which improve accountability to domestic constituencies**, through increased transparency and participation, in order to improve decision–making, combat corruption and make reform more difficult to reverse. There should be clarity over domestic political decision making processes and timetables, to ensure that conditions are realistic.

6.6 Conditionality on the use of funds

Programme aid flows are designed to provide general support for an agreed programme of policy reforms in the context of a budget policy in which expenditure priorities have also been broadly agreed. Attaching additional conditions on the use of the DFID funds is in these circumstances irrelevant. There are two main reasons for attaching conditions: firstly, to secure implementation in full of those parts of the budget felt to be particularly important for achieving poverty reduction, by ensuring that disbursement only takes place on qualifying budget lines (as applied in the Uganda Poverty Action Fund); and secondly, to satisfy accounting and audit requirements.

Restricting programme aid to specified poverty programmes can be useful as a mechanism to strengthen the influence of pro–poor factions within the budget discussions and, even more so, during the budget year when there are pressures for supplementary funding of items outside the priority programmes. There are also dangers in the approach. If DFID acts alone, earmarking may prove entirely fungible, unless it also includes conditionality on the Government contribution. Any such conditionality needs to be agreed with the donor community as a whole, through a process of negotiation led by the IMF and the World Bank: separate bilateral conditions may provoke an anarchic process impossible for Ministry of Finance to manage.

Even when DFID works with other donors, as in the Uganda Poverty Action Fund, it will always be difficult to define which budget lines should be protected, and there are dangers of over–protecting some areas at the expense of others that are no less important. A judgement needs to be made on whether the prioritisation of the budget should be left to the local political process supplemented with whatever policy leverage and conditionality is negotiated by the Bank and the Fund.

The approach to accounting and audit of UK programme aid funds has evolved over time to place increasing emphasis on actions which assess and help to strengthen the overall systems for financial management and accountability. One implication of this budget framework approach is to draw attention to the need for strengthened budget planning, management, and accountability. Irrespective of the form in which aid is given, donors cannot be indifferent to low standards of expenditure management. Technical assistance to strengthen systems and management needs to be reinforced by conditionality that insists on the Government making a determined effort to achieve acceptable standards of budget accountability. This should be regarded as an essential pre–requisite for donors continuing to provide fungible resources. The pervasive nature of the problems in budget management require an overall strategy for improvement, with co–ordinated donor support rather than piecemeal projects addressing only parts of the problem.

While efforts are made to strengthen overall financial management and accountability, DFID accounting requirements still need to be satisfied. The traditional approach of accounting for programme aid in terms of import documents is no longer recommended. These verify the use of the foreign exchange rather than the concessional resources transferred the Government. Since the concessionality clearly benefits the Government budget rather than the importer, import documentation is not only irrelevant, collecting such documentation may impose unnecessary transactions costs. The ideal disbursement mechanism is one that is straightforward to account for. Reimbursing debt service payments is the simplest, since accounting information is readily available, and can be verified from both sides of the transaction.

However, DFID programme aid disbursements can be used more imaginatively to test and improve Government accounting and disbursement procedures. In Uganda, programme aid has been disbursed via Government accounting systems, but with the addition of independent accounting and audit checks, plus tracking studies of how Government expenditures are actually used, and outcome auditing to check public views on the quality of services offered. This has provided comprehensive feedback on the quality of expenditure management and accounting, and can be fed back into the policy dialogue. At the same time, adopting a reimbursement route to public expenditures can avoid any audit risk, by ensuring pre–audit of relevant expenditures before disbursement takes place.

7. Sector Programmes

Annex 2 provides guidance on issues which should be covered in a submission seeking DFID senior management approval for sector programme support. This section introduces the rationale for sector programmes, and offers guidance on issues which need to be considered at different points in the life cycle of a sector programme and DFID support to it. It follows a broadly similar structure as the Annex. A detailed report on the current status of sector wide approaches is available in Brown, Foster, Norton and Naschold (2000), which includes more practical examples and supporting evidence for the guidance offered here.

Sector programme support has been discussed under a variety of different names, reflecting differing institutional positions: sector programmes, sector investment or improvement programmes, sector budget support, sector wide approaches or SWAPs, the term which we will use for convenience in the remainder of this section.

7.1 Rationale and definition of sector approaches

In recent years there has been growing awareness that standalone projects are often an ineffective and inefficient mechanism for channelling development assistance in aid dependent countries. The prevalence of project assistance can lead to[19]:

- **inconsistencies between policies and resource allocations**, where government and donor priorities do not coincide, and inconsistencies in the implementation of policies, where projects apply different approaches;
- **inadequate support for recurrent costs**, where external assistance is channelled primarily to investment projects, thereby undermining the sustainability of projects once donor financing has been withdrawn;
- **wide differences in standards of service coverage and institutional performance** between those isolated pockets that receive external assistance and the majority of institutions and regions that do not;
- **lack of government ownership** and hence limited commitment to the achievement of project objectives and outputs, particularly where project formulation is donor driven; and
- **weakened managerial and administrative capacity** since senior government personnel spend time dealing with project specific issues to the detriment of overall sector management, particularly where there are numerous donor specific reporting and accounting requirements.

The Sector Wide Approach seeks to address these problems by facilitating the integration of external assistance within the government's planning and management system. In essence, the SWAP is a mechanism by which Government and donors can support the development of a sector in an integrated fashion through a single sector policy and expenditure programme, under Government leadership, using common management and reporting procedures and progressing towards the use of Government procedures to disburse and account for all funds. In this context, sector corresponds broadly to a core government function such as education, health or rural water supply, which has an institutional structure and government financing programme.

The SWAP is, as the name implies, an approach rather than a blueprint: the structure, coverage and procedures adopted by SWAPs may differ within as well as between countries. The focus should be

[19] Cassells (1997: 8–9)

on the intended direction of change rather than just the current attainment. Most programmes, even quite well established ones, are still striving to integrate all sources of funding, improve sector coverage, bring ongoing projects into line with the SWAP, develop common procedures, and channel an increasing proportion of funds through government systems.

SWAPs must be built on policies, priorities and goals that have the support of government and the donor community. Sector policies should then be translated into a coherent strategy, which is costed, matched to available finance through an iterative process, converted to a workplan, and formalised in agreements between the implementing agency and the sources of finance. As implementation proceeds, arrangements are needed for joint monitoring and consultation on modifying and rolling forward the programme. The remainder of this section will consider each of these stages in turn.

7.2 Defining policies and strategies

Sector policies and strategies should address a number of fundamental issues, including:

- **The goals of public policy in the sector,** which should consider more than just service delivery functions, looking carefully at the kinds of public interventions are needed in order to achieve sector development objectives. Achieving health sector objectives for example may depend on public information campaigns or on water sector investments as much as on health service delivery. This does not mean defining a health sector programme which covers several ministries: that would be unrealistic for management purposes. It does require clarity in defining goals, how they are best achieved, the role of the agencies covered by the programme in achieving them, and what they can and cannot be held accountable for.

- **The role of the state and other actors in sector development**, distinguishing, for instance, role of the public sector, commercial operators and non–governmental organisations. This needs to consider the full range of functions of the sector ministry leading the SWAP, not just in financing or providing services to the public, but also in policy, regulatory and legislative functions.

- **The appropriate mix of services and coverage levels**, determined on the basis of policy goals and resource constraints.

- **The financing of public services**, specifically, the level of cost recovery desired from the beneficiaries of publicly provided services and the appropriate distribution of service delivery costs among different social groups.

- **The institutional framework for public sector service provision**, including lines of accountability, the degree of autonomy of service delivery agencies, and the degree of devolution to lower levels of the territorial administration.

While it may not be possible to review all of these issues at an early stage of the policy formulation process, decisions have to be made, even if these signify maintenance of the status quo. A policy fudge on the fundamentals will lead to confusion later. This has been a particular problem in agriculture, where the boundaries between the state and the private sector have been redrawn in favour of the private sector, resulting in a need to forge a new consensus between Government and donor partners on what public sector involvement is appropriate, and what resources it requires.

From the earliest stage of strategy formulation, it is important to relate policy to the resources available: the difficult choices will only become clear when ambitions are confronted with hard budget constraints. Economists play a vital role in costing, however roughly, the alternatives confronting policymakers, and documenting the problems of low effectiveness which result from ambitious but under–funded strategies.

7.3 From strategy to workplan and budget

The formulation of strategies and their transformation in workplans and budgets often proceed in parallel and involve iteration. The first cut strategy will outline broad goals (e.g. universal primary education, returning the road network to maintainable condition, delivering an essential services package of health services to a specified percentage of the population), based on an estimate of the level of domestic and foreign resources available. The resource envelope may be derived from the Medium Term Expenditure Framework (MTEF) where this exists, though most line ministries will seek to inflate the resources available to their sector in the planning process. It is important to assess the realism of what is proposed in relation to capacity to implement.

The programme needs to steer between two undesirable alternatives:

- Excessively detailed plans, with very long lists of actions to be undertaken. This approach makes it impossible to see the wood for the trees. It also means that only part of the action plan will in practice be implemented, which means that prioritisation is likely to occur outside the formal planning process, and largely in reaction to the most immediate pressures facing the managers, which may not be the most important priorities.
- Equally ineffective is the kind of strategic planning document which is long on high level goals and strategies, but short on the the specifics of how actions and resources within the power of the ministry will be used to achieve them. A common problem is a donor supported SWAP built on the shaky foundation of a budget process which is not based on outputs or activities.

The challenge is to arrive at agreement on fundamentals and then prioritise the overall strategy, identifying the most important tasks in the medium term and focusing attention and resources on the achievement of these goals. As implementation proceeds, policies will be clarified or adapted, and priorities will evolve as the most urgent issues are addressed. Evidently, the need to continuously adapt and evolve requires a permanent policy analysis and planning capacity within government.

7.4 Reaching agreement between key stakeholders

Ideally, both policies and strategies will be formulated in a broadly participatory manner, ensuring the involvement of the key actors in the sector. This is particularly important where, as is often the case, there is a need to reassess the government’s role and promote non–governmental service providers. Key participants in the policy and strategic planning process include:

- the various levels of the territorial administration, particularly where districts and provinces are responsible for service provision at the field level;
- service delivery departments as well as planners, so as to ensure that policies are grounded in reality;

- core ministries, such as planning and finance and civil service commissions, in order to integrate the policies with on–going budgetary and personnel management reforms;
- non–governmental organisations and the private sector;
- the wider public, including the intended beneficiaries of government programmes, through consultative exercises, PPAs and advocacy groups; and finally
- the main donors, so that their concerns may be taken into consideration at an early stage in the policy process.

Box 10 Apex organisations as a channel for policy dialogue with NGOs

Medicam was founded in 1989 as an umbrella organisation for NGOs in the health sector in Cambodia. In 1996 members voted to employ an Executive Director and small support staff. In the words of the Director, 'It's a deal: we encourage NGOs to follow policy, providing we can contribute to it'. Medicam is clear about the need for a more meaningful form of co–ordination and co–operation between MoH, donors and NGOs – not just information exchange, but an effort to deal with a 'Frankenstein' health sector comprised of unconnected activities. It proves a potentially effective intermediary, bringing village–level NGO perspectives upon the progress of reforms into policy debate in a coherent manner. It is also surprisingly neutral, being often quite critical of unruly NGO behaviour. However, this potential for policy influence may be compromised by what the Director sees as a declining interest from both the MoH and member NGOs themselves. In part this reflects the general malaise in the health sector co–ordination system, but it also reflects a worrying trend for elements of the MoH and individual NGOs to negotiate piecemeal on projects, rather than through the co–ordinating mechanism of Medicam.

In practise, it has not always been easy to articulate the involvement of all these actors in the policy and strategic planning process. While the donors have generally played an important role, non–governmental actors have often been marginalised, even where they are important service providers within a sector. This may be due, in part, to the uneasy relationship that some Governments have with NGOs, but is also due to limited experience and capacity for policy dialogue within the NGOs themselves. Apex organisations can play a valuable role – if NGOs and Government will allow them to – as they have in Cambodia (see Box 10).

7.5 Supporting government ownership

The issue of ownership of the sector programme is of central importance. Government commitment needs to be both deep and broad. A strongly committed Minister or PS may be moved, leaving the process high and dry if not embedded more deeply in the decision making institutions. There are limitations on the influence which external actors can have, but there is much to be said for encouraging a broad national debate on sector policy, and for ensuring that the strategy has the endorsement of the whole Government, not just the sector ministry.

Sector programmes which have originated from donor initiative in the absence of clear Government commitment have a poor track record. Donors can nevertheless play a useful role in supporting the formulation of policy and strategies, not least where Ministers and senior managers have used donor support as a lever for their reform initiatives. In this context, however, care should be taken not to press too hard, thereby undermining reformers and leaving them vulnerable to charges of being in the pocket of the donors.

A number of indicators can be used as aids for judgement for assessing the Government commitment and ownership of the process: the extent of national policy debate; the track record in confronting difficult policy choices; the degree of endorsement by Cabinet and by the central ministries of finance and establishments, and other actors with the power to support or frustrate the programme; the knowledge and understanding of lower levels in the hierarchy, and (informally) their views on how committed the Government is to the stated goals. It is important to understand the reasons for delays: too ready an acceptance of sector programme proposals may be evidence of lack of engagement rather than evidence of ownership. A Government which takes time to build consensus and to ensure that Parliament and other Ministries are on board may be showing evidence of real commitment, not of prevarication. A key indicator is willingness to vote the necessary budget, ensure it is released, and account for what is done with it and what is achieved.

7.6 Conditionality and partnership agreements

The SWAP, as a hybrid between programme aid and project support, has had a mixed approach to conditionality. Most donors have wished to avoid interrupting sector support for macro level reasons such as the IMF programme going off track. It would be undesirable in aid dependent countries to further increase the proportion of Government expenditure dependent on short term macro management, the problems of unpredictability of sector budgets would outweigh any benefits to macro management. Conditions, where applied, are usually limited to the sector. The impact of the macro situation on sector conditionality will be through a less direct route, usually Government inability to sustain the sector budget releases, which may trigger sanctions from the donor side.

SWAP management arrangements provide an opportunity for dialogue and give donors a mandate to seek to influence sector policy. It is important for donors not to abuse this opportunity by imposing policy conditions on reluctant Governments. In practise most donors have eschewed reference to conditionality in their SWAP policy, which is generally couched in terms of ‘partnership’ and ‘shared goals’, in recognition of the ineffectiveness of conditionally as a means of promoting reform[20]. In some cases, it has been found useful to formalise this in the form of a partnership agreement setting out what both Government and donors have agreed to with respect to the way of working.

The following is a summary of the principles usually stated in partnership agreements and the progress that has been achieved in their application:

- **All activities will be under one common sector–wide programme, fully costed, and integrated into a medium term budget framework.** Most programmes attempt to cost the programme and integrate donor and Government finance. In some cases, only the development programme is fully integrated (as for example, in Ethiopia’s sector programmes and Bangladesh’s Health and Population Programme) and some projects may continue be outside the programme. Medium Term Expenditure Frameworks are increasingly important in rolling SWAPs forward in Africa, as illustrated by the experience of Ghana, Uganda, Tanzania and Mozambique.

- **Government takes responsibility and accountability for the performance of the sector as a whole: partners have responsibility to support planning and financing of the sector programme.** In most cases integration with private sector spending is weak, even though Governments may account for less than half of sector expenditure. Goals are not always well linked to outputs and inputs and donor financing is still unreliable on timing and amount.

[20] World Bank (1998).

- **All partners aim to synchronise and establish common mechanisms for appraisal, programming, review, monitoring and evaluation**. Progress on this front has generally been good, though there continue to be some avoidable inefficiencies, for example large missions wasting time gathering information.

- **Reporting will be harmonised towards one common report system for all activities in the sector**. Donor trust depends on a rigorous and open review process. Annual reviews are generally in place, but there is a need to improve their analytical content (see Section 7.7).

- **Technical assistance should be demand driven, with preference to short term and local consultants.** Both Ethiopia and Bangladesh have successfully pooled TA under Government control. Long term Technical Cooperation is still perceived as necessary and being provided often by bilateral support, even when pooled systems exist.

- **Resources will be channelled increasingly through government systems and consolidated into joint accounts, with a view towards overall budgetary support, using common disbursement, accounting, reporting, auditing and procurement systems**. Some progress has been made in the application of common donor financial management procedures, based on Government systems, even in difficult policy environments, such as Mozambique, and where there are large numbers of donors involved. One of the major difficulties faced in establishing common financial management systems is the fact that the World Bank is unable to participate. These issues are addressed in Section 7.8.

- **Partners are committed to openness, transparency, consultation, the sharing of information.** Uganda's Poverty Action Fund and Education Programme are, in many respects, models for transparency and accountability within a SWAP framework, achieved by the strengthening of internal government procedures rather than ad hoc measures. This requires a wide range of interventions at various levels of policy formulation and implementation (see Box 11).

- **Partners are committed to dialogue before any interruption of support.** Dialogue has been used effectively to resolve policy disputes in most countries. However, the interruption of donor support for governance reasons, as in Ethiopia and Pakistan, has sometimes been unavoidable.

Most SWAP financing agreements usually take a similar form to project agreements, with both partners agreeing to implement the programme set out in the Government strategy document and workplan, and abide by the agreed management and decision–making arrangements. Some aspects of the programme may be the subject of specific undertakings: bilateral donors most commonly include conditions related to the accounting and audit of funds. The extent to which there are formal conditions beyond this varies, with the World Bank most inclined to include specific policy undertakings in financing agreements. Even where formal conditions exist, experience to date suggests that donors are reluctant to invoke them, especially the World Bank, which finds it difficult to interrupt an investment loan in all but the direst of circumstances. Adaptable programme loans (APLs), which are an annually renewable instrument, are an attempt to give the Bank more flexibility in reacting to performance.

The process nature of the SWAP, with annual discussions as the programme is rolled forward, gives donors a less formal channel for policy leverage than traditional conditions set out in grant or loan agreements. The annual review process (see Section 7.7) provides donors with a mechanism to voice their concerns, propose changes in policy and implementation arrangements. The aide memoires produced after each review are normally signed by Government and donors, and their recommendations are treated as accepted by Government[21]. However, these are often prepared and signed in a hurry and it may be unfair to hold Government to recommendations which they have little time to study or for consultation with local partners.

[21] Observation based on participation in reviews of Ghana health, Bangladesh health and population, and discussion of Pakistan SAP.

Box 11 Ensuring transparency and accountability in Uganda

The Government of Uganda has a commitment to transparency and participation, this is achieved by:

- **Encouraging broad participation in policy formulation and implementation**, at the national level, leading to the development of a Poverty Eradication Action Plan (PEAP). At district level, the Participatory Poverty Assessment Project (UPPAP) is working with 10 districts on participatory approaches to planning for poverty reduction.
- **Setting budget priorities and realistic limits**, consistent with ceilings established in the Medium Term Budget Framework. Sectoral working groups, comprising the Finance Ministry, line ministries and technical advisors, help develop sectoral priorities within the expenditure limits. Key expenditures are protected from cuts by identifying programmes important for poverty within the MTBF and including them in the Poverty Action Fund (PAF), which is fully integrated within the budgets of line ministries.
- **Monitoring the impact of poverty policy,** using 5% of PAF funds earmarked for this purpose, through a Poverty Monitoring Unit which integrates annual household surveys, conducted by the Statistics Bureau, with other data sources (e.g. participatory analysis, sector surveys, line ministry data sources) to track progress, and ensure that policy is continually influenced by poverty data and perceptions of the poor. MFPED supports regular Service Delivery Surveys, to check population access to services, views on problems and constraints in accessing them, and overall quality.
- **Ensuring that donors participate in monitoring and review**, by establishing an annual cycle for the management of donor funds. Starting in March of each year with the collection and analysis of data for a progress review, followed in April by a formal review of progress and rolling forward of sector Workplans for the following FY and indicative actions to the end of the strategic plan in 2003. By the end of April, Government and donors agree on targets derived from Workplans and sign individual financing agreements. In December, donors and government undertake a joint review of mid–year progress feeding into the annual Public Expenditure Review.
- **Complying with accounting requirements**. Uganda's Treasury Office of Accounts has produced final accounts within 4 months of year close in 1996 and 1997, and an Office of the Auditor General audit has been produced within the statutory 9 months. Internal auditors within the Ministry carry out a pre– audit of all payments to check they are authorised and within the vote. There are also OAG staff within Ministries, continuous ex–post audit of transactions throughout the year, and queries to the Secretary of the Ministry. A centralised payment system prevents accounting Officers exceeding vote allocation and provides accurate and timely data on level of payments.
- **Acting and following up on findings of auditors reports and monitoring systems.** Where a Tracking Study revealed significant diversion of funds to unintended uses, Government reacted by imposing conditions on the use of block grants by districts and improving transparency through advertisements in press and displayed at facility level. A follow–up found 90% compliance with the requirement to display school budgets and staff lists. Issues of corruption and financial probity have received further attention: the 1998 integrity study looked at incidence of staff seeking bribes by sector, participatory poverty assessment district reports have raised local corruption issues.
- **Improving Capacity for Financial Management,** through an enhanced Budget Framework process, integrating recurrent and development planning, at a sectoral and local level; a staff development plan in financial management at centre and local level, including non–salary measures to improve motivation and recruitment; computerisation of local accounts; and improved audit and audit follow up, including supporting accountability to the Parliamentary Accounts Committee.

7.7 Managing the SWAP process

Most African SWAPs have, wisely, built the Sector Wide Approach onto existing Government management structures. A common arrangement features an overall steering committee, chaired at Ministerial or Secretary level, and involving representatives from other relevant Ministries, including planning, finance, and local Government, and often local donor representatives. The steering committee will often aim to meet quarterly. An implementation committee, meeting more frequently, is likely to be needed at senior official level, also with inter ministerial and sometimes donor representation, and responsible for monitoring the overall programme and reporting to the steering committee. Many SWAPs have also found a need for more frequent working meetings to resolve operational problems.

The alternative model, which raises serious sustainability concerns, is based on the project implementation unit model, familiar from standard World Bank practice, and used in the Bangladesh Health and Population and Pakistan Social Action Programmes. While this is allows the application of World Bank disbursement procedures – which require separate accounting of Bank funds and adherence to Bank procurement regulations – it sets up a parallel management structure and does little to build Government capacity or to integrate different budget streams within a coherent programme. The Bank role in promoting this model for their own procedural reasons has been a cause of significant (and unresolved) arguments between donors in a number of countries.

Ideally, sector programmes would follow an annual planning cycle synchronised with the budget, within a medium–term time frame – usually three years – synchronised with the Medium Term Expenditure Framework. In Ghana, Uganda, Tanzania and Mozambique, the MTEF establishes the resource envelope within which the SWAP is planned and the sector budget is prepared. Detailed annual budgets and operational plans will then be drawn up on the basis of the first year of the MTEF and a rolling plan for the SWAP. In Tanzania and Uganda, the local Government/donor health sector working group helps to support Ministry staff in preparing the budget submission for the MTEF, covering both internal and external sources of finance.

Besides the annual budget and annual plan, one of the key instruments of SWAP management is the joint review. Ideally these reviews, plus regular reporting of progress, should satisfy all donor reporting requirements, eliminating the need for separate bilateral reporting requirements and field visits to verify the information provided. A major objective of SWAPs is to reduce the cost to Government of dealing with donor projects, and with separate donor monitoring and reporting requirements. This will only be achieved if the review process is perceived as rigorous and objective, and if it has available sufficient verifiable information to generate sound conclusions.

Lessons of practice to date suggest that the review can best fulfil this function if:

- it is supported by an effective monitoring system which covers the issues set out in Annex 2;
- there are agreed Terms of Reference and a team selected from experienced professionals covering the required disciplines;
- the analytical phase of the review is separated from the joint Government–donor review meeting, producing a report to be considered before the meeting and presenting an agenda of issues to be considered and suggested courses of action;
- the review report is genuinely independent of editorial influence from Government or donors: while gratuitously offensive reports are clearly unproductive, it remains important that excessive politeness does not undermine the credibility of the process and the willingness of donors to rely upon it.

One the goals of common management and review procedures is to reduce government's transactions costs of dealing with donors. Experience so far suggests that they have actually increased as SWAPs have replaced projects. Both Governments and donors have found the process of formulating the SWAP time consuming, partly because the new managerial instruments – financing agreements, budget frameworks, financial management and reporting systems – have to be designed from scratch. The fact that projects have continued to exist in parallel to SWAPs has tended to further increase workloads on both the government and donor side.

It is not yet clear whether management costs actually fall once the SWAP is ongoing, though health officials in Mozambique, Uganda and Tanzania seemed confident that they would, since contacts with individual donors would be reduced[22]. However, the evidence from donor agencies seems to suggest the contrary, since many donor agencies seek to supplement the joint review meetings with regular meetings on their programme support. Part of the problem has been that Governments have not established strong enough internal policy and programming capacity to avoid the need to rely on the donors (often in practice the Bank with support from some bilaterals including DFID) to put together documentation and reports for SWAP meetings.

Even if transactions costs are unchanged, there should be a net benefit in so far as an increased proportion of Government donor contacts are now aimed at supporting the effectiveness of Government systems rather than parallel project ones. Attention to policy issues has increased in Government and on the donor side as they struggle to understand developments on a broader canvass than projects required. This remains true even though one factor which is keeping transactions costs high in most countries is the continuation of project support in parallel to those donors supporting SWAPs with budget support.

7.8 Financial accountability and common procedures

There is broad agreement in principle that donors should apply common disbursement and accounting procedures and that these procedures should be based on the government's internal financial management system. In this way, donors will assist government in allocating resources in line with priorities and facilitate financial management and accounting. At the same time, the use of government procedures to manage donor funds will force both donors and government to improve and build capacity within the Government system, rather than expending effort on parallel, project management units.

In practice, however, there has been slow progress in this area, leading one recent study to argue that the development of 'common procedures is the greatest challenge to implementing SWAPs'.[23] Some indication of the extent to which common procedures are applied is given by a SPA pilot survey[24] covering 16 SWAP like sector programmes, including 22 financing operations in 5 sectors and 15 countries, to which 13 aid agencies provided 91 responses. Of the disbursements covered by these replies, 80% used donor project disbursement procedures, compared to only 17% using direct budget support. Admittedly, the earliest commitments were made only in 1996/97, when the sector wide approach was very much at a formative stage. Moreover, 40 percent of donor replies reported that they provide direct budget support using Government procedures for at least part of their support to sector programmes.

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[22] High level African delegates at a DANIDA sponsored Workshop in Harare in October 1998 felt that transaction costs had already fallen (at least for the recipient government). DANIDA (1998)
[23] Peters and Chao (1998), quoted in Walt et al (1999).
[24] SPA (1999).

Donors face a number of problems in complying with the principle of common procedures. Some donors' internal procedures – such applied to World Bank project loans – do not allow them to support common procedures and pooled funds. Some of the largest bilateral donors to Sector Programmes, Japan and Germany, cannot or have not provided budget support. Other donors may be put off using government procedures by the risk imposed by entrenched corruption, particularly where they have had their fingers burned in previous counterpart fund operations. The weak linkage between budget and activities may also discourage donors since it is difficult to demonstrate the benefits from sectoral budget support.

Nevertheless, there are a growing number of donors that now providing substantial sums via pooled arrangements using procedures based on those of Government. DFID is one of a number of donors who have shown that it is feasible to provide direct budget support to sector programmes even in quite difficult environments. Box 12 presents, as an example, the system applied in Tanzania's Health Programme.

Inevitably, the design of the SWAP financial management procedure will be determined by the architecture of the government system, including additional safeguards to address the perceived weaknesses, particularly those that may loosen control or the transparency of operations. Important design considerations include:

- **The basis of disbursement by donors**, distinguishing advance of funds or reimbursement. Use of a reimbursement mechanism, as in Uganda, minimises risk of misuse of money since donors can pre audit accounts releasing funds to Government. However, this may not be feasible if Government faces a liquidity constraint.

- **The degree of consolidation of funds.** Funds are generally disbursed by donors to a government account in the central bank, converted into local currency, and then transferred to either the Consolidated Account (as in Tanzania) or a special sector account held by Treasury (as in Mozambique, Ghana and Zambia). While the use of the consolidated account is to be preferred in principle, difficulties in treasury management and poor liquidity may lead both sectoral institutions and donors to prefer the segregation of funds.

Box 12 Common Financing Arrangements in Tanzania

Seven donors are pooling funds from October 1999, initially for support to 35 health districts in the first wave of decentralisation.

The MOH requests the Basket Financing Committee (a joint government and donor body) to approve the release of funds for activities costed in the agreed Plan of Action. If approved, this is passed to the Ministry of Finance who request forex transfer from donors. Donor funds are merged in a joint Holding Account in the Bank of Tanzania (BoT), converted by BoT into Shillings, and placed in the Consolidated Fund, where they are merged with Government of Tanzania (GoT) funds. The Accountant General warrants funds to the Permanent Secretary for Health (who is the accountable officer).

Some funds go via local government District Health Plans: this follows the same procedure but the Ministry of Regional Administration makes the request, and funds go to Regional Sub–Treasuries, who issue cheques to district accounts against their approved sectoral budget. The Permanent Secretary Ministry for Regional Administration and Local Government (MRALG) is the accountable officer. Issuance of cheques is centralised, which allows the Platinum system to track spending by source of funds and activity code.

District health plans are agreed at council level, scrutinised at regional level against guidelines and ceilings, consolidated and forwarded to MRALG. Proposed minimum standards to be reached at district level are reconciled with the essential service package. The Steering Committee receives district plans and approves release of funds on quarterly basis against approved district plans and budgets. Readiness Criteria have to be met before districts can receive and manage funds: these include approved district health plan and budget, positive assessment by the MRALG of technical and financial management capacity according to benchmarking criteria, satisfactory and timely reports, and the Government budget contribution deposited.

Under the accounting system, the first request for funds will cover 2 quarters. At end of Q2, request for Q3 funds will be accompanied by a statement of accounts for Q1, to be prepared within 30 days of close. A steering committee decision is to be made within 15 days of receipt. An annual independent audit is carried out by OCAG and independent firm, resulting in a management letter assessing controls and systems.

Source: DFID(EA), Support to the Tanzania Health Sector, PRC 21, June 1999

- **Approval of plans and budgets**. In most countries, donors have sought to base annual budgets on workplans and thereby link the volume of resources provided to the activities undertaken. While donors are closely involved in the elaboration of the workplan and budget at the national level, they may (Tanzania Health Programme) or may not (Ghana Health Programme) be involved in their approval at sub–national level. The desirability and practicality of involvement in the approval of plans at such an operational level is doubtful, particularly where, as in Tanzania, there are over a hundred districts.

- **Pre–conditions for the disbursement of funds.** Where a substantial proportion of donor funds will be disbursed through lower level administrative structures, donors have, in some cases, established accounting and financial management standards which local authorities must meet before authorising the disbursement of funds. In Tanzania, these Readiness Criteria must be met before a district can benefit from financing (see Box 13). In Ghana, failure to meet the criteria for the release of funds will result in funds being managed at the next highest level (regional rather than district), rather than being lost altogether.

- **The need for independent auditing, and triangulation of data**. This is an important safeguard. Even where Government produces timely audited final Government accounts, they may not address systemic weaknesses, may not detect all forms of misuse of funds (e.g. illegal charges), and may not be followed up. Independent auditing, and the multiple routes to checking on fund use and effectiveness as in Uganda can increase confidence, and help diagnose where and how the system needs to improve. In Mozambique, where sufficient audit capacity does not exist within government, the Government will contract private firms to carry out audits.

- **Required accounting standards.** It will be necessary to stipulate the accounting standards required, particularly in terms of the time allowed for the presentation of accounts. Care should be taken to ensure that these deadlines can be met, given existing, often manual, accounting systems. In Mozambique, the Ministry of Planning and Finance's guidelines call for submission of quarterly accounts 15 days from the close of the quarter, which seems extremely optimistic given the delays in presentation of government accounts in the recent past. Where Government has nominal accounting standards on the books which are in practice universally ignored, it may make sense to set donor requirements in terms of what is needed and is reasonably achievable, pending revision of the Government regulations.

- **The degree of uniformity of procedures between sectors.** Where donors develop procedures in collaboration with sectoral ministries there is a risk that each sector programme will develop its own financial management system. This was the case in Mozambique, before the Ministry of Finance stepped in to issue guidelines on a standardised sector programme financing system.

- **Measures to strengthen the system** and how can the SWAP disbursement procedures and the financing associated with them be used to support the capacity building process. The use of readiness criteria, as previously discussed in relation to Ghana and Tanzania, provides an example of mutually reinforcing linkages.

The development of an appropriate common funding system is a goal, often to be achieved in the medium to long–term. There are often sound reasons for donors preferring not to embark on a risky pooling arrangement in the short–term, not least of which may be the desire not to overwhelm fragile government accounting and treasury systems. Governments may share this concern, even though the pooling arrangements are clearly to their advantage. Progress made be made by a gradual approach, whereby one of two donors provide funds which are then used test and refine the system and further donors come on board once the teething problems have been overcome. As a flexible donor, this pathfinding role is a helpful one for DFID to play, and would suggest a need to work with Government and other donors in developing and testing a funding system with which both Government and donors are content.

8. Supporting Public Expenditure Reform

Problems of poor efficiency and effectiveness can emanate from any stage of the public expenditure process, and a comprehensive diagnosis of the nature of the problems and potential is required. Ideally this should be linked to a sequenced plan to address all of the important constraints. This does not mean that everything has to be addressed simultaneously, and there can be a case for working opportunistically to address particular problems when an opportunity arises. However, before a more piecemeal approach is attempted, it is essential to make a hard–nosed judgement on whether the conditions are in place for progress to be achieved and sustained.

Not all of these problems are present in all countries, nor in all Government departments within countries. Nevertheless, it is important that efforts to assess the effectiveness and efficiency of public expenditure should be informed by a good understanding of the informal rules by which the system actually operates, as well as the formal objectives and systems which are supposed to apply.

The key questions which need to be examined are:

- Has Government defined its role in a way which is compatible with the resources available to perform it, or embarked on a process for achieving this?
- Do line agencies have predictable access to approved budgets within a hard budget ceiling?
- Do civil servants have appropriate incentives to perform well, or will the reform process put sufficiently improved incentives in place?
- How well do the basic systems of budget planning, management and accountability function, and how will weaknesses be addressed?
- To what extent are there links from budgets to expected outputs? Is accountability for delivering outputs clear, and do those who are accountable have the necessary authority over resources?

Efforts to achieve reform at sector level are unlikely to succeed or be sustained if the basic budget systems are dysfunctional, and give too little incentive for realistic budgeting; or if civil servants are paid too little, or appointed and rewarded for reasons unrelated to their work. Although it would be foolish to be too dogmatic on the best entry point for achieving improved public expenditure effectiveness, the importance of overcoming the constraints which emanate from the centre reinforces the case for moving towards a medium term budget framework, supported by reforms of the overall budget planning and management process. Sector programmes should be able to achieve more where they are nested within such an overall reform process.

Where public expenditure planning and management is weak, DFID needs the skills to facilitate the design and appraisal of programmes of reform to build the systems and capacity for better performance. The World Bank public expenditure management handbook has excellent material on this, including very good diagnostic checklists.

This section will not duplicate material available in the handbook, nor repeat material given in more detail elsewhere in this chapter, but will suggest a few key issues on which economic advice can be helpful in reaching a judgement. The key value added by the economist should be a comprehensive assessment of:

- Diagnosis of the problems of budget management, and their consequences. What are the most important short and long term problems, and does the project address them?

- Can the reform strategy plausibly work, given the incentives and disincentives facing those who must alter their behaviour? (See Box 12 for one small illustration from Uganda.) This is a key area for assessment, where careful analysis of stakeholder interests and behaviour can illuminate how they may react to a new set of incentives and opportunities post reform. Careful review of evidence of commitment to reform will be helpful: evidence of prior actions, such as choices between competing budget priorities, will be helpful. It will also be useful to set out some future milestones for judging future commitment.

- Objectives and indicators linking the reform process to real world improvements in measurable performance. If the diagnosis is correct, it will normally be possible to link the reform objectives to significant benefits. If it is not possible to do this, the diagnosis may be wrong.

- The direct costs of the reform effort are likely to be small relative to the scale of public spending, and any plausible quantification of benefits is likely to yield a positive NPV, even where expensive consultants are employed. However, such a comparison is not all that informative for decision–makers. The largest cost is likely to be the opportunity cost of senior management time taken up in implementing the budget reforms, and this can be significant, albeit difficult to measure. If the reforms genuinely facilitate the tackling of the most urgent and important issues, they will pay for themselves several times over. If they distract attention from necessary decision–making, they can be very counter–productive.

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Annex I: Programme Aid Submission

This Annex contains suggested modifications to sections of the PRC submission format for programme aid, to reflect recent developments in policy, and to amplify some of the underlying analysis.

1. Rationale and Objective of UK Aid

What are the specific, verifiable objectives of DFID programme aid support, and how will they be monitored?

The intention of this section is to set out the specific rationale and objectives for a bilateral UK contribution in the form of general programme aid. It is concerned with DFID value added: descriptive and analytical material on the policies of the Government which is being supported is not required.

Possible roles of programme aid include:

- To provide additional resources, in the most efficient way, to a country which is judged to be capable of using them effectively to accelerate implementation of a sound poverty reduction strategy. The rationale for a bilateral contribution is to achieve a higher allocation of total aid resources than would obtain if all resources were allocated multilaterally. This assumes that multilateral donors do not reallocate perfectly in order to offset bilateral contributions, an assumption which appears to be accurate based on present allocation formulas used by, for example, the IDA. The monitorable indicators would be whether the target country retains a higher share in UK flows than in global flows, indicating that a bilateral contribution is needed in order to reach a target share; and whether UK support contributes to the country maintaining or increasing it's share of global aid relative to comparator countries.
- Linked to I, to signal to other donors, that the UK supports the policies which are being implemented, and is prepared to back them by providing finance in a form which gives the Government fuller responsibility to decide how they are used. The programme aid becomes part of a strategy to influence other donors to follow the UK lead, and also take action to maintain or increase their aid to the country and, more important, to provide it in ways which reduce the transactions costs of donor earmarking and procedures. Important indicators will be whether the UK provides a higher than average share of our bilateral aid in programme aid form, and whether other donors increase their share towards ours over time.
- To signal to other low income countries that the UK (and the donor community if the influencing strategy works) will respond to improved policies by providing aid in a more flexible form. Monitorable indicators would be the extent to which the policies of the country become internationally known, discussed, and copied.
- To meet an immediate financing need by providing quick disbursing support in a situation in which macro–economic stability and expenditure programmes important to poverty reduction would otherwise be threatened: programme aid is the only aid form capable of disbursing quickly enough to meet this type of emergency. To ensure that the assistance achieves sustainable benefits, it should of course be given in the context of an agreed stabilisation and economic reform programme negotiated with the Fund and Bank.
- Helping to develop and test improved procedures for programme aid, based on those of the Government with suitable strengthening if necessary, and encouraging other donors to also use them. The objective is to develop Government financial management capacity, and reduce transactions costs of aid, by supporting the development of Government processes

rather than absorbing capacity in parallel activity. Verifiable indicator will be measurable improvements in Government financial management performance, and whether other donors accompany or follow us in using new procedures.

- Using influence obtained or reinforced by programme aid to encourage Government to continue to adhere to the reform programme agreed with the Washington institutions, and to encourage other donors to maintain a consistent approach to conditionality and to support for the agreed programme. This objective is central, but difficult to specify verifiable indicators in advance. It requires good communication and lobbying between relevant parts of Government (which is likely to contain a number of divergent views), donors in country, donor capitals, and Washington. It is best verified in narrative form, in PCRs and in the background section to future programme aid submissions, describing the major alarms and excursions experienced in implementing the programme over the previous year, and the role which the UK played in helping to overcome them.
- Influencing the World Bank and the IMF to take account of DFID concerns in policy dialogue and the design of IMF and adjustment programmes, including the process for putting them together. The quid pro quo for donor acceptance of the Bank and Fund leadership role on economic reform is that they should in turn be receptive to donor concerns and priorities. A major UK concern should be the prominence of poverty reduction objectives in the design of reform programmes. Verifiable indicators will be difficult to frame, and formal indicators (such as participation in joint appraisal) may miss the point (did it make any difference.) It would be helpful to specify in advance specific objectives for DFID over the coming year, which might include specific objectives related to the conduct of the Poverty Reduction Strategy Paper exercise, and the way it is to be reflected in subsequent programme design and review.
- Helping the Government directly to achieve specific programme objectives within the economic reform programme. This may for example cover the case where programme aid is used to finance the costs of civil service retrenchment, or financial sector reform, or other measures with a specific financial cost to which programme aid disbursement is linked. In one sense, these types of reform could as easily be supported under project aid. The programme aid delivery mechanism may itself be linked to efforts to achieve improved financial management through associated TC and additional bilateral conditionality: the financial transaction provides an entry point for efforts to raise and monitor standards of accountability.

2. Place in country aid policy

This section will set out why programme aid is considered the most appropriate form of support. Reference can be made to the 16 cell matrix at Annex I in assessing whether programme, sector, or project aid forms are appropriate. Programme aid is likely to be especially appropriate where:

- A country is highly aid dependent, and transactions costs of project aid are imposing significant costs and are distorting the budget, **and** the priority policy reforms which are being implemented require actions by central economic authorities in order to enable sector level reform and expenditure programmes to work effectively.
- Macro–economic crisis in a poor country unable to borrow on commercial or IBRD terms requires quick disbursing support to enable stabilisation to take place while as far as possible protecting and improving the welfare of the poor.
- An aid dependent country adopting sound policies and implementing them well needs financial transfers to raise the level of activity, but does not need donor TC support, capacity building, or policy advice. This may be of more theoretical than practical interest.

Programme aid is unlikely to be a sensible bilateral option in large economies where the DFID support would make negligible difference. In these circumstances, DFID value added is likely to be greater if linked to a more specific or innovative area of activity.

This section will also report the effectiveness of the DFID role in previous programme aid relative to the objectives set (see previous section).

A PCR from the previous programme aid operation should be annexed.

3. Poverty reduction and economic policy

This section must cover:

- Diagnosis of the incidence and recent trends in poverty, and future prospects on unchanged policies;
- The process by which the policy reforms and budget plans supported under the programme aid were arrived at, including an assessment of ownership and commitment to their implementation;
- Description and analysis of the reform programme;
- The expected impact of the reform programme, on the prospects for sustained economic growth and poverty reduction, and the domestic and external financing requirements in order to achieve it. Analysis of the balance of payments and budget financing position in relation to the macro–economic programme.

Diagnosis

Proportion of population below international poverty line, main characteristics (e.g. depending on the country some or all of the following: rural/urban, geographical region, sources of livelihood, land/asset holding, gender, age, household composition, ethnic origin, disability).

Economic growth record, and progress in improving human welfare. Has economic growth been fast enough to raise average living standards, what evidence is there on how gains in living standards have been distributed?

Have health and education indicators been improving overall and for the poor?

Are present macro–economic policies sustainable, consistent with stable single digit inflation, orderly foreign exchange management with minimal restrictions on current account transactions, predictable budget management, manageable domestic and foreign debt?

Are other policies inhibiting economic growth and poverty reduction by distorting the pattern of incentives, e.g. price, taxation, trade, competition, and regulatory policies?

Are the major institutions of the State effective in creating a predictable environment for economic activity and enforcing the rule of law, and is this equally true for poor and rich?

Is the pattern of ownership of assets in the economy consistent with providing opportunities for poverty reducing growth?

Are there fundamental environmental constraints on the long term prospects for poverty reduction, e.g. through declining soil fertility?

Are the roles of the public, private and NGO sectors in the economy appropriately defined?

Who mainly benefits from public expenditure, how well is it managed and prioritised?

What overall judgement would you make on the prospects for economic growth and poverty reduction in the absence of the further reforms and the associated financing to be provided by DFID and other donors under the programme? This calls for explicit definition of the 'without further reform, and without programme aid' case. Where a country is not facing an immediate crisis, and is committed to sensible policies and further reforms irrespective of the donors, the realistic 'without' case may mainly relate to the absence of the financing: as ownership and prior commitment are given increasing prominence at appraisal, this may become the normal case, and will not count against a proposal.

Process

This section will assess the evidence that the reform programme has been designed in a way which ensures that the interests of the poor will be taken into account, that there is sufficient support for the programme to secure it's further implementation, and that reasonable safeguards have been put in place to protect donors if continued commitment is seen as risky.

How strong is the evidential basis for the reform programme, especially the structural measures and public expenditure priorities, and especially with respect to the objective of sustained poverty reduction? Are there effective mechanisms to monitor impact and adjust policies as necessary?

How wide has consultation been, including with civil society, and how much understanding and commitment is there beyond the Ministry of Finance and Central Bank?

How active a role has the Government played, relative to the Bank, Fund and donors?
Has top leadership supported the reforms, and explained the need for them to the electorate?

Is the pro–reform coalition strong enough to secure their implementation?

For a new tranche of support to an ongoing programme, the past track record is a key indicator of commitment. Have difficult decisions been taken on time? If there have been past periods of poor implementation, is there reason to expect improved future performance? Are reforms perceived to be working, and gathering political support?

Conversely, even if a programme has previously been on track, is there evidence of declining support, perhaps due to failure to achieve expected results, or due to gathering opposition by those losing access to benefits obtained in the pre–reform period?

Describe the negotiations on the reforms, and the formal conditionality in the Bank and Fund programmes (not the same as the far longer list of measures included in the policy matrix).

If commitment is less clear than we would like, what accounts for Government reluctance: lack of conviction or sufficient consensus by Government, opposition (in Parliament, on the streets, or through the ballot box), personal or sectional interests of those in power, or lack of capacity? Depending on the cause of wavering commitment, the donor judgement on whether conditionality linked to finance is an appropriate response may differ. In most cases, conditionality should be used to record what Government has agreed it will do, it will rarely be effective in leveraging changes to which at least the reformers in Government are not committed. Managing the political opposition to reforms may require flexibility on timing.

Where there is uncertain commitment to reforms judged critical to overall success, have the Bank and Fund secured prior implementation of the necessary measures, or have essential reforms been fudged or deferred to late in the programme?

Are conditions implementable, or have legislative or other approval stages been taken for granted?

4. Description and analysis of reform programme

Describe the main features of the reform programme, supported if possible by Annexing a policy matrix.

Given the over–riding objective of sustainable poverty reducing economic growth, and the diagnosis above, are the priorities appropriate, the measures adequately thought through and feasible, the timetable realistic?

Are there critical reforms which the programme does not address, what can and is being done (including by DFID) to encourage or support the Government to address them in future?

Specific assessment is required of:

- How the economic and social policies being supported will help to improve the level and security of the poors' livelihoods, their access to economic and basic social services, and how Government will assess and monitor this.
- How adequately gender and environmental issues have been considered in the design of the reform programme, and how deficiencies in analysis, policy design, and monitoring will be addressed.
- The extent to which the reforms ensure macro–economic stability, remove major market distortions, establish the conditions for accelerated private sector growth, and support an effective and appropriate role for the public sector.
- The major challenges in implementing the policies and programmes supported by the programme aid, and measures being taken to ensure that capacity is not a binding constraint, including any related capacity building or TC support by DFID or others.

5. Expected impact and financing requirements

Provide the standard World Bank or IMF forecasts quantifying the expected impact of the economic and social policies being supported over the medium term, including forecasts of GDP growth, investment (public and private), consumption, monetary aggregates, inflation, the balance of payments, foreign exchange reserve targets in months of imports, and forecasts of the budget and how it is to be financed, including broad analysis of expenditure priorities.

Are the macro–economic objectives reasonable, representing a challenging but feasible adjustment effort? It can be helpful to review earlier similar forecasts, to see if consistent biases can be detected. Questions worth asking include:–

Growth and distribution

Are the GDP growth assumptions reasonable in the light of previous experience, and the quality of the policies in place? Are they consistent with the forecast level of investment? Economic reform can generate efficiency improvements enabling a growth rebound for a few years even without increased investment, but a more normal relationship will eventually be re–established.

Are private sector investment assumptions, including offshore investment, realistic, given private sector perceptions of economic management and prospects?

What is assumed about per capita real consumption? What does it imply for average living standards, and is it realistic and desirable? Are measures needed and in place to protect consumption levels by the poor?

Has allowance been made for high probability extreme weather conditions (e.g. drought) over the period of the forecast? How will it be accommodated?

Balance of payments

The balance of payments target is normally expressed in terms of achieving the target GDP growth whilst maintaining a liberal foreign exchange market for current account transactions and achieving a specific foreign exchange reserve targets.

Are the forecasts for the overall balance of payments and its components realistic and consistent with other forecasts? Is the assumed growth in imports consistent with the GDP growth? If import propensity is assumed to change, what will bring this about?

Are export volume and price assumptions reasonable? Have appropriately cautious assumptions been made about capital account flows?

What is the target level of foreign exchange reserves relative to imports? If the target is set at more than four months import cover, what is the analytical basis for this relative to the risks faced? A build up of reserves to very high levels (over six months import cover) indicates that there is no balance of payments need for financing given the proposed policies, but the implication may be that the macro framework needs to be relaxed to permit effective utilisation of available resources, or that further structural measures such as trade liberalisation are warranted. The balance of payments target needs to be examined alongside the monetary and public finance outlook.

IMF financial programme

See the macro–economic chapter of the economists' guide.

What are the economic growth and inflation targets, is the overall growth of credit in the economy consistent with them, does it allow sufficiently for increasing money demand in countries recovering from high inflation?

Does the distribution of credit growth between public and private sector seem appropriate, given the growth prospects and financing needs and of each sector?

Does the underlying assumption about changes in the public sector deficit or surplus and how it is financed appear reasonable? Are there underlying pressures (e.g. coming elections, civil service wage pressure, contingent liabilities for parastatals) which may make the proposed fiscal adjustment unachievable, with implications for crowding out the private sector?

How secure are the underlying interest rate, inflation, and exchange rate assumptions, what are the risks and how will they be managed?

Public finances

A table should present the main expenditure programmes and their percentage shares, and trends in per capita real levels. It should also show the expected development of the structure of the budget.

How effective is the budget planning and management process in delivering effective expenditure programmes in line with Government priorities? (See economists manual chapter).

What are the key objectives of public expenditure over the period covered by the programme? Where specific output targets exist, they should be quoted: examples might include specific primary enrolment targets, or health output indicators (e.g. immunisation coverage, proportion of population with access to primary services within 5km), or km of roads returned to maintainable condition. More realistically, the objectives at the macro level may need to be in terms of the prioritisation of expenditure programmes. This might be in terms of the share of total expenditure on specific programmes (e.g. primary education, or village water and sanitation), supported by structural indicators of the health of the budget (for example, the relationship between investment, recurrent, and non–salary budgets; or targets for the number of public servants and their real remuneration.) In addition to priorities, the objectives may also focus on reducing less productive expenditures.

How is public expenditure to be financed?

Is the domestic revenue effort relative to GDP reasonable and moving in the right direction at a realistic pace given other policy changes?

How does proposed external support to the budget reconcile with external support to the balance of payments? What is the explanation for any discrepancy?

How does the proposed level of per capita expenditure, including donor support, compare with comparator countries? Is the debt service burden sustainable, if not how will it become so?

How does per capita expenditure after debt service compare with other countries?

Given the quality of domestic policies and execution, does the proposed level of external support seem appropriate relative to the needs of other countries?

Is the structure of the budget, and how it is financed appropriate, especially the balance between development and recurrent spending, and between salary and non–salary recurrent spending? Is programme aid needed in order to achieve a better balance between development and recurrent spending?

What is the outlook for the proportion of total expenditures, and of recurrent expenditures, financed from domestic revenues in the medium term? In the long term? What are the implications for sustaining recurrent expenditure programmes? What are the implications for longer term phasing out of programme aid?

6. Evaluation

What evaluation or research studies have been consulted, how have lessons learned been taken into account?

What evaluation arrangements are in place for monitoring the progress of the reform programme, and the impact on the economy and on the welfare of the poor?

Explain the choice of specific objectives for the UK finance, and the indicators to assess progress.

7. Design of UK programme aid

This section describes and justifies how the programme aid will be transferred to the local economy, including the payment and accounting and audit arrangements.

Accounting and auditing guidance in OI Vol I Sections G2, G11 to G15 should be consulted.

The concessionality of programme aid is transmitted to the economy via the Government budget, and the accounting should normally be in terms of the Government budget. The purpose of programme aid is to support Government economic and social policies, and the disbursement and accounting route should as far as possible use Government procedures. At the same time, the programme aid provides an opportunity to appraise budget planning and financial management systems, and to link disbursement of DFID programme aid to support and encouragement for actions to improve performance. The submission should highlight any value added from DFID participation. The economic manual includes examples of disbursement and accounting arrangements, including details of links to overall improvements in management and accountability.

The submission will include an assessment of budget planning and financial management. It will:

- Explain on what basis DFID can be satisfied that appropriate expenditure has taken place to a value equal to or greater than the UK aid disbursement.
- What action is underway to remedy weaknesses if any in financial controls?
- How does the design of the programme aid contribute to necessary improvements in local systems of resource allocation and management, while minimising requirements or restrictions aimed solely at satisfying DFID?

If there are weaknesses in the overall financial management and accountability, DFID may choose to account for programme aid in terms of expenditure within a specific area of the budget where adequate accounting discharge can be obtained. This is a short term solution, and does not take away from the need to press for improvements in budget wide financial management, and to report on plans and progress within the submission.

Management arrangements

Responsibility for aid management in DFID and recipient Government.
Expected timing.
Provision of any related technical assistance, with TORs annexed.

Monitoring

What criteria and arrangements have been established for measuring progress in meeting the conditions and achieving the objectives of the economic reform programme?

Are adequate arrangements in place within Government for monitoring the impact and feeding the results into policy, especially the impact on the poor?

What arrangements exist for enabling Parliament and other domestic constituencies to obtain information on the progress and impact of Government policies and programmes, and to hold Government accountable for progress achieved?

If the main responsibility is taken by the Bank and the Fund, describe their monitoring proposals and the extent of any DFID involvement envisaged.

What are the monitoring arrangements for the management of UK programme aid?

Undertakings and timing

This section should indicate the period over which the aid will disburse, and the conditions which will be applied.

Programme aid is given in support of an economic reform programme endorsed by the IMF and the World Bank.

In order to enable countries to plan ahead with confidence, it is helpful to provide indications of future programme aid levels beyond the current year, conditional on the Government continuing to remain on track with the implementation of the reform programme, and subject to respecting basic standards of good governance. Longer term indications are especially important where countries have a substantial track record of implementation, but can also be relevant in post crisis situations, where Governments need assurances of external support in order to rebuild shattered economies. In the latter case, the commitment may need to be more explicitly conditional.

Government also needs to know when programme aid support to the budget will be received, in order to manage cash flow within the restrictions of the macro programme, and in order to efficiently implement expenditure programmes while minimising borrowing costs. An explicit schedule of future disbursements should be agreed, subject to Government complying with conditionality.

Where there is a long track record of successful implementation of Fund/Bank reform programmes, and the reform programme continues on track with no major policy difficulties, the programme aid need not be linked to specific stages in Bank/Fund approval or review processes.

Where the programme is relatively new, or major policy issues are awaiting resolution, or Bank/Fund support is temporarily suspended, the trigger for DFID fund release will normally be the country reaching agreement with Bank and Fund. This may take the form of successful completion of an IMF review permitting tranche release, or negotiation and approval of a new annual IMF programme, or compliance with World Bank tranche release conditions. The choice of specific trigger will depend on issues of timing, the urgency of the need for funds, and the importance of the specific conditionality for the DFID poverty reduction agenda.

DFID should not normally add policy conditions additional to those of the Bank and Fund. Programme aid is intended to minimise the management burden of external aid, and it is unhelpful to reduce one form of transactions cost by reducing restrictions on how aid is used, only to add a new layer of complication in the form of proliferating conditionality. In principle, a country should have but one reform programme which it is implementing. It is also in practice extremely unlikely that DFID would enforce bilateral conditions in situations where Bank and Fund conditionality had been met, and other donors were disbursing: conditionality is rarely effective, but it is least effective when the threat of withholding aid is not credible.

If bilateral conditions are nevertheless used, perhaps because the DFID aid is linked closely to a specific area of reform, it will be important to check that the conditions are fully consistent with the reform programme, and with conditions imposed by other donors. Where there is a specific bilateral trigger for DFID aid, there may be a case for avoiding additional cross conditionality to Bank/Fund operations, other than the sine qua non of the macro programme remaining on track.

The other exception will be conditions related to DFID implementation, for example accounting and audit requirements.

8. Risks and assumptions

What are the main potential causes of failure to achieve:

- The objectives of the reform programme
- The specific objectives of the programme aid

What actions have been or will be taken to reduce these risks or their impact on the reform programme or DFID support to it?

Annex II: Sector Programme Submissions

1. Place in country aid policy

This section will set out why sector support is considered appropriate. Reference can be made to the 16 cell matrix in Section 5 of the Chapter on Aid and Public Expenditure in the Manual, in assessing whether programme, sector, or project aid forms are appropriate. Sector support is likely to be especially appropriate where:

- A country is highly aid dependent, and transactions costs of project aid are imposing significant costs and are distorting the budget, and the priority policy reforms by central economic authorities to enable sector level reform and expenditure programmes to work effectively have been or are being taken.
- The specific sector has been identified as important to future efforts to reduce poverty and progress towards meeting the international development targets.
- Government shows evidence of commitment to a policy in the sector which gives appropriate priority to benefiting the poor as part of a strategy which is based on a clear and realistic view of the role which Government should play in the sector.

Sector support is less likely to be a sensible bilateral option in large economies where the DFID support would make negligible difference. In these circumstances, DFID value added is likely to be greater if linked to a more specific or innovative area of activity.

This section will also report the effectiveness of the DFID role in previous support in the sector relative to the objectives set (see previous section).

A PCR from previous support to the sector should be annexed if relevant.

2. Background to sector policy

Formulation of sector strategy

- What was the process by which the sector strategy was put together?
- Has there been a consistent and appropriate policy and strategy, to which Government has demonstrated commitment by its actions?
- If significant change is proposed, who is sponsoring that change? Is ownership broad based and high level enough? Is the programme vulnerable to the loss of key personnel?
- Has there been a process of national consultation, who was involved, how were the interests of the poor represented?
- Has Cabinet and Parliamentary endorsement been obtained?
- Have the difficult issues been confronted, is the strategy linked to budget choices, clarifying what is not a priority as well as what is?

Dialogue with donors

- What role did the donors play in strategy formulation?
- If donors took a strong lead, how much evidence is there of Government commitment: participation in the process, Government leading local consultation and providing considered comments and responses from senior level, Government negotiating the strategy through the

local decision–making and approval processes, including budget allocation, actions up front on difficult measures, formal high level endorsement.

- Are there significant donors not on board with the process; are there risks of inconsistent actions?

3. Government budget planning and management

- Describe and assess the budget planning and management system within which the sector programme is nested. Does the budget attempt to cover Government and donor funds? Does it provide a medium term perspective through a medium term budget or expenditure framework? Is budget execution consistent with the budget approved, is action in train to improve this? Are budget releases made at the right points in the year?
- What evidence is there of Government allocating budget priority to the sector at levels consistent with the proposed programme? Are there any formal commitments to future budget shares?

4. Analysis of the sector programme

Where a joint Government/ donor document setting out the agreed programme exists, this section can be brief, referring to where issues are covered in the main document, and adding additional points and assessments.

Goals and Indicators

- Where DFID is supporting a sector programme jointly developed by Government and donor partners, a separate DFID logical framework may not be required. This section should highlight the key outcomes which the programme aims to achieve, and refer briefly to the section or Annex where the indicators to assess achievement and how they will be collected and reported are described. The objectives should be framed in such a way that they are specific, measurable, achievable, regularly measured, and time bound.
- Do the stated objectives reflect the key priorities if the IDTs are to be achieved and poverty reduced?

Technical, economic and social assessments

Summarise the assessments by professional advisers. Points to focus on:

- Is there a credible, evidence based diagnosis of the problems of the sector?
- Given the diagnosis, what evidence is there that the policy and programme interventions proposed under the sector programme are sufficient to achieve the stated objectives?
- Have the policies and programmes been fully and realistically costed?
- Is the proposed strategy technically appropriate, within the implementation capacity of those expected to implement it, cost effective compared to alternative approaches, and feasible given the interests and incentives of those involved?
- What is the rationale for the Government role, in terms of distributional objectives and market failure. Is Government relinquishing less appropriate roles to focus on core functions?
- How will effectiveness be monitored and fed back to inform future adjustment?

Work programme

- Is there a work–plan setting out actions needed in order to implement the programme, and who is responsible for taking them?
- Does it focus on a limited and feasible agenda of important measures?
- Does it establish a future process for tackling important issues on which further analysis and policy work is needed?
- How effectively has the programme been communicated to those expected to implement it, and those affected by it?

Costs, financing and sustainability

- Provide estimates of total expenditures in the sector, and the role of Government within that.
- Provide the forecast costs of the Government programme over the medium term, by major programme component or objective, and the proposed financing sources. Comment on their realism.
- Provide a longer term forecast, to assess the sustainability of the proposed service levels. What is the per capita cost of the services which the programme aims to provide? On assumptions concerning future revenue growth and the share of the sector, together with forecasts of future aid levels, are the per capita costs sustainable and compatible with extending services to all? If there is a gap, how can it be closed? Is there a need for further policy development, pilot study, or dialogue with Government to resolve the financing conundrum? How will it be taken forward?

5. Management and capacity issues

Government management arrangements

- Describe Government management arrangements, responsibilities for planning and implementing the SWAP.
- Describe the budget cycle, who is involved in planning and approving budgets, what are the arrangements for fund release and for financial accountability, what delegated authority do managers have.
- Describe communication and reporting channels.
- Assess capacity to implement the Work Programme. Are human resources sensibly allocated, are management structures supportive of capacity?
- Assess incentives, problems, motivation and corruption issues. What action is planned to deal with any problems, link to any safeguards or undertakings

Donor co–ordination

- How have donors worked together and with Government in putting the programme together? What problems if any?
- What involvement, if any, do the donors have in management: what committees are we involved in?
- Frequency and timing of reviews.
- What arrangements for agreeing terms of reference and participation in joint independent reviews of progress

- How will the proposed arrangements reduce the transactions costs to Government of dealing with donors?

6. The UK contribution

- Description of UK contribution: amount, timing, triggers for future release
- Disbursement arrangements. Are there joint funding arrangements based on Government systems? If so, are we using them? Justify if we are not.
- If no joint systems are in place, what are we doing to develop such systems for the future?
- Justify any restrictions placed on use of the funds, or any bilateral TC or financial contribution not fully integrated with joint funding and management.
- Describe the accounting and audit arrangements, procurement arrangements. Assess the systems for ensuring adequate accountability for Government funds, explain how weaknesses are being addressed, and what measures are proposed to increase confidence that donor funds can not be misused and can be accounted for and audited.

7. Monitoring and evaluation

What has been agreed as to how the programme will be implemented, and the indicators used? Annex the agreed indicator set, and baseline figures where known. Monitoring should include:

- **Process** indicators: measuring whether actions set out in the work programme have been completed on time and within budget where relevant. These are relatively straightforward to collect from internal management sources, and are usually the strongest element of the reporting system.
- **Input** indicators: measuring whether financial commitments and disbursements have reached the budget levels against specific categories of spending. Also includes data on physical input indicators: for example in the health sector, stock outs of key drugs at facilities of different types can be an important indicator, indicators of the presence and operational state of medical equipment at facilities can also be useful. Staffing indicators also come under this general heading, with breakdowns by type of facility and location.
- **Output** indicators. Most programmes collect a range of these from administrative sources, supplemented by census and survey data to permit ratios to population to be calculated. For example, in the health sector: immunisation coverage, outpatients seen per type of facility, bed occupancy and duration, births attended by medical staff. For the education sector, enrolments, attendance, attainment in standard tests of numeracy or literacy or in examinations.
- **Service quality** indicators: systematic data on the experience of those attempting to use services. Information can be collected on access and use made by different groups of poor and non–poor of both public and private services; overall opinions on the quality of service offered; specific information on whether facilities are open at appointed times; whether bribes are sought and at what level; what user fees are charged; whether necessary inputs were available (drugs in health facilities, books in schools); whether they were treated fairly and with respect, what could be done to make the service more responsive to their needs.
- **Cost effectiveness** indicators: composite indicators relating outputs achieved to the cost of achieving them can be helpful in defining the essential healthcare package, as well as permitting comparisons between good and weak performance, in order to help focus improvement efforts. At the most basic level, data on unit costs per outpatient visit or per bed night, or patient contacts per staff member can be useful. More sophisticated research into facility efficiency can be helpful in refining the service package, and setting achievable goals for efficiency improvement. The facility efficiency survey in Bangladesh came up with

surprising initial conclusions, that poor quality and hence poor utilisation of primary level facilities made their unit costs per patient extremely high, and actually higher than the general hospitals. In the education sector, combining cost data with drop out and enrolment data enables a useful composite indicator to be calculated showing the cost per completer attaining a given standard.

- **Outcome indicators** and proxies for them: health targets normally exist for a range of vital indicators such as infant and child mortality, contraceptive prevalence, and possibly specific indicators related to individual diseases which are the subject of specific targeting. Maternal mortality may be targeted, but is a low frequency event, making it difficult to observe trends. These outcome indicators are all likely to respond only slowly to health sector improvement, and may be more powerfully influenced by non–health factors in the short term (e.g. drought or famine), and are infrequently measured. The main reliance therefore needs to be placed on service quality and output indicators as proxies for whether the overall quality of health service delivery is improving. In the education sector, attainment tests are the key indicator, especially if value added can be tracked by following cohorts over time. Where that is not feasible, attendance and drop out data can provide a good proxy indicator of whether something useful is being delivered.

Other issues to be addressed include:

- Who is responsible for preparing reports, with what frequency? Is there a track record? Have they been produced on time? Is there a need to increase capacity, or for technical support? How will it be provided?
- What are the arrangements for objective and independent review of progress? Are we confident that there is sufficient ‘ground truthing’?
- Are there arrangements for local level monitoring, accountability to domestic constituencies at local and national level, proposals for strengthening this?
- Do staff within the system see monitoring reports, are they able to compare their performance with their peers?
- What proposals are there for mid term reviews or evaluations? They should be on behalf of the partnership, not bilateral.

8. Undertakings

- What undertakings have been agreed between Government and the donor group? Are there aide memoires or codes of conduct that set out formally what both sides of the partnership have agreed to?
- What sanctions or dispute resolution processes are specified for non–compliance?
- Are there additional conditions related to the assistance of some or all of the partners?
- Are there specific conditions related to UK assistance? What is their justification? What sanctions would UK apply if not met? Is it politically realistic to apply different conditions if other donors do not?

9. Risks and assumptions

What are the key risks of failure to achieve the objectives of the sector programme? Provide a risk matrix.