

IEG Working Paper 2008/---

**World Bank Support for Public Financial
Management: Conceptual Roots and
Evidence of Impact**

**Background Paper to Public Sector
Reform: What Works and Why? An IEG
Evaluation of World Bank Support**

Clay G. Wescott



***ENHANCING DEVELOPMENT EFFECTIVENESS THROUGH EXCELLENCE
AND INDEPENDENCE IN EVALUATION***

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ISBN No. 13: 978-1-60244-087-6

ISBN No. 10: 1-60244-087-5

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Wednesday, July 02, 2008

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ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
ADB	Asian Development Bank
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CFO	Chief Financial Officer
CPAR	Country Procurement Assessment Review
CPIA	Country Policy and Institutional Assessment
DfID	Department for International Development (United Kingdom)
DPL	Development Policy Lending
HIPC	Highly-Indebted Poor Country
ICR	Implementation Completion Report
IFMS	Integrated Financial Management System
IMF	International Monetary Fund
INT	Department of Institutional Integrity
MTEF	Medium-Term Expenditure Framework
MEF	Ministry of Economy and Finance
NGO	Non-Governmental Organization
OECD	Organization for Economic Co-operation and Development
PAP	Priority Action Program
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Survey
PFM	Public Financial Management
PIU	Project Implementation Unit
PRSC	Poverty Reduction Support Credit
PSR	Public Sector Reform
TCAP	Technical Cooperation Assistance Program

SUMMARY

The advice provided by the Bank on improving public financial management (PFM) is influenced by debates on theory and practice in developed and developing countries. This paper touches on some of the highlights of these debates, drawing from indicative literature mainly since 1990 from scholars and practitioners. The second part of the paper discusses examples of Bank support for reform of budget planning and execution, in particular financial management information systems (FMIS), medium-term expenditure frameworks (MTEF), procurement, auditing, monitoring and evaluation, and the strengthening of key budgetary accountability institutions, like public accounts committees of the legislature and supreme audit institutions.

1. SOME KEY DEBATES ON PFM SINCE 1990

1.1 Public financial management concerns the taxing and spending of government, which in turn influences resource allocation and income distribution (Rosen 2002: 16). The spending portion covers the budget cycle, including budget preparation, internal controls, accounting, internal and external audit, procurement, and monitoring and reporting arrangements. The revenue portion is closely related, and will be mainly covered in a separate background paper¹.

PUBLIC FINANCIAL MANAGEMENT IN DEVELOPED COUNTRIES

1.2 There were two main pressures driving public financial management reforms in developed countries starting in the 1970s and 1980s: first to cut spending and reduce fiscal deficits, and second to facilitate performance improvement through greater efficiency, effectiveness, and quality of public services. The dual imperatives of controlling spending and deficits while improving performance are recurring themes in these countries (see, for example Hoover Commission 1949), brought out this time in response to factors such as the increasing portion of budgets earmarked for transfer payments and debt repayment.

1.3 Public expenditure cuts were part of the loan agreement between the Government of the UK and the International Monetary Fund (IMF) in 1976, and spread to most Organisation for Economic Co-operation and Development (OECD) countries, along with a corresponding concern for getting greater value for money. These challenges may have been exacerbated by a crisis in legitimacy, with declining public trust in the ability of government to effectively manage public affairs and solve socio-economic problems.

1.4 Countries responded to these pressures by moving beyond past practices of approving, tracking and accounting for annual spending on inputs, to more systemic and integrated approaches of strategic allocation, operational management, and performance measurement. These reforms built on theories of public choice (Buchanan 1986), institutions (North 1990), and principal-agent (Eisenhardt 1989), along with initiatives first adopted in the private sector such as “total quality management” (Deming 1986) and “managing for results” (Drucker 1954, 2001), exhortations like “What gets measured, gets done” (Peters 1986), and adaptations to the public sector including “new public management” (Hood 1991) and related formulations (Osborne and Gabler 1992, Mintzberg 1996, Hatry 1999, Moynihan and Ingraham 2003, and Foltin 2005).

1.5 Among the wide-ranging public financial management reforms pursued by OECD countries over the last 25 years, eight broad components are noteworthy (OECD 1995,

¹ Cf. “Although good economic analysis calls for joint consideration of both (the expenditure and revenue sides), the practice is to deal with them as more or less separate issues” (Musgrave and Musgrave 1989)

OECD/World Bank 2003, Pollitt and Bouckaert 2004, Diamond and Khemani 2006, Brumby 1999, Rubin and Kelly 2005, World Bank 2000a: Annex 3)²:

- Achieving budget savings through more robust central controls, or by providing greater flexibility to managers and organizations in reallocating funds within budget line items to reflect changing conditions and priorities;
- Restructuring budgets to include expenditures for all government activities, global budgetary targets, hard budget constraints and program allocations to facilitate results monitoring and evaluation;
- A multi-year budget linked to a clear fiscal policy and realistic revenue estimates;
- Regular use of performance information in monitoring against targets to facilitate accountability and to better manage performance;
- Shifting from cost accounting³ towards accrual accounting⁴;
- Shifting from compliance auditing⁵ towards performance auditing⁶;
- Computerized information systems providing timely financial and related information to all parties in the budget process; and
- Greater use of devolved budget management, and market mechanisms such as user and capital charges, market testing, outsourcing, and performance agreements.

1.6 There is ongoing debate on the benefits and costs of these reforms. For example, reforms in OECD countries have pursued two broad approaches to budget savings. The first is a top-down approach, where central finance ministries decide on how much of which programs to cut. Success with this approach has depended inversely on the degree of political opposition mobilized to oppose the cuts in sensitive areas. The biggest challenge has been the trade-off with performance improvement, since operational managers may lose planned funds despite good performance, creating an unpredictable and demotivating environment. The second route to savings has been frame or block-budgeting, where the central finance ministry sets broad ceilings, and leaves the spending ministry to determine allocation. Although potentially more performance friendly than the first approach, it can lead to complaints from spending units that they are given tasks without adequate funding. This approach requires at least two phases of budgeting: first a discussion between the central finance ministry and spending ministries on appropriate ceilings, and then a discussion within spending ministries on allocation. This broader responsibility and accountability for budgeting also means that middle managers, including some front-line service providers such as teachers, need greater depth of PFM knowledge (Pollitt and Bouckaert 2004: 67-69).

1.7 A challenge for both approaches is to achieve maximum transparency. This is enhanced through a single budget document including all policies and assumptions that is available to the public and that allows independent agencies to verify forecasts and projections of the budget impact of taxing and spending (Alesina and Perotti 1996). As an example of fiscal transparency, 74 percent of OECD countries cover extra-budgetary funds in

² Although mainly including developed countries, OECD (1995) includes Turkey, and OECD/World Bank 2003 includes as OECD members six additional emerging market countries.

³ Recognizes cash transactions only.

⁴ Recognizes transactions when commitments are made, and accounts for depreciation of capital assets.

⁵ Audit measuring compliance with laws and regulations in the use of resources.

⁶ Audit measuring economy, efficiency and effectiveness in the use of resources.

activities in their budgets (OECD/World Bank 2003: question 5.2.b). A related trend finds citizens and non-governmental organizations (NGOs) increasingly engaged in the budget process (Tanaka 2007)

1.8 Going along with increased flexibility is often a shift from *ex ante* to *ex post* controls (Demski and Feltham, 1976). *Ex ante* controls are meant to prevent officials from doing wrong things or to compel them to behave legally. Officials are responsible to obey, and the controller attempts to monitor and enforce compliance. In contrast, *ex post* controls are executed after the official decides on and carries out a course of action and after some of the consequences of the official's decisions are known. Since bad decisions cannot be undone after they are carried out, *ex post* controls are intended to motivate officials to make good decisions. Officials are held responsible for the consequences of decisions, and the controller attempts to monitor consequences and rewards or sanctions accordingly. *Ex post* controls may be increasingly used as organizations give greater emphasis to performance. (Thompson and Jones 1986; OECD 1995: 35-45). Yet 85 percent of OECD governments still provide *ex ante* controls by spending units of commitments and payments (OECD/World Bank 2003: question 4.1.b); and countries using *ex post* controls, such as the UK, have stepped up enforcement, in that case by increasing the number of accountants in the civil service by 2 ½ times in the decade ending in 2002 (McSweeney 2006: 28).

1.9 Multi-year budgets were part of the planning, programming and budgeting systems rolled out in the 1960s in the US, and became a feature of most European country budgets during the 1970s as a planning tool to set aside funds for future programs. An OECD country survey (1995) points out that multiyear budgets, although useful in some respects, need to be used with care. Bringing the advantage of greater certainty over future funding, they initially had the disadvantage of setting a floor on future expenditure that proved unsustainable during periods of high inflation. To address this, some OECD countries changed them from plans to projections and from enablers of government expansion to constraints on spending. Alesina and Perotti (1996) add that there are also risks that multi-year budgets can reduce transparency by their complexity, and by postponing tough reforms to later years. 73 percent of OECD governments prepare multi-year budgets, but of those, all but three are for information purposes only, and do not require authorization by legislatures (OECD/World Bank 2003: question 2.2.a 1, 2).

1.10 OECD countries are placing greater emphasis on performance information. Although Pollit (2000) and Kickert (2006) show how specific country responses are influenced by administrative traditions, four broad stages of performance-enhancing reforms to the budget process are reportedly evident in OECD countries. Although these stages are helpful in understanding international trends across countries, individual countries may pick and choose from elements of two or more stages within each group.

1.11 The first stage is to publish performance information as part of, or alongside budget documents. Although this gets the performance discussion underway, it may be hard to link performance to specific budget allocations. A second stage is to change the budget format, moving away from traditional line-items to programmatic or other categories that can be better measured against performance (cf. Kim, 2006, Schick 2007). This deepens the performance discussion, but the information provided may not be in a format or sequence

that usable by key stakeholders. 32 percent of OECD countries include non-financial data for all programs in their budget, and 21 percent include performance targets (outputs or outcomes) as part of these data (OECD/World Bank 2003: question 5.4.a2, 3). A third stage is to change the structure and timing of the budget discussion so that legislators and other stakeholders can make more informed use of performance information. A fourth stage is to adopt an accrual basis for charging, to require reporting on, for example, contingent liabilities and capital assets. This final stage has only been achieved by a small number of countries, including the UK, Australia, New Zealand, Netherlands, and Canada (modified accrual) (Pollitt and Bouckaert 2004: 69-70 van der Hoek 2005).

1.12 The renewed emphasis on performance has been supported by improved monitoring and evaluation. First adopted by the US Government in the 1960s, evaluation results have increasingly been linked in, for example, Australia to the budget process. The reconsideration procedure introduced in the Netherlands in 1981 reviews policies to come up with more cost-efficient ones, or to abolish those with weak results.

1.13 A challenge in analyzing these reforms is that the reform claims of governments are often far ahead of actual implementation. Budgeting is a political process, and announcing that reforms are underway is far easier than actually carrying them out. A review of 30 years of financial management reforms by USA states found steady progress on adopting budget ceilings, adding discussion of efficiency in budget narratives, and expanding use of information technology, but a reduced emphasis on priority rankings and effectiveness analysis after 1990 (Burns and Lee 2004). International comparative studies also point out the difficulties of linking budgeting with good performance information because, *inter alia*, systems are: "...too ambitious, too cumbersome, and too distant from the engrained habits of political decision-making to take firm root, although they did work better in some departments and for some programs than others, and they did leave a useful residue of data and analytical capacity (Pollitt 2001)".

1.14 There are three stages of accounting reform in OECD countries. The first stage is a cash-based system, where cash payments are recorded when spent. The advantage is simplicity and ease of preparing and understanding reports. The challenge is the lack of incentives for efficiency and economy. A second stage is double-entry book keeping or modified accrual, where each transaction is entered twice: first as a credit to the cash account, and second as a debit to the asset/liability account. The advantage is that such a system starts to raise awareness of various performance issues, such as efficient use of capital assets. The third stage of accrual accounting means reporting on commitments rather than cash, and valuation and depreciation of assets. Where accrual accounting is delegated to spending units, it can in principle provide good link between spending, costs, and performance, somewhat comparable with accounting in private businesses (Pollitt and Bouckaert 2004 70-72). 48 percent of OECD countries prepare whole of government annual financial statements mainly on a cash basis, and 28 percent mainly on an accrual basis (OECD/World Bank 2003: question 4.2.j).

1.15 OECD jurisdictions such as states in the USA have made progress in improving many aspects of accounting since the 1970s, with better tracking of appropriations, departmental and unit expenditures. However, there has been little progress in the USA on

cost accounting, even though it would be useful for service improvements linked to benchmarking (Burns and Lee 2004)

1.16 The decision to adopt modified or full accrual accounting has been debated since the 1970s, with many jurisdictions adopting a combination of the two for different types of activities. Indeed, typical rollouts in many jurisdictions start with pilot projects which are then scaled up; as different parts of government use different accounting systems, it can be hard to understand performance across government. Other challenges include the difficulties faced by legislators and other laymen stakeholders in understanding accrual reports, the possibilities for managers of presenting information in a favorable (but not necessarily the most informative way), and the difficulties of depreciating certain community assets such as roads or national parks whose economic value and life are indeterminate (Ibid., Pallot 1990, Harris 2005, Sterck 2007).

1.17 There has been a similar range of auditing reforms in OECD countries. In the first stage, governments focus on high quality financial and compliance auditing, ensuring that laws and procedures are followed. A second stage goes beyond this, looking for waste, equipment not being fully or properly used, and so forth, along with problems in accounting data. The third stage of performance auditing usually means setting up a special unit to focus on issues of economy, efficiency and effectiveness. Auditing reforms may be launched by a country's Supreme Audit Institution, but corresponding reforms are generally needed in internal audit bodies within spending ministries and departments. While performance auditing may be initially introduced to help ministries and departments in crisis to recover, they may be subsequently used as a proactive tool to identify areas for improvement (Pollitt and Bouckaert 2004: 72-74, Foltin 2005). Among OECD national audit bodies, 81 percent have a mandate for performance as well as compliance audit (OECD/World Bank 2003: question 4.5.g)

1.18 All the above reforms are facilitated by the use of information and communication technology (ICT). For example, computerized financial management information systems are common features of OECD financial management reforms. Countries try, with varying success, to integrate and provide timely financial and related information to all parties in the budget process. Such systems can facilitate the transition from cash to double-entry to accrual accounting, and can help enable performance budgeting, decentralization, market testing, streamlined procurement, and electronic payments. They allow central agencies to have access to financial information as transactions are made. ICT systems enable 70 percent of OECD countries to use a treasury single account for all public revenues, and 91 percent where Ministry of Finance/Treasury has information on actual expenditure in time for effective monitoring. Complementary ICT can help to enable more efficient, cost-effective, and participatory government, facilitate more convenient government services, allow greater public access to information, and make government more accountable to citizens. Weighing against these benefits are the challenges of adopting and enforcing appropriate laws, regulations, and organizational changes, and of financing infrastructure, systems, technical support, and training, while ensuring equitable access and affordability (Diamond and Khemani 2006: 49-52; OECD/World Bank 2003: question 3.3.a, Wescott 2007).

1.19 Another feature of OECD countries is that broader, administrative reforms were often led by fiscal bureaucrats seeking to rein in spending and rent seeking by special interests by separating policy making from policy execution, and enabling governmental units to react to market pressures. These reforms, enacted by political coalitions favoring governmental reorganization, helped to impose wage discipline on public sector labor, instill a greater focus on measurable results, and encouraging competition through contracting out, privatization and deregulation (Schwartz, 1994).

1.20 Finally, OECD countries are also making greater use of devolved budget management and market mechanisms such as user and capital charges, market testing, outsourcing, and performance agreements. This move away from central controls can take on different forms depending on the degree to which independence of action is assigned to lower levels of authority. Deconcentration involves central agencies assigning certain functions and responsibilities to subordinate government or branch offices. Delegation takes place when authority for defined tasks is transferred from one public agency to another agency or service provider that is accountable to the former, but not wholly controlled by it. Devolution takes place when authority for defined tasks is transferred from a public agency to autonomous, subordinate-level units that may be holding corporate status, granted, for example, under legislation. Fiscal decentralization is one form of such practices: granting taxing and spending powers to local or regional governments. This and other forms can lead to a broadening of institutions producing and providing needed goods and services to the public at more efficient cost, wherever they are located and whether they are public, quasi-public or private. Indeed, that devolution often manifests itself in a plurality of agencies, public and private, operating at different scales of jurisdiction providing overlapping services (Diamond and Khemani 2006: 75-80).

1.21 This circumstance gives rise to debate about the consequences of devolution in terms of economic efficiency, the extent and consequences of increased public agency and market competition, clarity of accountability where mandates are devolved creating overlap of roles and responsibilities, and fiscal effects on subordinate organizations. For example, research comparing public and private sector procurement of consultants in Belgium found the latter had a better sense of market prices, and was more likely to do a cost-benefit analysis and in other ways evaluate the results of consultancies than the former (Roodhooft and van den Abbeele 2006). Taylor (2005) found that public sector tendering results in low price and quality because information on price is more complete than on quality, and because not all interested parties participate in the tender process; to remedy this, he recommends a two stage tender process that reveals more information to bidders and client, and a reduction in barriers preventing small bidders from succeeding. Fiscal decentralization may face performance risks of relying on inexperienced local officials, challenges of cross-subsidizing poorer jurisdictions, and the difficulties of controlling the build-up of debt (Bahl and Wallace 2005).

1.22 Musgrave (1998) has argued that the types of fiscal tools used by a government depend in part on the normative view of the role of the state *vis a vis* markets. These views may change over time. Reschenthaler and Thompson (1996) argue that the shift towards adapting private sector practices to the public sector has resulted in part from reductions in

information costs, which have produced four major shifts in the comparative advantage of alternative institutional arrangements. These are:

- The efficacy of the market has increased relative to government provision and control, which has had the effect of increasing the payoffs to free markets, secure property rights, and less government intervention;
- The efficacy of the market and other self-organizing systems has increased relative to hierarchically coordinated systems, which has had the effect of decreasing the payoff to hierarchy and vertical integration;
- The efficacy of decentralized allocation of resources and ex-post evaluation and control has increased relative to centralized allocation and ex-ante control, which has had the effect of decreasing the payoff to scale; and
- The efficacy of process-oriented structures has increased relative to functional structures, which has had the effect of decreasing the payoff to scope.

1.23 These shifts are hardly surprising. As Coase (1937) theorized and Williamson (1988) demonstrated, the comparative advantage of any institutional arrangement is affected by information or transaction costs. Changes in information costs should alter the relative advantage of alternative governance arrangements and institutional designs.

1.24 And yet, despite these powerful drivers of change, much of the actual reform taking place is incremental, based on targets of opportunity, rather than drawn from a coherent strategy, even with the most ambitious Anglo-Saxon reformers. There is a gap in most reforming countries, between the promise of new announcements and initiatives on the one hand, and the actual delivery of reforms on the other.

US Experience With PFM Reforms

1.25 The US federal government provides an instructive case of how financial management reforms have emerged over the last 25 years, building on experience acquired since the Budget and Accounting Act of 1921. The most important law in the 1980s passed in this area was the Federal Manager's Financial Integrity Act of 1982. It required each agency to make ongoing evaluations on the system of accounting and control, and to identify risk factors and make improvements. Annual reports to the President and Congress were required. This law was meant to address many weaknesses identified when President Reagan came into office in 1981. Among them was a perception that the government, which had once been a leader in computerization in the 1950s, had fallen behind the private sector, and was more open to waste and fraud. In addition, the Debt Collection Act of 1982 strengthened the government's ability to collect debts, and the prompt payments act of 1982 required the federal government to pay invoices within 30 days.

1.26 The Chief Financial Officers Act was passed in 1990, after a great deal of negotiation with Congress. Under this, there was a Chief Financial Officer (CFO) appointed for the government as a whole, and CFOs in each of the major agencies. The position gave leadership, policy direction, and oversight of financial management and information systems, including credit and asset management, cash management and internal controls. The Government Performance and Results Act of 1993, and the Government Management

Reform Act of 1994 gave further support to financial management improvements. The results are:

- All 24 agencies covered by the CFO act issued annual audited financial statements in 2000
- More than 60 percent received clean audit opinions
- The Treasury issued a consolidated financial statement for the first time in 1998
- A complete set of basic accounting standards was issued in 1996 covering the entire federal government. In 1999, the Institute of Certified Public Accountants recognized the standards as generally accepted accounting principles.

1.27 In addition, almost 80 percent of non-tax payments were made electronically in 1999, and more in successive years. There were significant cost savings and accounting improvements from the use of small purchase bank cards. However, much more remains to be done. Although 60 percent of the agencies had clean audit reports, those that did not amounted to 65 percent of discretionary budget authority. Subsequent reforms have tried to address this (Jones and MaCaffrey 2001).

1.28 The US case shows that even in a developed country, budget execution and accounting reforms take a long time to put in place, and longer to produce the desired results. One reason is that even when reforms are carried out as promised, their impact may be less than expected. As one observer put it:

Even when developed to the ultimate stage of perfection, governmental accounting cannot become a guaranty of good government. At best, it can never be more than a valuable tool for promotion of sound financial management. It does not offer a panacea for all the ills that beset representative government; nor will it fully overcome the influence of disinterested, uninformed citizens. It cannot be substituted for honesty and moral integrity on the part of public officials; it cannot eliminate the demands of selfish interests, whether in the form of individual citizens, corporations, or the pressure groups which always abound to influence government at all levels (Mikesell, 1956: 10).

1.29 A final conclusion from the OECD country experience is that while there is lots of evidence of heightened discourse on financial management and other public sector management reforms, and better tracking of inputs and outputs, there is little evidence that the considerable cost of the reforms is justified by the benefits achieved (Pollitt and Bouckaert 2004: 103-142, 194-196). Among the reasons for this is that various public sector rules, regulations and processes instituted for diverse reasons including control, accountability, transparency, affirmative action, regional balance and the politics of compromise among elected leaders, often work against achievement of efficiency and effectiveness in transforming inputs into results (Jones and Thompson 1999).

APPLYING DEVELOPED COUNTRY PUBLIC FINANCIAL MANAGEMENT EXPERIENCE IN DEVELOPING COUNTRIES

1.30 Starting in the 1950s, the financial management advice most sought by developing countries was how to raise more revenue to finance the capital investments governments were seeking to make. The United Nations started offering advice on tax administration in the 1950s, the US Foreign Tax Assistance Program was started in 1962, and the IMF Fiscal Affairs Department began in 1964 to give advice on taxation, public budgeting and accounting. The Musgrave commission in Columbia came up with a revenue target as the difference between private savings and foreign inflows on the one hand, and investment needed to achieve a target growth rate on the other (Goode 1993), building on the dominant thinking of the time of state-led development.

1.31 On the expenditure side, a host of challenges gained attention largely following the oil price shocks, where fiscal deficits of developing countries increased from 3.5 percent to 6.3 percent of GNP during 1972-85. These challenges included weak public expenditure and resource planning (e.g. weak priorities and linkage with macroeconomic framework), inconsistent budget structures (e.g. inconsistencies and weak links between capital and recurrent budgets), budget implementation (e.g. weak cash management) and accounting and reporting (e.g. absence of commitment accounting), and selective reforms to improve performance and allocation.

1.32 Toward the end of the 80s, there was a belief that centralized financial controls introduced during the crisis needed to be replaced in many cases with decentralized controls at the spending unit level, with greater integration of policy and financial considerations. This also linked with greater citizen demand for improved service delivery and greater accountability for results through contractual and other mechanisms (Premchand, 1990: 31-7). Countries also sought to reduce high, progressive income taxes, import duties and export taxes and replace them, for example, with a value added tax (VAT) that would help facilitate market directed allocation of resources, while being broadly politically acceptable, and administratively feasible (Goode 1993).

1.33 These demands from the developing world were a response in part to the recent thinking in OECD countries outlined above on how to adapt new tools to carry out deliberate changes in the structure and processes of the public sector to get them to run better.

1.34 Development agencies also changed their views over this period, increasingly realizing that deficient PFM systems can undermine their development assistance. They realized that even though aid projects may have good financial controls, they could result in government resources being freed up to fund other things; if PFM systems were deficient, the development results from these resources were likely to be less than desired. Donors became increasingly aware that the distinction between development and recurrent spending was less important than once thought: teachers salaries were just as important as school construction for achieving education. They realized that project-centered aid could not succeed with poor macroeconomic and fiscal policies, and that economic development required not only physical investment, but also good public sector management (Allen et al, 2004:4-5).

1.35 There was increasing awareness that PFM outcomes depend on the nature of budgetary institutions (Von Hagen, 2005), and that sound PFM requires not only a strong budgetary authority, but also capable a legislature, in some cases supported by civil society budget groups (Krafchik, 2003; Lienert, 2005; Robinson, 2006, DfID et al, 2007). There is some evidence of recent increasing work by multilateral donors in these areas (Santiso, 2006). At the same time, there is evidence that countries with "rules that establish limits on deficits, that prevent sub-national and decentralized agencies to incur in debt financing, that have medium term fiscal frameworks and reserve funds in place, and by more hierarchical procedures, that establish restrictions on the legislature and on the bargaining power of ministers and provides the executive with discretion to cash manage expenditures, tend to present lower primary general government deficits" (Filc and Scartascini, 2004).

1.36 The next section will sketch out three broad debates carried out over the last two decades relevant to these changes: first, the degree to which developed country public management tools are transferable to developing countries; second, the role of governance assessment in the transfer process; and third, the search for analytical frameworks for public financial management. A final section will sketch out ongoing debates on some of the specific reforms underway.

TRANSFERABILITY OF IDEAS

1.37 There is a consensus in the literature that important differences between developing and developed countries require that public financial management tools be used selectively, and adapted to local conditions. Batley and Larvi (2004: 5-6, 29-30) point out some key differences in context between developed and developing countries. First, the pace and nature of reforms in developed countries are designed and carried out by the respective governments, and with the democratic support of their electorates. By contrast, reforms in developing countries are often designed by international agencies, and not fully understood or supported by citizens. In some cases, these reforms may be carried out by bureaucratic and political elites with the intent of preserving their existing interests, although the eventual outcome could be different (Cheung 2005: 276-7). Secondly, common reform packages designed to address fiscal crises in developed countries are being transferred to a highly diverse set of countries, including transition economies, weak capacity and post-conflict states, post-authoritarian democracies, and Confucian meritocracies. Many of these developing countries have much deeper fiscal crises and sharper declines in public service than developed countries, yet programs often used OECD country designs as models. Where programs vary, the reason is often more failure to meet negotiated conditions, rather than differences in design. Thirdly, implementation of reforms in developing countries is uneven, with stroke-of-the-pen reforms often moving quickly, while necessary structural changes move slowly or not at all. In addition, chronic institutional weaknesses in many developing countries hinder reform effectiveness. For example, rivalries between planning and finance ministries lead to conflicts over fiscal goals, poor communication, and decisions on personal appointments and projects overlooking technical merit in favor of personal and political considerations (Nwagwu 1992). There are also considerable differences among developing countries, even within the same region (Cheung 2005: 274-5). In countries with weak capacity, centralized management models provide the best starting point, since decentralized models typically rely on complex financial reporting systems (Nunberg, 1992).

1.38 Another difference concerns election year increases in fiscal deficits. Although these occur in both developed and developing countries, they are larger in developing countries because potential rents are larger, and the proportion of informed voters in the electorate is lower (Shia and Svensson 2006). There are also very different interpretations of words like public management, efficiency and transparency when translated into different languages, even among people with common historical and cultural traditions (Pollitt and Bouckaert 2004: 18). Some keywords from the reform toolkit, such as accountability, have no equivalent in other languages (such as Spanish, Vietnamese, and Chinese (Pei 1999:100) in this case).

1.39 Wildavsky (1986) and Stevens (2004) stress the differences between formal, managerial budgeting in developing countries, and the informal budgeting that actually takes place, responding to their poverty, uncertainty, and differing political cultures. Jabbara and Dwivedi (2005) and Fukuyama (2004) question transfers of Western models, drawing the language, practices, and values from business to the public sector, to non-western societies. Sarraf (2005) finds that integrated financial management information systems can facilitate recurrent/capital budget integration and improve accounting and reporting systems, but only if the country's budget and accounts classification is reformed and the system is appropriately phased and adapted to a country's capacity to maintain it. From a donor perspective, Dorotinsky and Floyd (2004) make the related point that smaller, more focused projects are more likely to succeed than larger and more complex projects. However, they point out that projects shouldn't be too narrowly focused, taking opportunities to help PFM institutions support and reinforce one another.

1.40 The requirements of accession to the European Union (EU) would seem to have motivated PFM reforms to meet accession requirements, although it is difficult to assess the relative attribution of other factors that may have contributed to these positive outcomes, including the dual transitions from totalitarian regimes to democracy, and from state-planned to market economy (McKendrick, 2007).

Governance Assessment

1.41 Effective PFM reforms are technically and administratively sound, and politically astute. To inform their PFM support, donors are increasingly carrying out governance assessments to understand the informal practices as well as formal rules, and institutional and political contexts that shape PFM processes (DfID, 2007). Schneider (2006) identifies three broad types of governance assessments: quantitative, qualitative and interpretive, each with advantages and disadvantages. Quantitative studies such as Binder et al. (1971), Kaufmann et al (1999, 1999a, 2002, 2003, 2005) and International Budget Project (2006) may offer advantages of precision, comprehensiveness, and comparability over time and across regions. Comparing governance components in a country over time, they can indicate progress; comparing countries at the same level of development, they can indicate weaknesses that could be prioritized for reform. However, the accuracy of such indicators can be contested. The construction, aggregation and weighting of governance indicators may not be grounded in explicit theory, and may not reflect a sound understanding of underlying causal factors. Goldsmith (2007) among others argues that some countries can develop fast with weak

governance institutions, including PFM. In others, rapid development makes governance worse for some time, though the pendulum may swing back. This field of thought runs up against the problem of how little we know about which institutional reforms can work best and in what sequence, given a country's circumstances.

1.42 Among other challenges of such surveys, those surveyed may have professional or financial incentives to provide certain answers, or their views may be inaccurate due to lack of knowledge of the place or issue being assessed (Besancon, 2003). Errors can also come from lack of: controls for language, culture and context to ensure that questions are answered in the same way; appropriate assessment of measurement error; stability of questions over time; stability of countries measured; and clarity in reporting and interpretation of changes in absolute vs. relative levels of performance (Hood et al, 2007). Arndt and Oman (2006) argue that the aggregate indicators could be presented in a more transparent manner, and their conclusions drawn from “expert” surveys checked against parallel surveys of other stakeholders.

1.43 Qualitative studies (e.g. World Bank, ADB and DfID, 2005 and Wescott 2001) take a comparative and historical view to understand in rich detail the context, sequence of changes, and externalities that produced the governance structures and political culture of a given country. Case studies highlight lessons such as the importance of clear political direction and support to drive PFM reform forward (Dixon, 2005). Analytical frameworks can be used to assess where a country is on a continuum of state strength and capacity, which can in turn help to identify reform priorities (Grindle, 2007). Other tools take interview data from country experts, and analyze it using simulation software to better understand the political incentives that can influence whether policy reforms are feasible and sustainable (Nunberg and Green, 2004; Reich and Cooper, 2000; Duncan and others (2002) and SIDA (2006) carry out such analysis without the software; see Marquette and Scott, 2005 for the limitations of these approaches). Deleon and Resnick-Terry (1999) explain how quantitative efforts to measure governance went out of favor in the 1980s as scholars turned their attention to mapping the intricate sequences of governance reform a country has gone through, and what are the appropriate next steps, given the complex interactions that have happened already. The disadvantage is that there are too many variables with too many complex sequences to do time-series or cross-country comparisons of the type done in quantitative studies; thus quantitative studies have again become prominent from the mid-1990s to today.

1.44 Interpretive studies start with the question of what is the meaning of governance or a component of such in a particular context, and then how can it be improved on these terms. These studies have the advantage of taking a fresh, innovative worldview, but may not allow for hypothesis testing as in quantitative studies. For example, Kaul (2006) posits a seismic shift where nation states are morphing to become “intermediary states”, needing to respond to both domestic and external policy demands, including competitive pressure from other states seeking mobile factors of production. Traditional state functions are being taken over by multinational businesses and public-private partnerships. Regional and global public goods are getting more attention. Public financial management is evolving and adjusting to these trends.

Analytical Frameworks for Public Financial Management

1.45 Debate also continues on the appropriate analytical framework to evaluate a developing country public financial management system, which can measure changes in the system, and predict how they will affect financial outcomes. Wildavsky (1986: 313-330) takes a pragmatic approach, arguing that traditional budgeting forms (incremental, line items, annual budget) persist because their defects are also virtues. For example, incremental budgeting is easier because it isn't comprehensive, and because it estimates future revenue and spending based on past performance, which can be known, rather than on the future prospects, which are unknown. Because of the chronic uncertainties and lack of functional redundancy in developing countries, they typically go one step further and practice repetitive budgeting: where the annual budget may be treated as a supplemental budget request, to be justified and approved when the time comes to actually start spending.

1.46 In contrast, Campos and Pradhan (1996) set out three ideal outcomes of a public expenditure management system: fiscal discipline, allocation of resources consistent with policy priorities, and good operational management. Fiscal discipline means expenditure control and careful management of deficits. It's a challenge even for developed countries to achieve, because of a number of "tragedies of the commons", such as politicians focused on staying in power by keeping stakeholders content, and often tempted to finance spending through deficits, which are paid back by future generations. This challenge is greater in developing countries where political support of politicians and top officials is often gained through providing patronage. In addition to deficit spending, some countries show lack of fiscal discipline by using windfalls from high resource prices such as oil to finance consumption, rather than to invest in productive assets for future generations. Fiscal discipline is based on good revenue forecasts, systems for accurately planning and monitoring expenditures, and for allocating them to priority areas to achieve goals of sustainable development. Strategic allocation means that resources are allocated based on the government's key policy priorities. It is only possible with good arrangements at the center of government, and with sound, intergovernmental coordination. Good operational management means economy (quality inputs at the best price), efficiency (outputs at the lowest possible cost), and effectiveness (achieving the intended result).

1.47 Campos and Pradhan go on to indicate institutional incentives and other arrangements that seem to affect these outcomes (e.g. the "tragedy of commons" encourages spending units to use public resources at little cost to them; electoral cycles can hinder strategic prioritization; information asymmetry can impede efficient allocation and use of resources), and posit that success will come if there are binding constraints to tie politicians and officials to the three outcomes. They show that increasing transparency and accountability in certain ways (e.g. through opening financial markets) can act as such a constraint, exacting a high cost to officials if they violate the arrangements.

1.48 Some steps have been taken to merge the two or more sets of procedures for financial management in many countries—one for the government, and one or more for donors (cf. Premchand 2000: 197-207)—into a government system that donors can accept. However, political and institutional weaknesses hamper country efforts to address the reform

process, along with a proliferation of assessments and uncoordinated advice by international partners (Shah 2005).

Selected Priorities for Reform

1.49 Aside from broad debates on transferability of ideas, governance assessment, and analytical frameworks for public financial management, there are specific debates on the reforms themselves.

1.50 Following developed country experience, there is some evidence of success in developing countries with *fiscal decentralization*, providing more budgetary flexibility to achieve efficiency and nation-building gains (Bahl and Wallace 2005). Developed countries spend about twice the share of total expenditure on subnational governments than developing countries. Expenditure by subnational government is also higher in countries with large populations, and in transition countries. The proportion of sub-national expenditure hasn't changed for the last 3 decades on average because, *inter alia*, central governments want to hold on to major revenue instruments to have flexibility in dealing with fiscal imbalances, infrastructure planning, construction and maintenance is beyond the capacity of many local governments, the central government is in a better position to address inequalities among regions, and officials from central ministries lobby for keeping the status quo. However, there may be increase in subnational expenditure proportion in future because of popular demand, and increased understanding of possible efficiency gains.

1.51 In another example, as developing countries draw from the menu of OECD *accounting* reforms, there are differing views on the results. Improved cash accounting in Uganda and Zambia gave better information on expenditures where capacity was too limited for a commitment based system. But the restriction on cash wasn't enough to solve the problem of excessive commitments without the active involvement of the President (Uganda) and the IMF (Zambia) (Stasavage and Moyo 2000). Mongolia's attempt to adopt full accrual budgeting and accounting, output budgeting, devolution of hiring to agency heads, and performance contracts wasn't based on careful diagnosis (Nixson and Walters 1999), and had to be scaled back to a model more suitable for local conditions. A program underway to implement modified accrual accounting at the treasury level, supported by adoption of international accounting standards and implementation of an IT-based budget and accounting package is showing promise (Dondog 2004).

1.52 Similarly, there is continuing debate on the suitability of *multiyear budgeting*. Many developing countries have followed the example of developed countries in adopting this reform, to help achieve greater certainty on future funding. Despite concerns expressed earlier about achieving transparency in multiyear budgeting, and challenges evident in developed countries in making effective use of this tool, and the many added challenges facing developing countries (Oxford Policy Management 2000), medium-term expenditure frameworks are central features of the Poverty Reduction Strategy Paper (PRSPs) and Poverty Reduction Support Credit (PRSCs) prepared in recent years. Craig and Porter (2003) point out that aside from technical problems of using this tool effectively, its use for upward accountability to central ministries and donors can undermine local political legitimacy and

accountability, sideline the role of legislatures, and cut off important sources of local knowledge on what works and doesn't work in poverty reduction.

1.53 *Financial management information technology* (IT) systems have been successfully adopted in some cases when there is sufficient commitment, capacity, and resources as part of a broad and appropriately phased reform program. If conditions are right, there may be significant efficiency gains (Ibid.; Diamond 2006; Wescott 1987). For example, e-procurement in South Korea, Brazil and Philippines has reportedly improved efficiency and transparency, reduced acquisition cost, and may have reduced corruption (Seong and Lee 2004, Joia and Zamat 2002, Campos et al 2006). Malaysia's e-Perolehan (2004) government procurement system is a build-operate-transfer scheme led by a private company.

1.54 In some parts of Africa, the principal benefit from IT may be ensure more systematic adherence to financial rules by manual systems, which may be run in parallel to IT-based systems and more relied on by finance staff. Successful IT-based financial systems reforms are commonly iterative and modular rather than integrated, built around scarce, high-quality public managers wherever they may be working (Peterson et al, 1996). On the other hand, in both developing and developed countries, the expected benefits can be blocked by traditional bureaucratic forms, technical difficulties, lack of skills, and weak project management.

1.55 Delays in IT adoption by governments stem from the nature of public sector financing and procurement practices. To ensure accountability, government agencies need to go through a lengthy process of securing funds, seeking competitive tenders, and awarding contracts. To prevent undue influence by any one official, many decisions along the way are made by committees, which can lead to compromises and an unclear focus. In addition, when acquisitions are finally made, the technology has often moved far beyond where it was when the project was first conceived; thus governments often install outdated systems. They also pay excessive prices, since new products may have come into the market during this period that can deliver the same ICT power for much less money. The difference between the outdated tender price and the market price is also an arbitrage opportunity for corrupt officials. Capacity-building support in this area is likely to be most effective if preceded by an understanding of how work gets done in target organizations, including actual practices often very different from what may be indicated in formal rules and regulations (Heeks 2001, Wescott 2007).

1.56 Developing countries have in many areas followed the OECD example of introducing *market mechanisms* to improve performance and accountability. For example, countries have formed autonomous tax administration agencies in an effort to separate policy making from implementation, and to enhance incentives for the latter. Debate on the effectiveness of such reforms continues, with analysts finding some cases leading to increased revenue collection, and others leading to increased corruption. Countries also devolved budgets and financial control to semi-autonomous agencies such as teaching hospitals, water authorities, and semi-commercial agricultural bodies. These led to performance improvements when the policy framework and accountability framework was clear. However, such improvements were constrained in many cases because of inadequate accounting systems, weak personnel management, unreformed financial administration

regulations, unpredictable financial resources, and unclear authority relationships between principals and agents (Toye 2000: 45-8, 103-5; Siddiquee 2006; O'Donnell and Turner 2005; Manning et al, 2000).

CROSS-CUTTING DEBATES

1.57 In concluding this brief survey of recent debates on financial management, transparency and governance, there are two cross-cutting questions that can be raised: First, does more aid weaken governance? Second, what should be the scope of reforms?

Does More Aid Weaken Governance?

1.58 Aid can have the unintended consequence of weakening governance because governments can raise significant financing without having to rely on increasing taxes; thus they have less need to provide a conducive business climate, and to provide accountability to their citizens⁷ (though they may be held accountable by international donors) (Brautigam 1992, Craig and Porter 2003). Aid can divert scarce skills from government, encourage corruption and conflicts over control of aid funds, and reduce citizen demand for reform. Aid can also weaken administrative effectiveness through high transaction costs, the fragmentation and weak coordination of donor projects, the lack of integration in the budget process, moral hazard, soft budget constraints, and unrestrained future claims on recurrent budgets to maintain donor investments (Knack 2001; Godfrey et al 2002, Brautigam and Knack 2004, World Bank 2000: 20, Moss et al, 2006).

1.59 Using International Country Risk Guide (ICRG) governance data, Brautigam and Knack (2004) found that aid dependence was linked with an increase in corruption, and worsening bureaucratic quality and rule of law. They find a modest reduction in the negative effect of aid on governance in Africa between the 1980s and 1990s, but the change isn't statistically significant. Yet, Tavares (2003) uses a different methodology in analyzing ICRG data to argue that more aid may be associated with less corruption, perhaps because donor rules constrain recipient government officials, or because more aid helps to pay better salaries to officials.

1.60 Ear (2007) uses pooled, time series cross-sectional (panel data) analysis drawing on data in Kaufmann et al. (2005) to confirm a negative effect of aid dependence on rule of law; but, unlike Knack and others, he finds no significant negative effect on other aspects of governance. In addition, he finds that components of aid have a statistically significant effect on rule of law (negative effect from technical cooperation) and on voice and accountability (positive effect from proportion of grant element).

⁷ Resource-rich countries face similar challenges (Collier, 2007)

Scope of Reforms

1.61 There are continuing debates over whether reforms should be comprehensive in scope, taking a “big bang” approach, or incremental and opportunistic (Wescott 2006). Some stress the need for a “top down”, politically-driven, all-encompassing reform process to take advantage of narrow windows of opportunity. Thus Werlin (1992: 204), citing the example of countries such as Korea, argues that reforming central bureaucracies is primarily a problem of political will and government capacity to effectively use persuasive and manipulative (rather than coercive and corrupting) forms of power. Rodrik (1996) cites Polish macroeconomic reforms beginning in 1989 among others as succeeding due to “speed and stealth”. Reforms in New Zealand between 1984 and 1990 (Pallot 1991) and in Canada in 1994 (Aucoin and Savoie 1998) are cited as examples of comprehensive strategies that delivered important results.

1.62 On the other hand, North (1990:89) views piecemeal reforms as more typical: “The single most important point about institutional change, which must be grasped if we are to begin to get a handle on the subject, is that institutional change is overwhelmingly incremental”. Esman (1991:138-139) advocates a “bottom up” approach. He claims that system-wide reforms disrupt familiar routines and threaten established centers of powers without demonstrating convincingly their effectiveness. He prescribes, instead, incremental, confidence-building measures, such as training, new technologies (e.g., e-government), introduced with staff participation and focused at the level of individual programs or organizations (see also Lindblom 1959, 1979, Wildavsky 1986:313-330, and Pollitt and Bouckaert 2004: 194-6). Brautigam (1996) makes a related argument that reforms should concentrate on a few critical functions, shifting politically important patronage opportunities to less vital agencies. Grindle (2004), focusing on public financial management reforms called for in Poverty Reduction Strategy Papers, argues that the reform agenda needs to be reduced to a set of achievable reforms.

1.63 Although there would seem more evidence of success of incremental rather than strategy-driven reform, both types are possible. Reforms need to move “as fast as possible when circumstances permit, and as slow as necessary when accountability needs to catch up, absorptive capacity to grow or public tolerance to be rebuilt” (Schiavo-Campo et al, 2001:733). Implementation may need to proceed in many small stages. Some of these can be planned, and scheduled based on priorities and complementarities. Others will proceed based on targets of opportunity.

2. PUBLIC FINANCIAL MANAGEMENT: BANK SUPPORT SINCE 1990

2.1 This part of the paper will review the available evidence on the extent to which the Bank has achieved the following objective of the Bank’s PSR Strategy (2000: 60): “...more efficient use of public resources for development through improved public

expenditure analysis and management.” It will address examples of Bank support for reform of budget planning and execution, in particular financial management information systems (FMIS), medium-term expenditure frameworks (MTEF), procurement, auditing, monitoring and evaluation, and the strengthening of key budgetary accountability institutions, like public accounts committees of the legislature and supreme audit institutions. It will mention some aspects of closely related work to improve the fiduciary environment for Bank lending, mitigating fiduciary risks, and strengthening the FOREX control environment and disbursement arrangements, but will not focus on these issues, which are addressed elsewhere (e.g. World Bank, 2006e:5-8; in press-b). It focuses on evidence from 18 country case studies, while bringing in broader comparative evidence when possible.

2.2 Four key elements of Bank support will be addressed:

- i. Diagnosis, strategy and expectations,
- ii. Design and implementation of PSR program and projects,
- iii. Overall country outcomes, and
- iv. Attribution.

2.3 In addressing these four elements, consideration will be given to the following questions linked to the ongoing debates on public finance and related topics sketched out above:

- Have public financial management reforms first rolled out in developed countries been transferred to applicable developing country settings? Have they been adapted to local conditions?
- Did the Bank understand the differences between formal, managerial processes and the practices that actually take place, and take the differences into account in designing and carrying out its support?
- Has the bank stressed “getting the basics right” before supporting more complex financial management reforms?
- Has PFM in sector ministries been a better entry point than PFM in core ministries, or vice versa? Have PFM projects/components been usefully piloted in sector ministries before wider rollouts? Has PFM in sub national jurisdictions been a useful entry point?
- Has the Bank’s PFM approach resulted in improved public sector performance? Were the benefits achieved greater than the costs incurred? In what technical areas and country contexts has the Bank been effective/ineffective and why?

2.4 The analysis will also review evidence from a PFM perspective on whether the following, process objectives from Bank’s (2000) Strategy are being met:

- Are the Bank’s governance projects more adaptive to country context and politics, and more responsive to demand from the private sector and civil society, than projects approved prior to 2000? Have blueprints been replaced to an extent with more responsive and opportunistic approaches? Is more attention paid to implementation and results monitoring? How serious are governments about public financial management (PFM) and governance reform? Are stated intentions matched by

- follow-through on implementation that achieves intended results? Are they more serious about loan-funded than grant-funded work?
- Were relevant analytical frameworks in public financial management used to underpin diagnostic work? Were the menu, sequencing, and product choices by the Bank informed by this diagnostic work? Are analytical work and toolkits providing higher quality diagnosis, more relevant to Bank and country needs, and better aligned with country capacities, than prior to 2000?
 - Have product choices shifted towards more flexible, long-term lending instruments than prior to 2000? If so, have they been coupled with effective PFM improvements to mitigate fiduciary risks of corruption?
 - Is there evidence that since 2000 the Bank has drawn on a more highly skilled group of PFM specialists than in prior years in designing and carrying out its work?

DIAGNOSIS, STRATEGY AND EXPECTATIONS

2.5 This section reviews whether relevant analytical frameworks in public financial management were used to underpin diagnostic work, how diagnostic work evolved over time, and whether the menu, sequencing, and product choices by the Bank were informed by this diagnostic work.

2.6 In the 1990s, the Bank helped address PFM issues through Analytical and Advisory Activities (AAA) (e.g. public expenditure reviews [PERs]), technical assistance, and investment and program lending, often in cooperation with partners such as the IMF and DFID. PERs (formerly Public Investment Reviews) had evolved to assess both investment and current expenditure, in line with the realization that both types of spending made vital contributions to development. In the early 1990s, PERs in the 18 case study countries largely focused on fiscal discipline, and allocation of resources consistent with policy priorities (budget making), with little direct attention to operational management (budget execution).

2.7 A World Bank (1998a) evaluation found that PERs were improving their analysis of the institutional context of PFM, including the process of budgetary decision making and differences between formal and actual practice, and this improvement has continued to the present. Drawing on the frameworks of ideal PFM outcomes discussed in the first part of this paper, international benchmarks, indicators and related reports have emerged to enhance monitoring of public finance systems and practice such as the IMF Code on Fiscal Transparency (1998, revised 2001) and the related Report on the Observance of Standards and Codes (ROSC) from 1999⁸, the Highly-Indebted Poor Country (HIPC) Tracking Assessment And Action Plan (World Bank and IMF 2002, 2004), the Public Expenditure and Financial Accountability (PEFA) Framework (World Bank 2005), and the Open Budget Indicators. These can be termed "second generation" governance indicators. In comparison to broader governance measures such as those of the World Bank Institute (WBI) and Transparency International (TI), these are more specific in measuring performance or institutional arrangements, and more transparent in composition and aggregation (Knack et

⁸ Although most standards covered by the ROSC are in areas of financial sector regulation and supervision, and market integrity, the standard of greatest interest to participating governments is reportedly the Code on Fiscal Transparency (World Bank and IMF 2005a).

al, 2003). This work has been useful in identifying reform challenges across countries in a consistent manner. Additional diagnostic reports have been added giving focused attention to certain aspects of PFM, including country financial accountability assessments (CFAAs) and country procurement assessment reviews (CPARs) (for about 100 countries from 1999-2004) (World Bank, in press), along with related tools from other donors such as European Commission (2001) Audits and (2001) Assessments of Fiduciary Risk (see Annex 1 and 2 for comparative coverage of indicators and reports). Many of 19 Institutional and Governance Reviews (IGR) completed from FY01-06 also include significant PFM content.

2.8 PFM AAA of all types has increased over the period under review. The number of PERs has increased from 68 (17 per year) from 1999-2002 to 93 (over 23 annually) in 2003-5. Over the same periods, CFAAs increased from 33 to 72, CPARS from 45 to 64, ROSCS from 1 to 110, and other PFM and procurement studies from 3 to 19. These PFM studies increased as a proportion of total ESW from 11 percent to 15 percent over the same period. A common weakness of these reports is inadequate treatment of institutional and governance issues (Allen et al, 2004: 41-4). On the plus side, PERs have more variation in coverage than other types of reports, but have generally increased the extent of analysis of PFM issues over the review period since the 1990s, with a particular emphasis on the budget formulation phase. Provincial PERs introduced in some countries also include useful PFM analysis and recommendations (e.g. World Bank, 1996a, 2005f, 2006a).

2.9 A recent evaluation found that 64 percent of CPARs and 71 percent of CFAAs were of satisfactory quality, with steady improvement in quality noted following publication of respective guidelines, and increasing donor collaboration. However, as previously noted by Allen et al (2004) they could have been more effective with improved coordination among units preparing them and other PFM reports, and avoided confusing situations of clients getting multiple PFM action plans. They should include a single, action plan, an integrated fiduciary risk framework that considers the impact of corrupt practices, a strengthened role for country and other donor stakeholders, and more indicators to track and measure results and reform costs (World Bank, in press).

2.10 Despite these shortcomings, a review of 22 countries found that CFAA/CPARs contribute to a greater focus on PFM in subsequent Country Assistance Strategies (CASs), and that they contribute to increased PFM lending. CASs in 13 of the 22 countries proposed Development Policy Lending (DPLs) with PFM prior actions and conditions, while only four CASs proposed such lending prior to the completion of the CFAA/CPARs. Likewise, there were twice as many CASs with proposed PFM investment lending than was the case previously.

2.11 These instruments have only had a modest overall impact on the design and effective implementation by Governments of PFM reform agendas. Further, CFAA risk assessments were not a primary consideration in the choice of instruments in CASs. For example, Bangladesh received budget support in 2003 from the Bank despite an unfavorable CFAA in 2001. (World Bank, in press: 37; 41-42). However, an evaluation of budget support in five countries found no clear evidence that budget support was more susceptible to corruption than other forms of aid (IDD and Associates, 2006).

2.12 A particularly notable addition to the PFM reform toolkit is the PEFA Framework, being implemented through a partnership of eight cooperating development partners including the Bank. 40 countries have completed (PEFA Secretariat, 2007: Table 1) one or more PEFA assessments. PEFA's Framework includes a set of 28 indicators for measuring performance, and a framework for reporting. Building on the three budgetary outcomes discussed above, the indicators measure six dimensions: budget credibility, comprehensiveness and transparency, alignment with policy, predictability and control, accounting and reporting, and external scrutiny and audit. Although there is not a PEFA indicator for corruption, improvements in the 28 areas can help reduce opportunities for corruption. PEFA and other related indicators are useful because they measure actual practice, rather than perception or reputation, and they look at actions that would be the immediate objectives of reform.

2.13 Although PEFA represents a useful standardized approach to analyzing PFM progress, there are still limitations. One is that of the PEFAs completed as of November, 2007, only 11 countries have published reports on the PEFA website. Although one can understand sensitivities on having reports published, the lack of publication diminishes the usefulness of the reports in stimulating demand for deeper reform. Another issue is that the highest standard in many categories may not ever be reached by developed countries, and may not be appropriate as a target for many developing countries, where a more pragmatic approach, as discussed above, may be called for. In addition, the range of some indicators may not adequately reflect variation in the relevant range for most developing countries.

2.14 Some donors have reportedly pushed to have progress on meeting PEFA benchmarks used as aid conditions; the PEFA Secretariat has resisted this, because the possible moral hazard on both donor and borrower side might compromise the integrity of the ratings. It should also be emphasized that PEFA is not intended as a tool for comparing different countries, but it can be useful for analyzing progress within individual countries. In FY08, for example, Zambia and Mozambique will have their second PEFA, giving an opportunity to analyze progress. PEFA ratings can also be compared with HIPC tracking ratings to assess progress, after adjusting for differences in the two methodologies. Finally, it should be underlined that PEFA examines PFM processes, not the desired outcome of more efficient and effective public services. Although it is presumed that better PFM processes will contribute to better service outcomes, that needs to be separately validated.

2.15 A World Bank (2006h) review found that 32 out of 34 recent Development Policy Operations (DPOs) which included PFM as part of the program content had conditions, triggers and milestones linked to PFM-related analytic work, and in most cases were appropriately sequenced, took into account parallel actions, supported the evaluation of results, and avoided addressing too many issues. However, four DPOs didn't have indicators for monitoring progress, 13 did not confirm that implementation arrangements were in place such as training and technical assistance, and some included vaguely formulated conditionalities such as: "substantial reduction in number of outstanding audit reports; progress on implementation of PFM reform program; improve quality of budgetary process; budget partially integrates development and recurrent expenditures; recruitment of internal auditors has commenced". The authors found the PEFA indicators ideal to underpin a PFM monitoring and evaluation framework, but suggested complementary work would be needed

when requested by borrowers to provide in-depth diagnosis of key systems to help implement improvements. (World Bank 2006h) A review of good practices is shown in Box 1 below.

BOX 1: GOOD PRACTICES OF LINKAGES BETWEEN ANALYTICAL WORK AND PROGRAM PREPARATION IN DPOs

Ethiopia - 2nd PRSO.

Joint fiduciary assessments serve as a key input to the joint budget support decision cycle.

Indonesia - 1st DPL; El Salvador - 2nd Broad Based Growth DPL and Georgia - 1st PRSO.

Prior actions are linked to the PFM analytic underpinning that informs each action

Peru - 3rd Programmatic Decentralization and Competitiveness DPL; Timor-Leste – Consolidation Support Program and Madagascar - 2nd PRSO.

Progress on implementation of the action plans of analytic underpinnings is reported in the program document, while also mentioning specific PFM reform programs and technical assistance through which these actions are effected.

Niger - Public Expenditure Reform Credit.

The program document states that the recommendations of the PEMFAR are the core of many of the proposed measures in the operation, especially in the PFM area.

Guatemala - 1st Broad Based Growth DPL and Bolivia – Social Sector Programmatic Development Policy Credit II.

A table shows how the findings/recommendations from the analytical work are taken into account in the design of the operation and the choice of policy actions.

Source: World Bank 2006h:4.

2.16 The country cases have also confirmed that the introduction of these new tools has improved efficacy of PFM diagnostics over time, and particularly since 2000. For example, initial AAA in Cambodia in the early and mid-90s focused mainly on fiscal policy issues such as reducing deficits, reprioritizing expenditure, and increasing tax revenues, with only very brief discussions of financial management issues such as expenditure control systems, e.g. World Bank, 1994. The Cambodia Public Expenditure Review (World Bank, 1999) provided detailed analysis of PFM challenges and many good recommendations. Because Cambodia was a relatively new client where it was judged a participatory PER wouldn't have been feasible, the PER was done entirely by Bank staff. Although of overall high quality, there was no time-bound, plan for carrying out the recommendations. There were also important areas omitted from the analysis. For example, cash management problems in Cambodia resulted in part from the need to pay arrears accrued in the previous year with current year budgets. As a result, current year commitments couldn't be paid, and became arrears for the following year. Cash shortages were exacerbated by the ability of powerful Cambodians to reduce or avoid taxation. Although revenue estimates took these factors into account, the timing of revenue collection was highly uncertain. This, in turn, led to a situation where the bulk of expenditures were made in December, when there was maximum certainty of funds availability at the end of the fiscal year. This problem wasn't acknowledged in the PER, nor was it understood during IMF diagnostic work at the same time, in preparation for the IMF-led, multi-donor Technical Cooperation Assistance Program (TCAP). Partly as a result (other factors included weak donor coordination, and partial understanding of reforms by key counterparts), PFM reforms to improve cash disbursements over the next few years delivered

fewer results than expected until TCAP advisors and their counterparts realized the extent of the problem and took action (IMF, 2005) (CDRI, in press)

2.17 The Cambodia Institutional and Financial Assessment and PER (IFAPER, 2003) combines a more comprehensive analysis and recommendations (e.g. the arrears problem is fully discussed) on fiduciary oversight and PFM, and includes 63 short and medium term, priority actions on top of 15 ongoing reform activities. IFAPER was a joint document with the Asian Development Bank (ADB), and had participation from other key donors as well, along with government officials (World Bank and ADB, 2003). In capacity-challenged Cambodia, such an ambitious agenda could only succeed with careful prioritization and sequencing, particularly when one considers recommendations (to an extent overlapping) from other studies, such as the 11 recommended actions for procurement reform in the FY04 CPAR, and the 64 recommended actions for fiscal reform contained in the FY05 CPPR. Many recommendations suggested adopting participatory approaches to PFM to foster demand for transparency and accountability.

2.18 Cambodia's 10 year PFM program approved in December 2004 is a credible effort to lay out key priorities in a time-bound plan, has become a promising foundation for a multi-donor effort to provide support, and helped to deliver a modest improvement in PFM performance in 2006⁹. An FY06 project is supporting this effort by helping with improved budget formulation and execution, internal and external audit, and a merit pay initiative in the Ministry of Economy and Finance (MEF), in collaboration with 10 other donors.

2.19 In the Dominican Republic, the introduction of performance budgeting (recommended in the CFAA) might raise concerns, given the reported deficiencies in basic systems. Yet the recommended first step of piloting the principles of performance-based budgeting in the Ministry of Education seems promising, since that ministry had been modernizing its PFM systems for the past two years, and had implemented an integrated financial management systems (IFMS) (World Bank 2005g: 8; in press: 22).

2.20 Mongolia's PER acknowledges Government intentions to build a performance-oriented public sector through advanced tools such as performance-based pay and contracts, performance-based budgeting, accrual budgeting and accounting, and performance monitoring and audits. Yet it recommends appropriately sequenced steps focusing first on basic internal financial management practices of budget and funds control, internal auditing, procurement and asset management, and second on basic performance management steps including budget planning and output costing. And it recommends piloting these basic improvements in a promising, service-delivery ministry or agency (World Bank, 2002c).

2.21 Burkina Faso has relatively good PFM performance in comparison to its peers, meeting 9 of 16 HIPC tracking benchmarks in 2004, up from 8 in 2001, with seven "A" ratings. This positive result may have benefited from comprehensive PFM assessments carried out in 2000-1, including a CPAR, Fiscal ROSC, and CFAA. While the three reports offered more than 280 recommendations, none of the reports referred to the

⁹ 2006 indicator 13 (Quality of Budget and Financial Management) improved from 2.5 in 2005 to 3.0. These improvements, along with striking improvements in economic management, have helped move Cambodia's overall CPIA out of LICUS-range in recent years.

recommendations of the others, and there were cases of alternative approaches recommended in different reports to attain similar objectives. More consistent and coherent recommendations might have facilitated government action (Allen et al, 2004: 39).

2.22 In another example, Bangladesh's initial PER in the review period (World Bank 1991) focused, in terms of the 3 PEM priorities (Campos and Pradhan 1996), on two of them: allocation of resources consistent with policy priorities, and improving fiscal discipline. The only discussion on improving operational management is a 2 page section, admittedly very preliminary in nature, awaiting decisions by the government, listing the broad responsibilities of key government departments. This PER is cited in the President's Report of the only PSR adjustment operation of that decade, the Public Resource Management Credit (FY92), along with the previous FY90 PER and related studies.

2.23 The next Bangladesh PER (World Bank 1996) had a similar focus, but an expanded (7 page) institutional section with recommendations on improving budgeting, accounting and audit. A subsequent paper (World Bank 1998b)¹⁰ made similar recommendations. These recommendations were not addressed by Bank projects in the late 90s, since there weren't any, nor were they mentioned in the PER update (World Bank 1997), but some were addressed by DfID PFM support. However, at least one recommendation was successfully implemented with help from the Reforms in Budgeting and Expenditure Control (RIBEC) project (1996-2002), supported by : greatly improving accuracy and timeliness in the production of accounts, budget reports and budget presentations, allowing actual expenditures to be compared with budgets at the ministry and national levels (World Bank 2002b:114).

2.24 Bangladesh's CFAA in 1999-2000 led, *inter alia*, to the creation by the Government of an independent Public Expenditure Review Commission, charged with reviewing all aspects of public expenditure and reporting to the government and Parliament. Yet, the FY03 PER points out that most of the key institutional recommendations of the previous PER, update, and CFAA had not been adopted (World Bank 2003b:25). The section on core institutional issues is expanded to 21 pages, including more extensive recommendations than before (World Bank 2003b:24-44). By now, the PER had incorporated an excellent diagnostic of institutional challenges, and an ideal menu of reforms to tackle them. However, there was no indication of the institutional and political economy barriers to change; nor was there a change management strategy that could be used to successfully implement the recommendations¹¹. The EMTAP investment project (World Bank 2004a:15) was approved to address key institutional constraints highlighted in the PER, but again the change management strategy isn't clear for combating political economic barriers to change (some are listed as "critical risks and possible controversial aspects", but there is no indication of how the risks will be addressed),

2.25 Public financial management diagnostics have been further improved through publication of Bangladesh's PFM indicators based on the PEFA framework (World Bank, 2006f: Attachment 4). 5 of 28 indicators are rated "B", providing a foundation of good

¹⁰ For broadly similar recommendations, see also Public Administration Reform Commission, 2000.

¹¹ For a review of theory and practice that could inform the Bank's work on PFM change management, see Fernandez and Rainey, 2006.

practice to build on. Recommendations are given on how to improve Bangladesh's ratings for the lagging indicators, and many are incorporated in a government action plan (Government of Bangladesh, 2006). However, there is no guidance offered by the Bank on political economic barriers likely to constrain future reform implementation, and how to address them (World Bank, 2005b).

Formal vs. Actual Practices: Understanding of Political Economy

2.26 The country cases examined whether the Bank understood the differences between formal, managerial processes and the practices that actually take place driven by political economy factors, and took the differences into account in designing and carrying out its support. The Bank's record on this in supporting PFM was mixed.

2.27 In some cases, more recent AAA better took into account actual practices than had been the case previously. For example, in Guatemala, the FY05 CFAA compares the legal mandate of institutions with what happens in practice: "The National Procurement Directorate is not adequately staffed to fulfill its mandate (coordinate policy, run the internet-based procurement system *Guatecompras*) and focuses almost exclusively on operational functions (90 percent of its time goes to managing framework contracts)". Prior AAA such as the FY02 CFAA and the FY00 PER did not discuss such matters.

2.28 In Honduras, governance is increasingly prominent in the AAA, which frequently discusses the political economy of reform and provides recommendations on how to overcome political obstacles¹². The FY04 CEM has a chapter on improving governance in Honduras, which reviews governance indicators, PFM, CSR, and the judicial reforms. The Bank is currently drafting the Governance Strategy note. Its purpose is to provide a framework for World Bank engagement in supporting governance and transparency for the period covered by the latest CAS (FY07-10).

2.29 In other cases, such improvement was less evident. Between 1992 and 2005 in Ethiopia, for example, the Bank provided extensive PFM AAA. All in all, 10 PERs (2-3 Volumes each), 2 CPAR (98 and 03) and one CFAA (03) were delivered. Additionally, various studies concerning decentralization also looked at PFM issues. The studies were usually undertaken jointly with other donors, the Bank being in the lead. The analytical work was relevant, but lacked clear and sequenced recommendations, and had less impact than desired. Institutional aspects were frequently not part of the exercise, and political realities such as the extent to which the regions were, *de facto*, free to determine their expenditures, were not sufficiently covered. The series of eight PERs from 1994-2002 may have tried to cover too much to be usefully absorbed and implemented by a limited capacity client, although they were helpful for donors. The Government is pursuing a program of fiscal

¹² For example: "the constraints imposed by the *Estatutos*, will be politically difficult to address. As a first step, the government should aim to develop a coherent and comprehensive public sector pay and employment policy that addresses simultaneously fiscal affordability and performance incentives in the public sector. The articulation of such a policy will not eliminate the ability of powerful and organized groups to push for further salary increases but would strengthen the government's hand in politically difficult negotiations and stand a better chance of mobilizing public opinion, especially when unreasonable demands pose a serious threat to fiscal stability or would crowd out other priority expenditures. As part of this effort, it would be advisable for the government to begin developing a medium-term fiscal envelope for personnel expenditures, which provides a top-down resource constraint" (World Bank, 2001b).

reforms and medium-term expenditure management with donor technical assistance, but it hasn't benefited as much as expected from the PER process (World Bank 2002b).

2.30 Other donors were also challenged in this area. The IMF found during its Cambodia Technical Cooperation Assistance Program (1998-2003) that its progress working with the MEF and Customs was slower than with other counterparts, explained as a result of many short-term, patronage-driven appointments in MEF with little appetite for change.

“A clear lesson that can be drawn from this experience is that (donors) should carefully analyze the political commitment of the authorities before committing major resources, and should look ideally at past implementation record. In this context, it is important to maintain a detailed implementation record of the TA experience in different countries in order to be able to make an informed cross country decision when resources are allocated. This underlines the need to develop an effective monitoring system to assess why past technical assistance (TA) recommendations have and have not been implemented”. (IMF, 2005)

Responsive To, and Helping to Shape Demand

2.31 The Bank's (1998a) review of PERs found that they had only a modest impact on Bank lending, borrower systems, and aid coordination since borrowers viewed PERs as an internal Bank process, not useful to them. It recommended, *inter alia*, greater demand responsiveness and sensitivity to political and institutional constraints. Subsequent World Bank (2001) guidelines recommended, where appropriate, substantial participation by clients in PFM data-gathering and analysis to facilitate ownership by clients of the results of the analysis. They further recommended work to strengthen weak domestic external review capabilities of local research institutions, NGOs and of agencies outside the executive, citing as good practices the 1996 PER in Colombia, the 2001 Nigeria Fiscal Federalism Study, and the Bank's partnership with a South African NGO to build African NGO capacity to assess government budgets. Where such constituency building is not acceptable to the executive, only highly focused analytical tasks should be undertaken where there is strong demand from the executive and a credible commitment to implement reform, with the example noted of the 1997 China PER.

2.32 CFAAs and CPARs also try to bring in stakeholder participation, with most resulting in a discussion of the findings and action plan at a workshop. However, only 20 percent of a representative sample of CPARS and 14 percent of CFAAs had joint government participation in preparing the report and action plan, as suggested in the CFAA guidelines (World Bank, in press).

2.33 The country cases examined whether the Bank's PERs and other PFM AAA subsequent to this was more responsive to demand from borrowers, including the private sector and civil society groups focused on PFM (e.g. de Renzio and Krafchik, undated), and more active in helping to shape the demand. The Bank's record in this regard was mixed.

2.34 A good example of improved borrower participation in PERs is in Tanzania. The Bank did a PER in 1997, and since then the government has taken it over, doing a PER each year. Discussion goes on all year, leading up to a public conference in May on the PER, and feeding into the budget process finalized in June.

2.35 Although recent Uganda PERs have been written by Bank staff, with drafting managed by the Country Office, Government's involvement in the PER process is very prominent, with the Budget Director of the Ministry of Finance, Planning and Economic Development (MoFPED) chairing one of the PER review meetings. Government officials say that it was useful to have a Bank-only report, albeit one built on a very participatory PER process involving the Government, donors, and various other stakeholders. Within government, there remains the perception that the Bank's dialogue on AAA is overly focused on the MoFPED.

2.36 A key challenge of this participatory process is reportedly that the Bank's analysis is often bland on key areas. PERs may not include a clear list of recommendations. Rather, the Bank's analysis often reflects agreed plans with the GOU, and could be seen as a documentation of the late stage of a participatory process, rather than conclusions flowing from evidence and technical analysis. This suggests that government involvement in the formulation of conclusions and 'recommendations' poses a trade-off: it could strengthen the implementability of the findings, but close government involvement may "preclude an arms-length Bank view in what is also meant to serve as due-diligence/fiduciary ESW", and compromise the analytical quality of the PER (World Bank 2005a).

2.37 The 2000 Vietnam PER is another example of a Bank-led participatory PER. The concept paper for the PER incorporated inputs from all major stakeholders, and a counterpart government team of officials from both central and sectoral ministries, and local consultants, worked closely with the Bank PER team. Workshops were held to review the draft PER, including some focusing on sectors, and some outside of Hanoi, with a final one-day plenary workshop bringing together all key stakeholders. Although this process resulted in Government ownership, this came at the expense of some narrowing of topics, moderating of recommendations, and some additional cost (World Bank 2001). The participatory process was further developed in the Vietnam PER of 2005 (Government of Vietnam and others, 2005a and 2005b), which pulls together a more comprehensive diagnostic picture than the previous PER. Discussions are ongoing with the Government on a possible PEFA; among Government concerns are the possibility that likely low PEFA ratings would discourage the flow of budget support. Both the Uganda and Vietnam cases could be examples where seeking full diagnostic rigor may not be the best approach; where good enough is enough (Grindle 2004). It remains to be seen how much actual implementation of PFM improvements will follow from this participatory, diagnostic approach.

2.38 Bangladesh is a case where the Bank has sought to broaden participation in AAA to civil society and think tanks. The Bangladesh CAS (2001-2003) stated the intention of, inter alia, effective dissemination of AAA, enabling more informed public debate, and using 'citizen scorecards' to monitor performance.

2.39 There is some evidence of this in consultations with civil society groups during the preparation of the I-PRSP, and the incorporating of labor concerns in the design of the SOE retrenchment program (World Bank 2003:28). In another type of example, a training-of-trainers component in a Bangladesh procurement project training about 1400 in new procurement regulations and procedures, reportedly helped build support for passage of the procurement law, and to help ensure effective implementation. Success factors included:

competitive selection of participants, well-targeted incentives (top performers sent to follow-up course in Italy provided by the International Labor Organization), trainer-trainees contributed to design of training, and use of participatory didactic techniques. Training was managed by the Central Procurement Technical Unit, which also monitored how trainees used skills learned on the job following training. A local training institute successfully took over the training after the initial phase. Multiple forms of monitoring and evaluation helped measure the extent of learning, behavioral and organizational change, and used this to modify and improve the course (World Bank, 2008: 40).

2.40 Although these examples signified progress, dissemination of other PFM AAA did not improve in Bangladesh during this CAS period. Possible reasons include the fact that no significant budget or experienced staff were provided to do this work. There are generally no incentives for headquarters based staff to disseminate AAA findings in country; their main incentive is that their manager(s) see(s) it done and consider(s) it to be of high quality. This is part of a broader issue that under matrix management, according to Bank staff, the Bank has gotten better at building cutting edge skills, but worse at integration of knowledge in support of operations at country level. There is also reportedly low awareness among Bangladesh-based staff of the potential contributions of NGOs and other actors, concern among Bank staff that such work might constitute political lobbying forbidden by the Bank's charter, a feeling among NGOs themselves that they couldn't contribute on core governance issues, and threats to NGOs that criticizing the government could cost them public funding (indeed, 5 were shut down during the CAS period by Government for alleged links to opposition parties). Recognizing these shortcomings, the latest CAS (2006-2009) provides for increased governance capacity in the Country Office, and a determined effort to expand demand-side approaches to build a broad, national consensus for reforms.

2.41 In Bulgaria, a 2004 Quality Assurance Group (QAG) assessment of AAA found that while the Bank-Government dialogue was rated "highly satisfactory", dialogue with non-official stakeholders has been minimal and dissemination has been "badly neglected". While the public expenditure and institutional review (PEIR) (2002) had very good dissemination, the CFAA (2003) and the Fiscal Decentralization (2003) studies did not. Poor dissemination is reportedly due to the government's top-down approach to public management and the insufficient internal Bank incentives for effective dissemination.

2.42 Finally, in addition to increasingly providing participatory AAA, the Bank has helped over 30 countries build or strengthen their own monitoring and evaluation systems. Results have been highly varied. In countries such as Sri Lanka and Malawi, just placing M&E on the policy agenda has been a major accomplishment, or, as in Egypt, building a common Monitoring and Evaluation (M&E) language. Dedicated funding can be important to getting M&E started, as with Institutional Development Fund (IDF) grants on Brazil and Mexico; yet such funding may not advance the M&E agenda if not focused on capacity building, as in Egypt's IDF. Effective use of good practice cases such as Chile can help to generate demand. Use of too many indicators and inattention to bureaucratic realities produced disappointing results in Uganda. One common weakness is that legislatures have limited capacity to be involved in using M&E to hold governments accountable for results. (World Bank 2004, 2005d).

DESIGN AND IMPLEMENTATION OF PSR PROGRAM AND PROJECTS

2.43 This section examines trends in lending from 1990. It then reviews evidence on whether PFM operations: 1. were linked to PFM-related analytic work; 2. addressed basic systems before moving to more sophisticated systems; 3. transferred appropriate practices from developed countries; 4. chose appropriate entry points; and 5. demonstrated effective use of more flexible lending instruments.

2.44 Since 1990, there has been an increase in total Bank support to PFM (including procurement), and within this, an increase in development policy (adjustment) lending. The number of projects with substantial PFM components (25 percent or greater) increased from 110 over the period 1987-99 to 202 over the period 2000-2006. About 38 percent of these were adjustment loans in 1987-1999 and this increased to about 67 percent during the years 2000-2006. The number of PFM conditions increased from 719 over the period 1990-1999 (or about 72 per year) to 1,770 over the period 2000-2006 (about 253 per year).¹³ Institutional Development grants for PFM increased from 15 in 1992-1999 to 90 in 2000-2006, and from 3 percent to 18 percent of the total number of IDF grants.

2.45 Loan commitments on projects with PFM components of 25 percent or greater of the total amount increased from 6,768.9 m current USD over the period 1987-1999 to 17,561.1 m current USD over the period 2000-2006.

2.46 If one multiplies the commitment amount of each loan times the share designated as a PFM theme, the amount we can attribute to “PFM lending” increased from 4,246.1 m current USD to 7,708.7 m over the respective periods. This increase represented an increase from 1.47 percent to 5.66 percent of total World Bank (WB) lending.

2.47 The number of PFM-focused projects rose in all regions from 1987-99 to the period 2000-2006, including an increase from 23 to 65 projects in Africa, 5 to 18 projects in East Asia and the Pacific, and 11 to 22 projects in Europe and Central Asia. Total commitments on projects with PFM components over 25 percent rose in all regions except Middle East and North Africa, most notably in Africa, Europe and Central Asia, Latin America and the Caribbean, and South Asia.

Getting the Basics Right First

2.48 The Bank’s (1998: 8) *Public Expenditure Management Handbook* begins by stressing “getting the basics right”, drawing on Schick’s (1998) notion that countries should control inputs before seeking to control outputs, account for cash before moving to accrual accounting, and operate a reliable budget for inputs before moving to budgeting for results, a comprehensive budget and reliable accounting system before trying an integrated financial management system, a proper budgeting and accounting function before strengthening the auditing function, and a reliable financial auditing system before trying performance auditing

¹³ This listing includes a large number of “Desired Action” conditionalities. If one removes this group, the number of conditionalities rose from 467 conditionalities in 1990-99 (about 47 per year) to 818 conditionalities in 2000-06 (about 117 per year).

(see also Shand 2001, Diamond 2006). Yet, overemphasizing budget basics can lead to a control-oriented approach that hinders deeper PFM reforms (Andrews, 2006).

2.49 There is evidence from case studies where the Bank gave proper attention to basics. In countries like Bulgaria, working to meet the standards for admission to the EU, improving PFM has been important part of the agenda. There, as in Russia, the experience with central planning, which was a bad idea for the economy, has at least left a legacy of planning capacity and ethos that can be useful for planning and executing a government budget. Progress has taken place even in weak capacity countries just emerging from conflict such as Sierra Leone, which has achieved greater transparency and accountability in budget execution, and improvements in procurement, and in both internal and external audit.

2.50 In a different type of example in Guatemala, the Integrated Financial Management System (IFMS) program supported basic public finance building blocks (modernized accounting frameworks and improved cash management functions) and well sequenced capacity building. The IFMS I (FY95-99) helped the government develop a bookkeeping structure that integrated its budgeting, accounting, and cash management functions, and a comprehensive database for improved reporting and budget management. IFMS II (FY98-02) supported the expansion of the system to all other agencies and the Comptroller General's Office, and the creation of modules for debt and capital projects. The government launched Guatecompras. IFMS III (FY02-08) is expanding coverage to decentralized agencies and municipalities not covered by first two projects. The project also plans to reform the central Government's human resources function, begin introducing E-Government applications, and continue supporting the CG Office. (Parison 2005). However, the Bank was too ambitious in trying to implement a full MTEF framework by the early 2000s. The planning (within line ministries) and not the PFM side has been the problem.

2.51 Honduras presents a less successful IFMS example, supported initially by the FY 96 Public Sector Modernization Technical Assistance Credit (PSM TAC). The IFMS was installed and operational in 5 pilot ministries and the FY01 Implementation Completion Report (ICR) quotes several significant efficiency gains achieved by it. However, the emphasis on the mechanization of the processes and computerization made the IFMS increasingly awkward and voluminous, to the point that it became unmanageable. The priority given in Honduras to IFMS rather than to simplification and modernization of procedures is reportedly a common problem in other countries (World Bank 2006j). After 5 years of unsuccessful trials, the Ministry of Finance (MoF) decided to drop the entire IFMS and begin a new one in late 2004. The FY01 Economic and Financial Management (EFM) Project would support the implementation of the second IFMS. The new IFMS rationalized and simplified processes and has led to rapid progress. The IFMS has been rolled out within the central administration in 2006 and the 2006 budget was elaborated based on it. Despite this progress, remaining deficiencies at the end of 2006 included: i) a lack of comprehensive access to the system by all sectors resulting in delays in recording transactions; (ii) problems with the accounting module, which is still not yet fully operative; (iii) the lack of an interface with the procurement systems that allows many payments to bypass the system.

2.52 In another example, an integrated personnel and payroll database was installed in Ghana in 1995, but wasn't working well, so few agencies were using it for other than record

keeping purposes. Even then, there were problems with controls and data input and payroll output. A subsequent effort to implement a budgeting planning and expenditure management system (BPEMS) achieved adoption of the new chart of accounts, installation of the new software after long delays (and with a 50 percent cost overrun over expectations). Yet the main goals of producing the national budget (partial operation expected 1998, full operation 1999) were not achieved until starting in 2006, when a partial rollout was achieved at the Ministry of Finance and Economic Planning/Controller and Accountant General Department (CAGD) and the Ministry of Health, with core functionalities (general ledger, purchase order and accounts payable) available for processing and reporting transactions of personnel and administrative expenditures. The BPEMS delays meant that the cash management subsystem couldn't go ahead. It was only because of help from an IMF advisor that Ghana was able to meet its HIPC PFM completion target at the end of FY04 with a stand-alone cash management and commitment control system that prepared realistic cash plans and releases in line with budget, and compiled reports published in the monthly gazette. The Bank's initial project supporting these reforms was evaluated as overly complex, creating "a very big conceptual, technical, and managerial challenge." Institutional analysis pointed out gaps in policies and outputs, but didn't link "the poor performance with the mandates, role, organizational structures, overlapping responsibilities, outdated procedures and processes, and skill levels" (World Bank 2004e). There were also weak arrangements for quality assurance in both Bank TA projects working in the area, and disagreements between the design consultants and the implementing contractors that hindered progress (Lawson et al, 2007: 75).

2.53 In Indonesia, the Bank (1996b: 2, 5) helped introduce modernized government accounting systems starting in 1988 in 13 Government departments. However: "...reports produced by the systems are still inadequate both in terms of quantity and quality in order for them to be used as the basis for sound economic decision making. The final result of this sub-project component can be evaluated only when the systems have been implemented in all government agencies in all the 27 provinces which is not expected to happen before the year 2000".

2.54 The systematic roll-out of the new IT system was not achieved under a follow-on project either. Design elements that proved overambitious in the first project were carried over to the second, including the use of double-entry bookkeeping, separation between capital and current budget items at the program level, and requiring cooperation of spending units to verify data and provide quick feedback on errors (World Bank, 2001c). In 2002, after 12 years of reform, the old manual system was still widely used to prepare State Budget Realization Reports for the Government and the Parliament. The first PER by the Bank (2007c) to comprehensively analyze the quantitative dimensions of budget performance found, for example that 2005 expenditures were 28 percent over the approved budget, up from 2 percent in 2003; and yet, despite these basic system deficiencies, the government is proceeding to adopt advanced PFM practices including accrual budgeting and accounting for its 2006 budget. This may have been influenced by a favorable discussion of OECD experience with these tools by the Bank (2000a); by contrast, the latest PER urges caution in implementing these tools, given the severe capacity constraints (World Bank, 2007c: 99).

2.55 Another example of over-ambition is reportedly the Indonesia's Bepeka Audit Modernization Project, which depended on strong support of key stakeholders; yet Parliament, National Police and the Attorney General's Office were reluctant to take effective action on BPK audit reports (World Bank 2005e). Improving and sustaining performance using advanced, PFM tools is very difficult in the absence of a disciplined public sector that follows the rules: for example, sticking to the budget, and following personnel regulations. Yet, Bank loan conditionalities required accrual-based general ledger accounts in Albania (1993), and accrual accounting in Jamaica (2002) and Paraguay (2004), all countries of uncertain readiness for such tools.

2.56 Guyana's PFM program in the 1990s was also overly complex. The complexity caused problems at various stages of procurement and implementation. When Bank support for PFM restarted after 2000 it concentrated more on the basics first. Ambitious PFM reforms in Yemen could have used a more incremental approach, starting with core Treasury systems and general ledger, building broader capacity and commitment for more extensive reforms. An advanced, financial management information system supported by the Bank, although showing initial results, may be difficult to sustain in a low capacity environment.

2.57 An issue facing some IT-related PFM projects are delays in procurement. Procurement of components for an integrated Treasury and Budget Management Information System under the Public Financial Management Reform Project in Vietnam has led to delays of between twelve and eighteen months, due to issues in the bidding process, finalizing contracts, and related institutional issues.

2.58 Procurement delays were also reported in the Ghana case discussed above. In the Ghana case, IFMS procurement was delayed for one year because of weak government procurement processes. Yet, in the medium term, these processes are improving. The same project also produced a study in 1997, contributing to a new Procurement Law enacted in 2003, intended to make procurement more transparent and structured, and less discretionary. A 2006 rating using OECD/DAC indicators indicated higher than average performance, with substantial progress made in implementing actions agreed in the 2003 CPAR (World Bank 2003c, 2004b).

2.59 In summary, the Bank-sponsored projects have sometimes focused on basics first, but not always. As expected, it contributes to success when done, and reduces success when not. In a few cases, like Honduras, adjustments in design have begun to overcome the problems arising in earlier, overly complex efforts.

Transfer of Practices from Developed Countries

2.60 The country cases examined the related question of whether public financial management reforms first rolled out in developed and countries have been transferred to applicable developing country settings, and the extent to which they been appropriately adapted to local conditions. Again, the evidence is mixed.

2.61 One innovation first introduced in developed countries and now being promoted by the Bank among borrower countries is a multi-year perspective in fiscal planning,

expenditure policy and budgeting. This innovation has been challenging for both developed and developing countries, with mixed results (Holms and Evans, 2003; Diamond, 2006). Tanzania has adopted a well-functioning system, with Bank support. Such an innovation can be appropriate for a borrower in a context of high aid dependency, where the big uncertainty on the revenue side is the donor support. Tanzania's MTEF is a useful tool for coordinating commitment from the donors and thus getting enough certainty on the revenue side to plan the budget. Tanzania's MTEF had the top "A" rating in both HIPC tracking exercises (question 7), and a "B+" PEFA rating (indicator PI-12) (World Bank, 2006c).

2.62 In another example, Bank support was instrumental in initiating the MTEF process in Albania. By establishing close linkages with the activities financed by both the World Bank (Structural Adjustment Credit, PRSC series, Public Expenditure and Institutional Review) and other development partners (primarily), the Bank helped create momentum for the MTEF process. In addition, the number of ministries that prepared sector strategies linking expenditures to strategies increased from 4 in the 2001-03 MTBP to 10 in draft 2006-08 MTBP 1. A technical assistance for macroeconomic and fiscal analysis supported by the Bank developed an input-output model for better economic forecasting. Improvement in revenue predictability suggests strengthened capacity for macroeconomic and fiscal analysis (World Bank 2007b).

2.63 To cite other examples, Burkina Faso has reportedly made excellent progress in incorporating well-costed, multi-year perspectives in budgeting, also with the top "A" rating in both HIPC tracking exercises, and a strong PEFA rating (European Union 2006). MTEF's are also well rated by PEFA assessments in Uganda and Moldova, The MTEF is reportedly the primary source for annual budgets in Albania (World Bank 2006e: 53). However, other analysts question some of this progress, and point out, for example in Albania, Burkina Faso, Tanzania and Uganda, lack of transparency to the public and other shortcomings in MTEF and other key budget information (International Budget Project 2005a, 2005b, 2005c, 2005d; Holms and Evans, 2003 rank Burkina Faso's MTEF as "struggling").

2.64 Vietnam started piloting MTEFs with Bank support in 2005 with 4 ministries (comprising 60 percent of ministerial spending) and 4 provinces, based on a medium-term fiscal framework encompassing all government spending. Reportedly, these reform processes are helping policy makers become more aware of mismatches between resource allocations and intended results. However, additional work is needed on improving investment appraisals to achieve greater development effectiveness¹⁴

2.65 Ghana, which has made good progress in PFM overall, has a "C" rated MTEF, with weak links to the annual budget, limited debt sustainability analysis, sector strategies not fully costed, and weak links between investment and forward expenditure estimates. Part of the problem is that work on the Ghana Poverty Reduction Strategy focuses on the design of new tools, such as medium term priority programs, rather than on programming expenditure through the MTEF and annual budget (Lawson et al, 2007: 77). MTEFs in Kyrgyz Republic's ("D" rated), Honduras and Bangladesh (both "D+" rated) are still in the early stages of development, and most of the benefits have yet to be realized (Oxford Policy

¹⁴ Personal communication from Department of Planning and Investment, Ho Gang Province, Vietnam.

Management 2006; World Bank 2005b, 2006f). In the case of Guyana, the Bank's work on procurement, audits, and coordination of capital and recurrent budgets was appropriate in its focus on basic systems; initial Bank support to developing an MTEF was reportedly premature, given the unmet challenges of the annual budgeting process.

2.66 Mali's MTEF had the top "A" rating in its 2004 HIPC tracking exercise (question 7). However, a more recent assessment finds inadequate integration among the many tools developed to support reforms, including the MTEF, the sector MTEFs, the macroeconomic framework, the new budget nomenclatures, and the multi-year investment program. Timetables of the different exercises aren't properly synchronized. Sector MTEFs are prepared mainly to satisfy donors, and are separate from the program budget process (World Bank in press-c).

2.67 Even where MTEF is proving useful, a less detailed and more strategic planning exercise might serve the purpose better. In Slovakia, for example, a medium term budget framework including program budgeting was approved with Bank support for 2003-7 and 2006-8, and included a firm (in comparison to previous years) ceiling for the current year, and indicative ceilings for the next two years. This had the effect of discouraging the past practice of budget requests out of line with available resources. However, program budgeting is still considered to be separate from the "real" budget preparation, there is little time devoted to substance, performance indicators are focused on outputs rather than outcomes, and program managers aren't accountable for results. In addition, budget execution doesn't take place on a programmatic basis, reinforcing the view that the program budget isn't the "real" budget (World Bank, 2007e).

2.68 An earlier type of innovation was Bolivia's 1990 Financial Management and Control Law (SAFCO), which sought to increase the efficiency and effectiveness of the public sector by switching from a centralized rule-based system to a more modern, decentralized, results-oriented system. Enacted because of strong pressure from the Bank and other donors, it lacked sufficient incentives for public officials to enforce it. As a result, required annual operating plans were formally undertaken as an annual "ritual", but ignored with regards to agency programming and resource allocation (Dove, 2002; World Bank, 2000b).

2.69 In summary, MTEFs and related innovations were in some cases successfully adopted, and proved helpful both in strengthening government's PFM, and the predictability of funding from donors. Yet, in other cases, MTEFs haven't yet delivered expected benefits.

Choosing the Correct Entry Point

2.70 The country cases examined the advantages of supporting initial diagnosis and reforms at sectoral vs. central levels.

2.71 The Public Expenditure Tracking Survey (PETS) diagnostic tool is an example where significant results can be achieved at the sectoral level. First applied in Uganda, it found that only 13 percent of non-wage funds from the central government reached surveyed schools between 1991 to 1995. These results were publicized, and community pressure built

up on school authorities to change; follow-up PETS found that after reforms supported by the Bank and others, the comparable funds-flow was up to 80-90 percent in 1999 and 2000. PETS in Tanzania and Ghana found similar problems, but follow up reforms have been slower to take shape (Kanungo, undated).

2.72 The Priority Action Program (PAP) in Cambodia is another type of example with partnering between central and line ministries for improved PFM, supported by the Bank and other donors. It builds on the experience of the 1996 Accelerated District Development Program, introduced to speed up the flow of small disbursements to districts health programs through an imprest-like system, shifting from pre-audit to post audit of spending. The PAP, recommended by the 1999 PER and launched in 2000, scaled up this effort, and expanded it to education, agriculture and rural development. The result has been better alignment of funds to policy objectives, and faster disbursement in some operational units. A study of health performance in PAP vs. non-PAP provinces found mixed results, while an education ministry study found much lower repeat rates for students in PAP provinces. Cash management challenges such as erratic and delayed disbursement have prevented these initiatives from having a larger impact (World Bank and ADB. (2003:74-7).

2.73 A related Cambodian initiative supported the contracting out of government health services to NGOs. A randomized study found a one baseline standard deviation improvement in targeted outcomes (availability of 24-hour service, reduced provider absence, and increased supervisory visits) in participating districts relative to comparison districts. Government health funding increased in participating districts, while private expenditure decreased by about the same amount as residents moved away from unlicensed drug sellers and traditional healers to government clinics (Bloom et al 2006).

2.74 Another sectoral initiative in Cambodia was the piloting of nascent MTEFs in education and health under the IMF-led TCAP and related initiatives; this experience is being scaled up to other sectors with support from the Bank and other partners. Bank staff working on Cambodia underline that support from the Ministry of Finance and Economic Planning has been crucial for these sectoral interventions to succeed. Core ministries need to provide space for sector reforms which then may succeed if the sector ministry has capacity. Priority Action Program (PAP) works best in Education and Health, less so in Agriculture and Rural Development.

2.75 The country cases also looked at examples where the Bank had supported PFM reforms at the sub-national level¹⁵. For example, starting in 1995 in Argentina, the focus of PFM AAA and lending shifted to improving provincial government PFM systems to facilitate cutting expenditures, and increase revenues. The Bank applied a fairly standard model in provinces it assisted, including adopting finance legislation, with budgeting, accounting and audit procedures compatible with those at national level, and using these systems to cut back on expenditure; some provinces have responded well to this model, e.g. Salta, which also received similar types of support from other donors. Other provinces have achieved progress by alternative means, e.g. Santa Fe, and some haven't achieved much progress because, *inter alia*, constitutional protection of organizations and procedures, and

¹⁵ A different, ongoing IEG evaluation is focusing on the Bank's decentralization support.

the Bank's focus on formal rather than informal work practices, e.g. Cordoba (World Bank, in press-e).

2.76 State level reform has also received Bank support in India. For example, State Financial Accountability Assessments were carried out in Andhra Pradesh (jointly with DfID) and Orissa, followed up by lending to support state government PFM reforms. Despite political challenges, PFM improvements were achieved including deficit reduction and improved revenues and transparency in both states, and improved budget execution and monitoring, financial accounting, and cash management in Orissa. These cases show the need for strong analytical underpinning for designing effective state level policy based lending, and the importance of taking political economy factors into account,

2.77 In summary, some countries found it helpful to pilot nascent MTEFs and other reforms in ministries with demonstrated PFM capacity, to draw lessons from the pilot, and then to gradually scale up to other ministries. Other types of diagnosis and reforms supported by the Bank were also initiated at the sectoral level, such as PETS, accelerated disbursement pilots, and outsourcing. Sub-national jurisdictions were also entry points for PFM support, with mixed results depending on the reform context. These initiatives were most successful when core ministries provide the space for the sectoral or sub-national interventions to succeed.

More Flexible Lending Instruments

2.78 This section looks at whether product choices shifted towards more flexible, long-term lending instruments since 2000. It also asks whether these instruments have been effective in achieving PFM outcomes.

2.79 Many examples were reviewed in case study countries. On the positive side, Bank support for PFM in Guatemala was in the form of 3 Integrated Financial Management System projects (Technical Assistance Loans for a total of US\$54.9 million). The three loans were approved back-to-back and will extend from 1995 to 2008. PFM performance in Guatemala is modestly better than that of its peers¹⁶. Although broad anti-corruption indicators have not improved, the 2005 PEFA assessment found good ratings on over 1/3 of the PFM areas covered, indicating better systems in place to prevent corruption. There is a strong overlap between the good ratings and the areas the Bank supported. (World Bank in press-b).

2.80 Indonesia's Government Financial Management and Revenue Administration Project is an adaptable program loan with three phases covering the period 2004-2012. The first phase, currently underway, focuses on treasury payment systems; budget preparation and execution; public procurement and implementation of public sector accounting standards; and the strengthening of the oversight of budget formulation and execution. Although some components have preceded well, the main component, a new treasury system,

¹⁶ CPIA indicator 13 (Quality of Budget and Financial Management) was better than that of Guatemala's peers (countries broadly comparable in human development, urbanization and population: Bolivia, Nicaragua, Morocco, El Salvador, Sri Lanka, Cambodia, Ecuador and Armenia. (World Bank in press-b).

has been delayed due to procurement issues, an issue with IT-related projects discussed in the previous section. The delays stem from, *inter alia*, an overly complex project design, limited availability of counterparts, and mistrust between client Ministry and the Bank. A more perceptive capacity assessment during loan preparation could have anticipated these issues, and suggested alternative implementation arrangements that might have prevented ensuing problems (Serame 2007).

2.81 Tanzania also utilized and adaptable program loans (one nearing completion and a second in advanced preparation) with a 15-year time horizon to support public service reform. The long time horizon, with the task manager in the field has increased the effectiveness of this support.

2.82 As mentioned in the previous section, the period under review witnessed the trend shift in PFM assistance from investment to policy based loans, including multiple PRSCs¹⁷. For example, four PRSCs in Uganda implemented over the period FY01-FY05 helped improve budget execution, and ensured adherence to the 1997 Poverty Eradication Action Plan. An MTEF was extended to all key sectors, and the wage bill and donor projects were increasingly incorporated into the budget. Procurement procedures and audit oversight also improved (World Bank, in press-a). They helped contribute to some improvement in PFM performance (although there were also slippages¹⁸), which is higher than that of peer countries, based on a comparison of HIPC and PEFA scores where possible, and/or discussion in PEFA assessment. Of the well rated PFM areas, 2/3 benefited from relevant Bank project support, and most of the others may have been influenced by AAA. Of the lower rated areas, most benefited from Bank support, and most remained at the same level¹⁹.

2.83 However, in some countries there are reportedly problems that arise in policy-based lending. A recent assessment of PFM support in Mali suggests that investment lending or technical assistance credits would be more appropriate in supporting PFM reforms because of their institutional and procedural nature. There are also problems created when PFM and non-PFM conditionalities are packaged in one adjustment operation, since problems in the latter can hold up disbursement in the former (World Bank in press-c).

2.84 The final issue is whether the new lending instruments are supported by effective PFM improvements to mitigate fiduciary risks of corruption. Although it wasn't possible under this evaluation to assess this systematically, an assessment of 47 recent DPLs found that 94 percent provided sufficient evidence of governments' commitment to PFM improvements, including satisfactory funds flow arrangements and controls, and that improvements were proceeding satisfactorily (World Bank 2006h).

2.85 In conclusion, regarding lending instruments, there has been a shift towards more flexible, long-term lending instruments since 2000, including a shift in PFM assistance from investment to policy-based loans. The results of this shift are broadly favorable, with strong

¹⁷ PFM support through PRSCs is being examined in more detail in a separate evaluation.

¹⁸ Based on HIPC tracking, 6 out of 15 indicators worsened between 2001-4, while 3 improved. For more on the methodology used for PFM trend analysis in this paper, and the limitations, see the discussion in the "attribution" section that follows.

¹⁹ 2006 indicator 13 (Quality of Budget and Financial Management) improved in recent years. Uganda's peers (countries broadly comparable in human development, urbanization and population: Cameroon, Kenya, Sudan, Haiti, Nepal, Ghana, Lao PDR and Cambodia, had a lower average value for indicator 13. (Republic of Uganda, 2005).

performance, for example, in Guatemala, Tanzania and Ghana. Yet delayed treasury system in Indonesia, and the modest PFM improvements evident in Uganda in recent years point to continuing challenges under the new instruments. And in Mali, there are indications that investment rather than policy-based lending might have achieved greater results.

OVERALL COUNTRY OUTCOMES

2.86 The evidence in the first section of the paper suggests that PFM reforms can take many years to take hold and deliver improved performance, even in developed countries; and, even when there is evidence that performance has improved, attribution is difficult to prove (see Section 4). With these caveats, this section will address three questions:

- 1.) Are PFM systems supported by the Bank improving?
- 2.) If so, is there a link between these improvements and the Bank's work? and
- 3.) Is the Bank supporting the most challenging PFM reforms, or is it agreeing with borrowers on vague or easy targets?

2.87 The first step towards answering the first two questions is to look at countries where the Bank has offered PFM lending, which in turn is generally backed up by PFM analytical support as analyzed in the previous section and by technical assistance provided by the Bank or other partners. Out of 75 countries where the Bank provided PFM assistance after 1999 and for which CPIA data is available in 1999 and 2006: 48 (64 percent) showed an improvement by 2006 in PFM performance based on the CPIA 13, 11 (15 percent) showed no change, and 16 (21 percent) showed a deterioration²⁰. However, there is evidence that some of this improvement may stem from broader forces (e.g. global and professional standards, business lobbying) leading to improvements in weak performers. For example, out of 22 countries with 1999 CPIA 13 scores at or below 3.0 where the Bank didn't provide PFM assistance (again, for those with CPIA data in 2006), 7 (32 percent) showed an improvement in PFM performance based on the CPIA, 9 (42 percent) showed no change, and 6 (28 percent) showed a deterioration.

2.88 Based on a simple OLS regression, the presence of Bank PFM projects is significant in explaining movements in CPIA 13 between 1999 and 2006 after controlling for the initial CPIA level (see tables on pp. 62-76). However, one should not, at this stage, interpret these as the *causal* impact of PFM projects. These results are confounded by a long list of factors, including difficulty in capturing the timing of the impacts of the programs, nonrandom selection of countries for PFM programs, bias that result from the selection of the countries that do not receive CPIA ratings, omitted variable biases (e.g. changes in incomes, governments, and so on), and the lack of information about non-World Bank PFM reforms, and other considerations.

2.89 In addition to PFM lending support and AAA, an important incentive for PFM improvement has been the process of HIPC accession. Taking the 23 countries participating in HIPC that were monitored first in 2001, and then again in 2003-4, and considering the benchmarks set for 15 PFM elements, the number of countries meeting or exceeding the

²⁰ 13 countries do not have CPIA data in both years. These are excluded from all totals and percentages. Only data since 2005 are publically available.

benchmarks increased for 8 indicators, declined for 6, and stayed the same for 1. Given the length of time normally required for PFM systems to improve, this relatively rapid, net positive result is modestly encouraging, and reportedly due to the incentive that would accrue to countries achieving HIPC accession. An evaluation of the enhanced HIPC initiative found that increased resources from debt relief have been targeted for poverty reduction, with 49 percent allocated to the education and health sectors for a sample of countries with available countries (World Bank 2003a). The ongoing improvements in PFM systems before and after HIPC accession helps to facilitate such targeting. For example, the indicator with the highest number of countries meeting the benchmark (21) was “5. Budget expenditures are classified on an administrative, economic, and detailed functional or programmatic basis”, thus facilitating the targeting expected under HIPC.

2.90 Despite the progress, much work is still needed. Of the three main PFM areas (see Annex 1) budget reporting improved the most, with 14 countries improving and 4 worsening. Within this indicator group is for example, “13. Regular fiscal reports track poverty reducing spending”, where countries meeting the benchmark increased from 3 to 7. A total of 42 percent of reporting benchmarks in the reporting area were met in 2004, up from 33 percent in 2001. However in the other two PFM areas of formulation and execution, there were modest declines between the two reporting periods in countries meeting the benchmarks (World Bank and IMF 2005). Traditionally the Bank gave more attention to budget formulation than to budget execution, and traditional financial management looked mainly at Bank projects, not the whole spending cycle. While somewhat more attention now goes to the downstream aspects, more consistent effort is still needed in that direction.

2.91 A concern going beyond PFM is the challenge of measuring institutional development (ID) impact of Bank support. In the recent past, all Bank projects were given a rating as part of their ICR on ID impact. However, no guidance was provided to staff on how to ascertain this. For example, staff commonly confused organizational with institutional impact and challenges; when confronted with weak performance, the advice offered is often to restructure organizations, rather than to address the institutional rules and incentives that may be at the heart of the problem. Draft guidance to address this was prepared by the Bank (cf. Fuhr and Krause 2001: 8), but it was never adopted. The ID impact rating was then discontinued as a result of the Harmonized Evaluation Criteria of 2005. The definition of “outcome” was changed in such a way that it now encompasses the project's ID impact, thus, there is no more separate ID impact rating. Yet there is still no guidance provided on how to ascertain ID impact as part of outcome.

2.92 The country cases give further examples of country progress associated with Bank support, and remaining challenges. In the case of Ghana, in 2002, the Bank shifted its approach from managing project outputs to targeting PFM outcomes, including meeting benchmarks for HIPC completion point. Ghana met all HIPC completion point triggers in FY04, including strengthening procurement, internal audit, reporting on cash expenditures and commitments, and devolution of responsibilities to local governments. The PFM system progressively improved in meeting HIPC PFM benchmarks, from 1 out of 15 in 2001 (the worst of all countries surveyed), to 7 in 2003-2004, and 8 in 2006 which exceeds the average of 6.5 for the 24 HIPC countries surveyed in 2004 (World Bank, 2006d; World Bank and IMF, 2004)). This recent work has been supported by a series of PRSCs, with improving

PFM as a central focus, and also benefited from a resident IMF advisor starting in 2002, favorable commodity prices, and new leadership at the Comptroller and Auditor General's Department in 2005.

2.93 There were three 2004 Ghana CAS expected outcomes in the area of strengthening of key budgetary accountability institutions which were met. First, Parliamentary Committees have held regular and effective meetings, and presented 237 reports to the Parliament since 2004. The Public Accounts Committee submits its report to the House within six months of receiving the Auditor-General's report. The Bank, along with other donors, has supported this effort through dialogue with PER and PEFA teams, and training from WBI. Second, there have been major improvements in access to information. Ghana's first PEFA assessment in FY06 found that the transparency and comprehensiveness of the Budget Statement had improved over the previous two years, although in-year reporting on budget execution is less comprehensive than the PEFA standard, and hampers reporting on budget execution. The PEFA assessment also praised timely completion of the Auditor General's report and greater Parliamentary scrutiny of the budget, but indicated the need for more remedial action by the Executive to address problems raised in audit reports. Civil society has also increased its monitoring of allocations and expenditures, particularly at the local government level. The Whistleblowers Act has been enacted. Third, the CAS outcome of implementing Citizens Report Cards in 40 districts has been achieved, with support from Bank lending (World Bank, 2007).

2.94 The Bank's PFM work in Ghana is exemplary for the results achieved in meeting benchmarks, and for the wide-ranging approaches used, spanning technical, legislative and civil society initiatives. Ghana's experience is consistent with the results of a recent study of general budget support, finding that in the 5 of the 7 countries with established track records, channeling aid through country systems has strengthened budget processes, including comprehensiveness and transparency. Among the reasons for this are:

1. Sector ministries engage directly in the budget process, and are less likely to work off-budget because of their close relationships with donors; and
2. Donors have heightened concern with PFM and combating corruption because of fiduciary concerns about their resources passing through national PFM systems, and because of the key role of these systems linking policy and implementation (IDD and Associates 2006).

2.95 However, Ghana's remaining PFM challenges can't be underestimated. The slow pace of civil service reform means that top officials resist efforts to reduce discretionary control, including PFM reforms in that direction. As a result, political commitment to PFM reform, although overall it is a net positive, has been inconsistent. There may have been too much emphasis on "slow but big wins", and not enough on simple administrative changes that could bring quick gains such as the treasury decentralization process piloted in 2006. While the Government might have been given useful advice from TA consultants on addressing this and other weaknesses in strategy and sequencing, the TA provided focused instead on narrow technical areas such as audit and procurement (Lawson et al, 2007: 77-9)

2.96 By comparison, in 2002, Cambodia met only 3 out of HIPC PFM benchmarks. A ten-year PFM reform program was approved by the government in 2004 with Bank support. It adopts a platform approach (Brooke, 2003) with four successive reform episodes, where each episode creates the basis for launching the next. Emerging, early results are positive, including reducing the budget deficit from 6.9 percent (2003) to 2.6 percent (2006). An assessment in 2005 found that Cambodia now met 5 of the HIPC benchmarks, a modest improvement (IMF and World Bank, 2005, World Bank and IMF, 2006.). Among the reasons for the relative success (e.g. in comparison to civil service reforms) seems to be merit based posting of staff in key positions, good team leadership in the Ministry of Economy of Finance, and incentives for these key people comprising a mix of donor paid benefits, salary top ups, and grey area benefits (e.g. privileged information, help for family members in setting up businesses). In addition, 2 ½ years of diagnostic work, dialogue and PFM strategy formulation bringing together government, and critical mass of donors led by the Bank, helped to clarify clear reform responsibilities within government and coordination within and across government.

2.97 An analysis of conditionalities in case study countries finds a trend toward greater use of specific and monitorable “hard” conditionalities²¹ (e.g. “Reduce Sales Tax Rate To 17.5 percent”), rather than less precise, “soft” conditionalities (e.g. “Evaluate Poverty Focus Of Public Expenditure”). For example, in Ghana, the proportion of “hard” conditionalities increased from 45 percent 1990-1999, to 100 percent 2000-2006. In Argentina, the increase was from 84 percent to 97 percent over the same period.

2.98 Finally, ministries of finance and finance departments of ministries are “production organizations” (Wilson, 1989: 159-63), having an advantage over many other public authorities in that both their inputs (PFM systems) and outputs (e.g. minimal deviation in actual expenditure from budgeted expenditure) can be observed and measured. PFM theory suggests that these outputs will lead to the eventual impact of more efficient and effective service delivery and production of public goods. However, the actual link between PFM outputs and their eventual development impact was not empirically verified in this evaluation.

Unintended Consequences

2.99 The country cases highlighted some cases where Bank interventions in some cases avoided unintended consequences from past practices, while in other cases created unintended PFM consequences from new approaches. On the positive side, the shift by the Bank and other donors toward greater predictability of funding, providing financial information to governments for budgeting and reporting, and using government systems to manage aid helps to avoid the unintended consequences of past practices that weakened countries' abilities to manage their resources. For example, PEFA assessments gave donors in Tanzania an "A" rating for predictability of direct budget support, and donors in Bangladesh "B" ratings for predictability of direct budget support and proportion of aid managed by national procedures.

²¹ Not including “desired actions”, which are voluntary.

2.100 Yet, there are also unintended negative consequences from the new approaches. The Bank has been highly cautious in considering use of procurement processes of governments or other donors, preferring Project Implementation Unit (PIU) processes rather than using government systems²². This can slow down improvements in government systems, exacerbate the delays discussed above in IT projects, and still does not ensure that procurement will be corruption-free. For example, decentralized procurement in Honduras within the ministries and agencies has languished for lack of capacity and because perceptions of corruption make donors reluctant to channel resources through the regular civil service. Instead, a proliferation of PIUs has led to expensive and fragmented procurement managed under a host of balkanized rules and regulations. However, this seems to be improving. The US Millennium Challenge Corporation (MCC) recently agreed to use the new IFMS for the management of its program in Honduras. This is a notable achievement given the strict requirements of the US government (World Bank 2006i).

2.101 In a different type of example, the Bank has worked aggressively to investigate allegations of corruption in Cambodia concerning procurement in bank projects; but despite a high profile to this effort, the outcome is mixed. Although corruption was not mentioned as a risk in the FY02 demobilization project (World Bank, 2001a) (nor does the word appear anywhere in the PAD), there was a declaration by the Department of Institutional Integrity (INT) in June 2003 of misprocurement of motorbikes for demobilized soldiers by the PIU. On the plus side, the Bank provided the government with the full report of the INT investigation. The Bank debarred the consultants concerned from future Bank work, and received accelerated repayment from the government of the value of the misprocurement (US\$2.8 million). The project was subsequently closed, and the ICR found the project unsatisfactory (World Bank, 2006g). Subsequent (INT) investigations in 2005-6 of 63 contracts financed by seven other projects resulted in declarations of misprocurement by PIUs in six projects on 42 contracts (and a declaration of non-eligible expenditures on one contract) valued at US\$12.1 million. Disbursement on three projects was partially suspended pending the execution of actions plans, which were communicated to the RGC in July 2006.

2.102 Cambodia has made progress on the action plans, and all the suspensions were lifted in February 2007, but on condition that all procurement on Bank projects will be turned over to a procurement agent hired by the Bank. Although perhaps a necessary fiduciary step given prevailing corrupt practices in Cambodia, a risk is that there will be less Bank attention to improving the government's mainstream procurement systems. These INT issues were problematic for another reason: because no details were initially released by the Bank, based on the need to protect informants. Leaders claimed that the Bank was unfair and not transparent in not sharing its own findings. This was in contrast to the well documented 2003 declaration of misprocurement, and the participatory IFAPER. Problems may have been compounded in February 2007, as not enough details were publicly offered as to why the projects could now proceed without threat of further corruption. The result has been to divert attention from the problem (corruption in procurement) to the process (non-transparency). In the future, use of a Cambodia-savvy public relations specialist in communicating INT findings would be helpful.

²² This approach is under active reconsideration by the Bank. See World Bank, 2007f.

2.103 Another form of unintended consequence is that reform progress achieved can be reversed. In Ukraine, for example, many CPAR recommendations were adopted as amendments to the public procurement law from 2001-2005. As a result, 70 percent of all tenders were competitive in 2005, compared to less than 50 percent in 2002. Likewise, sole-source contracts were reduced to 15 percent in 2005, from 24 percent in 2002. Yet from 2004-2005, Parliament has approved (and overridden the President's vetoes) three amendments to the law weakening the procurement function, and increasing the risk of corruption (World Bank, in press-d: 47). In another example, important PFM improvements were carried out in Argentina starting in 1991 as part of a package of emergency reforms intended to address an economic crisis. These included passage of a Financial Administration Law, creation of a PFM information system and single treasury account, and introduction of multi-year budgeting. Although fiscal stability and solvency improved initially, slippages began once the crisis had passed. Formal measures were circumvented, and expected behavioral changes not realized. In recent years there has been an increasing tendency to exempt agencies, off budget and fiduciary funds from coverage by the integrated system and single account. Improved revenue generation and exit from convertibility reduced the pressure to push the reforms ahead (World Bank 2007d, in press-e).

ATTRIBUTION

2.104 The outcomes indicated above can be attributed to many factors, including the Bank's work. The overall statistics on country PFM performance in Section 3 indicate many instances where the presence of Bank PFM projects was associated with measurable improvement in PFM. Yet there were many other factors at play, including policy loans, conditionality, ESW, technical assistance, and policy advice from other donors, and debt relief, greater aid harmonization and alignment. One of the Bank's most important partners in PFM is the IMF. The collaboration in PFM among the Bank and Fund was clarified in a 2003 agreement (World Bank and IMF, 2003) and a subsequently strengthened approach (World Bank, 2005c), and coordination between the two organizations in the country cases was reportedly good. DfID was another important partner, taking a leading role in PFM support in, *inter alia*, Bangladesh and Ghana, in close partnership with the Bank. Other donors played important, supporting roles, including the regional international financial institutions (IFIs), bilaterals, and UN agencies. There are reportedly 50 donors providing PFM support, and on average, seven working in each country; thus, close coordination to avoid duplication and mixed messages is essential (Allen and Last).

2.105 Progress in harmonizing PFM support in recent years has put in place a unified dialogue between government and most donors, including joint participation in PFM analytic studies, joint support of the overall PFM reform program, and the joint PFM review mechanism, where six donors²³ have joined the Bank and Fund in participating in PEFA assessments. These steps forward on harmonization are expected to reduce duplication of effort on analytic work, to reduce the burden on borrowers, and to provide mechanisms for reaching consensus among all concerned partners, leading to a more coherent and prioritized support to PFM reforms. In many countries, the Bank has a leading role in building this

²³ The donors are the European Commission, DfID, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the Strategic Partnership with Africa.

consensus among partners, including providing technical expertise and analysis to persuade government and partners of the merit of the jointly-supported policy choices.

2.106 As an example of donor partnerships in PFM, take the case of Bangladesh. Building on the recommendations of the Committee on Reforms in Budgeting and Expenditure Control, and the Finance Secretary's need for budgetary support, the Public Resource Management Adjustment Credit was approved in FY92 with institutional strengthening for budgeting, accounting, investment programming, tax administration (including introduction of VAT) and debt management. Both the Bank and DfID offered follow-on support, but the government chose DfID both because of the preference for grant financing, and because they could avoid conditionalities. The implementation of DfID assistance starting in 1996 was not initially smooth, with disagreements between DfID and government, and between DfID Dacca and DfID London. In the end, the project was considered a success by DfID, with strong support from the Finance Secretary.²⁴ After a lull in Bank engagement on PFM throughout the rest of the 90s, new investment and program loans starting in FY2002 contributed to a number of advances.

2.107 PFM was selected as an entry point in part because of concern over high budget deficits (7.4 percent in 1992, 6.2 percent in 2002). In the latter case, the new BNP government from 2001 won office with promises of improving governance, and PFM and procurement were the areas the government was most prepared to engage in with the Bank and other donors. DfID's willingness to provide well-designed, sustained grant support to PFM (RIBEC (1996-2002) and its successor Financial Management Reform Program (2002-2006)) was also a key factor, coupled with the comparative strength of the Bank to pursue PFM conditionality in policy lending, a modality not available to DfID. Also important was the willingness of a number of successive, capable finance secretaries to help push through reforms. Procurement was selected as a PFM component because of the timely availability of CPAR recommendations as a new government committed to delivering on good governance campaign promises came to power. As discussed above, advances in procurement were aided by a close partnership with the International Labor Organization to provide capacity building support.

2.108 Finally, a comparison of HIPC tracking and PEFA scores, along with other details in PEFA assessments gives an indication of PFM improvements, and possible link to the Bank's work. In Ghana, for example, ten of 28 PEFA indicators were well rated, with 8 Bs and two rated A. Of the ten, 8 improved in recent years. Four of these eight benefited from relevant Bank project support, and others may have been influenced by AAA. Of the remaining 18 indicators, 7 C-rated ones improved in recent years, and 4 of these benefited from Bank project support²⁵. Similar analyses were carried out for 8 other country cases where both HIPC tracking and PEFA scores are available.

²⁴ Nigel Thornton Agulhasm 2006. Public financial management reform in Bangladesh. Prepared for 2006 Asian Regional Forum On Aid Effectiveness: Implementation, Monitoring And Evaluation Manila, October.

²⁵ A different study, also using HIPC and PEFA data, finds a slower rate of progress, highlighting the need for caution in interpreting these data. The study concludes that despite the "exceptional" progress made on PFM policy reforms, and the strong motivating factor played by budget support, these reforms have not yet translated into concrete improvements in the overall performance of the PFM system (Lawson, 2007: 73).

2.109 As most countries have undergone at most one PEFA assessment, around 2006, trend analysis needs to take into account PFM scores from previous HIPC assessments (usually from both 2001 and 2004). This way, trends can be derived by adopting the HIPC ratings to their PEFA counterparts. In addition, some trends can be found on the basis of evidence provided in PEFA assessment reports. For the eight case study countries that had both HIPC and PEFA assessments, the countries scored an A or B rating (that demonstrates sound PFM practice) on an average of 10.5 indicators in the PEFA assessments, and an average of 17.5 on the C and D level (that reflects the need for improvement).

2.110 Comparing these outcomes with HIPC ratings suggests PFM improvement since 2001. For the indicators where a trend could be derived, countries showed improvement for an average of 55 percent of the indicators that scored A or B in the 2006 PEFA assessments. In the case of C or D ratings, an average of 25 percent improved. These upward trends are the result of many factors, one of which is the World Bank's work on PFM. Still, it is worth noting that for 70-80 percent of the indicators that showed an improving trend, the Bank provided support to those countries through targeted lending conditions, investment project support, and ESW recommendations.

2.111 Of the three broad categories of budget formulation, budget reporting and budget execution, the eight countries had the greatest proportion of well-rated indicators (A/B) under budget formulation (55 percent), and the smallest proportion under budget execution (about 20 percent).

2.112 DeRenzio and Dorotinsky (in press) took a different approach with 15 countries with both HIPC and PEFA ratings, looking at the 11 HIPC indicators where there is closest correspondence between the two assessment methodologies. Over the period 2001 to 2006, five countries showed improvement in the number of HIPC benchmarks met (with Ghana improving by six benchmarks), six showed a decline, and four remained largely unchanged. Based on raw scores, eight countries improved, four declined, and three were unchanged. In terms of the different phases of the budget cycle, the greatest improvement was in budget reporting, with less improvement in budget formulation, and some deterioration in budget execution. At a more detailed level, over 90 percent of countries could limit the discrepancies between budget allocations and budget outturns in 2006, compared to less than 50 percent in 2004. 80 percent of countries met the benchmark on improvements in budget classification in 2006, the same as in 2004. However, there was a decline in the quality of medium-term projections in budget processes, and in ability to reflect donor funds in the budget.

2.113 PEFA is not intended as a tool for comparing different countries, because differences in applying the PEFA methodology by different country teams can produce different PEFA scores that may not be comparable across countries. This prevents conducting, for instance, a cross-sectional analysis on the level of a single indicator. Nonetheless, these averages show considerable variation in country performance. For example, in Burkina Faso, over half of the PFM areas examined under a PEFA assessment were well regarded. Focusing on the PEFA indicators that can be traced back in time, this reflects an improvement for about 80 percent of these indicators—all of which benefited from relevant Bank support. These improving indicators are based on key achievements like enhanced budget classification,

increased participation in the annual budget process, and adaptation of the budget to the MTEF.

2.114 On the other hand, in Uganda, momentum for PFM reforms has come down after achieving considerable results in the 1990s. The PFM agenda has targeted key building blocks, but progress has been slow and outcomes have not fully materialized. For instance, the MTEF, the Institutional Financial Management System, Output-oriented Budgeting, and Results-oriented Management are individually complex, and the success of each hinges on the success with the others. This is reflected in the flat overall trend implied by the HIPC and PEFA ratings: of the eight countries, Uganda showed the lowest improvement in both A/B and C/D rated PEFA indicators—despite the provision of Bank support through lending and ESW directed at a majority of these indicators.

2.115 These and other examples suggest that there is wide variation in PFM experience among countries, with countries making progress at different paces, and in different areas, while others experience temporary setbacks. PFM trends will be monitored in future years through follow-up PEFA assessments. In FY08, for example, Zambia and Mozambique will have their second PEFA, giving an opportunity to see their progress more accurately.

Table 1. Selected PEFA Ratings and Approximations for Improvements/Setbacks

	No. A/B ratings	% Impr. A/B	% Impr. C/D	% Setback C/D
Tanzania	14	45	27	9
Ghana	10	80	39	11
Zambia	6	100	26	0
Average ²⁶	10	55	25	13

Source: HIPC tracking data 2001, 2004, and PEFA assessments circa 2005-2006.

Bank Staff Better Skilled

2.116 Finally, this section asks whether in delivering the PFM outcomes examined above, there is evidence that since 2000 the Bank has drawn on a more highly skilled group of PFM specialists than in prior years in designing and carrying out its work, including skills in institutional and governance areas, better supported by proactive networks. A survey of regional public sector managers found that there are 53 staff working on country support to public expenditure and financial management, compared with 47 staff working civil service, tax administration, and anticorruption. There is a comparable contingent with Operations Policy and Country Services (OPCS), not counting those working mainly on the financial management and procurement of Bank projects. This represents an increase since 2000.

2.117 In addition to the increase in staff skills, the launching of the Financial Management Sector Board has helped to ensure greater consistency in the quality of PFM operational, analytic and fiduciary work, human resources, knowledge management and outreach, and internal and external partnerships. The Public Finance Thematic Group within the Public

²⁶ Averages calculated to include ratings and percentages for these and additional countries with unpublished data: Burkina Faso, Honduras, Malawi, Uganda, and Mali. NB. There were no setbacks (declining trends) in A/B ratings based on analysis of these data.

Sector Group also assists with, *inter alia*, knowledge management and staff training, and the Procurement Network on quality, human resources, knowledge management, outreach and partnerships in procurement.

3. CONCLUSIONS

3.1 A literature review looked at debates mainly since 1990 among scholars and practitioners on PFM and related reforms in OECD countries. It then examined how these debates influenced thinking and practice in developing countries, considering the transferability of ideas, governance assessment, and analytical frameworks for public financial management, along with specific issues concerning reforms of fiscal decentralization, accounting, multi-year budgeting, financial management information technology, and combating corruption. These and related debates on the theory and practice of improving public financial management are expected to continue. The complex and context-specific nature of the work means that considerable research is still needed to better judge which reforms and reform strategies are likely to succeed in any given country.

3.2 The paper then considered World Bank support since 1990 to improve PFM analysis and management, and examined how this work was influenced by the above debates. It reviewed four key elements of Bank support: diagnosis, design and implementation of projects, country outcomes and attribution.

3.3 In terms of scale, there has been a sharp increase in PFM diagnostic work and lending since 2000 in all regions, with the most notable lending increases in Africa, Europe and Central Asia, and Latin America and the Caribbean.

3.4 These investments are increasingly linked with improvements in PFM, as measured by CPIA (from 1999), by HIPC tracking in 23 countries (from 2001-4), and by PEFA assessments ongoing or completed in over 70 countries (from 2005). The development of these indicator sets by the Bank and donor partners were major steps forward in underpinning borrower PFM monitoring and evaluation frameworks.

3.5 Lending operations are generally well informed by PFM studies that have moved from a focus on fiscal policy issues in the early 90s, to increasing coverage of fiduciary, financial management and institutional issues. More recent studies show greater awareness of political economy contexts, and how to overcome political and organizational obstacles. Greater numbers of recent studies involve substantial participation by clients in PFM data-gathering and analysis to facilitate borrower ownership of the analytical results. There were also references in Bank-supported programs to the strengthening of parliamentary oversight of PFM. However, there is great scope for deepening the institutional and governance content of these studies, for better prioritizing recommendations so they are more realistic and in line with institutional capacities, and for better integrating findings into common sets of recommended actions.

3.6 There are good practices cases where the Bank supported basic public finance building blocks in a logical sequence of increasing sophistication. However, there were other cases where project designs were unmanageably ambitious, and complex project components such as IFMSs were promoted before addressing basics like simplification and modernization of procedures, and operation of reliable accounting and treasury systems. Pervasive procurement delays also made a number of IFMS components less effective than desired. Likewise, MTEFs were in some cases successfully adopted, and proved helpful both in

strengthening government's PFM, and the predictability of funding from donors. Yet, in other cases, MTEFs proved too complex to be useful in a developing country context, without first addressing basic systems weaknesses.

3.7 Some countries found it helpful to pilot nascent MTEFs and other reforms in ministries with demonstrated PFM capacity, to draw lessons from the pilot, and then to gradually scale up to other ministries. Other types of diagnosis and reforms supported by the Bank were also initiated at the sectoral level, such as PETS, accelerated disbursement pilots, and outsourcing. Sub-national jurisdictions were also entry points for PFM support, with mixed results depending on the reform context. These initiatives were most successful when core ministries provide the space for the sectoral or sub-national interventions to succeed.

3.8 Regarding lending instruments, there has been a shift towards more flexible, long-term lending instruments since 2000, including a shift in PFM assistance from investment to policy-based loans. The results of this shift are broadly favorable, with strong performance, for example, in Guatemala, Tanzania and Ghana. Yet a delayed treasury system in Indonesia, and the modest PFM improvements evident in Uganda in recent years point to continuing challenges under the new instruments. And in Mali, there are indications that investment rather than policy-based lending might have achieved greater results.

3.9 Bank interventions in some cases avoided unintended consequences from past practices, while in other cases new PFM approaches created unintended negative consequences. The shift toward greater predictability of funding, providing financial information to governments for budgeting and reporting, and using government systems to manage aid helps to avoid the unintended consequences of past practices that weakened countries' abilities to manage their resources.

3.10 Yet other new approaches have had unintended, negative consequences. The Bank is reportedly overly cautious in considering use of procurement processes of governments or other donors, preferring PIU processes rather than using government systems. This can slow down improvements in government systems, exacerbate the delays discussed above in IT projects, and does not ensure that procurement will be corruption-free. In yet another type of example, participatory processes in AAA may lead to bland recommendations, rather than conclusions flowing from evidence and technical analysis. In some such cases, seeking optimal quality may not be the best approach, where good enough is enough.

3.11 In summary, the Bank's increased PFM lending and analytical work can be linked with encouraging PFM improvements among borrowers, usefully adapting PFM tools from other jurisdictions, and carrying out effective monitoring with robust assessment tools accepted by major donors. However, Bank performance might have achieved greater success with deeper institutional and governance analysis, greater attention to addressing basic systems before moving to advanced PFM tools, and improvements in the Bank's procurement practices.

4. ANNEXES

ANNEX 1: MAPPING HIPC, PEFA, AND BUDGET TRANSPARENCY INDICATORS

	HIPC Indicators ²⁷	PEFA Indicators ²⁸	Open Budget Indicators ²⁹
Formulation	1. Composition of the budget entity	PI-8 dimension(iii) assesses central availability of fiscal information on sub-national government; PI-9 dim.(i) assesses fiscal reporting for autonomous agencies and public enterprises; PI-7 assesses coverage of fiscal reporting for Central Government operations;	Questions (Q) 1-2, 47-8, 101
	2. Limitations to use of off-budget transactions	PI-7 dim.(i) Level of extra-budgetary expenditure which is unreported	Q 35
	3. Reliability of budget as guide to outturn	PI-1 Aggregate expenditure out-turn compared to original approved budget PI-2 Composition of expenditure out-turn compared to original approved budget	Q 19-34, reporting on prior year's expenditure, revenue and debt
	4. Data on donor financing	PI-7 dim.(ii) Income/ expenditure information on donor-funded projects which is included in fiscal reports. D-2 Financial information provided by donors for budgeting and reporting on project and program aid	Q 44, 59
	5. Classification of budget transactions	PI-5 Classification of the budget	Q 3-4, 18
	6. Identification of poverty-reducing expenditure	Indirectly covered by PI-5.	Q55
	7. Quality of multiyear expenditure projections	PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	Q 5-6, 9-10, 49
		PI-3 Aggregate revenue out-turn compared to original approved budget	Q 19-34, 106 reporting on prior year's expenditure, revenue and debt
			Q 7-8, 45-6: revenue sources identified in budget, including tax expenditures and earmarked revenue
		PI-6, Comprehensiveness of information in budget documentation	Q 11-17
		PI-8, Transparency of Inter-Governmental Fiscal Relations	Q 36
		PI-11, Orderliness and participation in annual budget process	Q67-74
			Q50-54, non-financial data and performance indicators
Execution	8. Level of payment arrears	PI-4 Stock and monitoring of expenditure payment arrears	Q 41

²⁷ World Bank and IMF, 2003a.

²⁸ Source: World Bank 2007a., and PEFA Secretariat, 2005.

²⁹ Source: International Budget Project, 2005.

	9. Quality of internal audit	PI-18 Effectiveness of payroll controls PI-20 Effectiveness of internal controls for non-salary expenditure PI-21 Effectiveness of internal audit	
	10. Use of expenditure tracking surveys	PI-23 Availability of information on resources received by service delivery units	Q 84-6, 92-5 in-year expenditure reports (e.g. monthly, quarterly)
	11. Quality of fiscal/banking data reconciliation	PI-22 dim.(i) Regularity of bank reconciliations	
		PI-9, Oversight of aggregate fiscal risk from other public sector entities	Q 37-40
		PI-14, Effectiveness of measures for taxpayer registration and tax assessment	
		PI-15, Effectiveness in collection of tax payments	
		PI-16, Predictability in the availability of funds for commitment of expenditures	Q 97, executive consults legislature when shifting funds mid-year
			Q 99-100, rules on supplemental budgets
		PI-17, Recording and management of cash balances, debt and guarantees	Q 91 (debt), Q42-3, reporting on contingent liabilities
Reporting	12. Timeliness of internal budget reports	The subject impacts on, but is not directly covered by PI-24.	Q 84-6, 92-5 in-year expenditure reports (e.g. monthly, quarterly); Q 87-91, 96, in-year revenue reports
	13. Classification used for tracking poverty-reducing expenditures	Partly PI-24 dim.(i) Scope of in-year budget execution reports in terms of coverage and compatibility with budget estimates.	ditto
	14. Timeliness of accounts closure	Partly by PI-25 dim.(ii) Timeliness of submission of the financial statements	Q 101-114, also covering reporting on non-financial performance indicators
	15. Timeliness of final audited accounts	A combination of PI-25 dim.(ii) Timeliness of submission of the financial statements for external audit & PI-26 dim.(ii) Timeliness of submission of audit reports to the legislature.	Q115-118
		PI-10, public access to key fiscal information	Q58-66, 120-1
		PI-13, Transparency of taxpayer obligations	Q56-7
		PI-27, Legislative scrutiny of annual budget law	Q 75-83
		PI-28, Legislative scrutiny of external audit reports	Q 119, 122
Procurement	16. Effective procurement	PI-19 Competition, value for money and controls in procurement. PI-20 on internal controls also needed to assess procurement.	Q 98

ANNEX 2: ASSESSMENT INSTRUMENT COVERAGE OF PFM COMPONENTS

Figure 2: Assessment instrument coverage of the main components of public financial management

Component	PER	CFAA	CPAR	Fiscal ROSC	HIPC AAP	EC AUDIT
Legal framework for expenditure management						
Intergovernmental fiscal relations						
Relations between government and nongovernment entities						
Government structure						
Budget coverage						
Expenditure analysis						
Fiscal framework and expenditure programming						
Budget preparation						
Treasury systems, cash management, and expenditure monitoring						
Public procurement and management of physical assets						
Internal control and audit						
Accounting, reporting, and records management						
Debt and aid management						
External audit						
Personnel quality, capacity, incentives, and management						

Key: Level of coverage
 = Complete or substantial coverage
 = Partial or moderate coverage
 = Little or no coverage

Source: Allen et al, 2004.

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