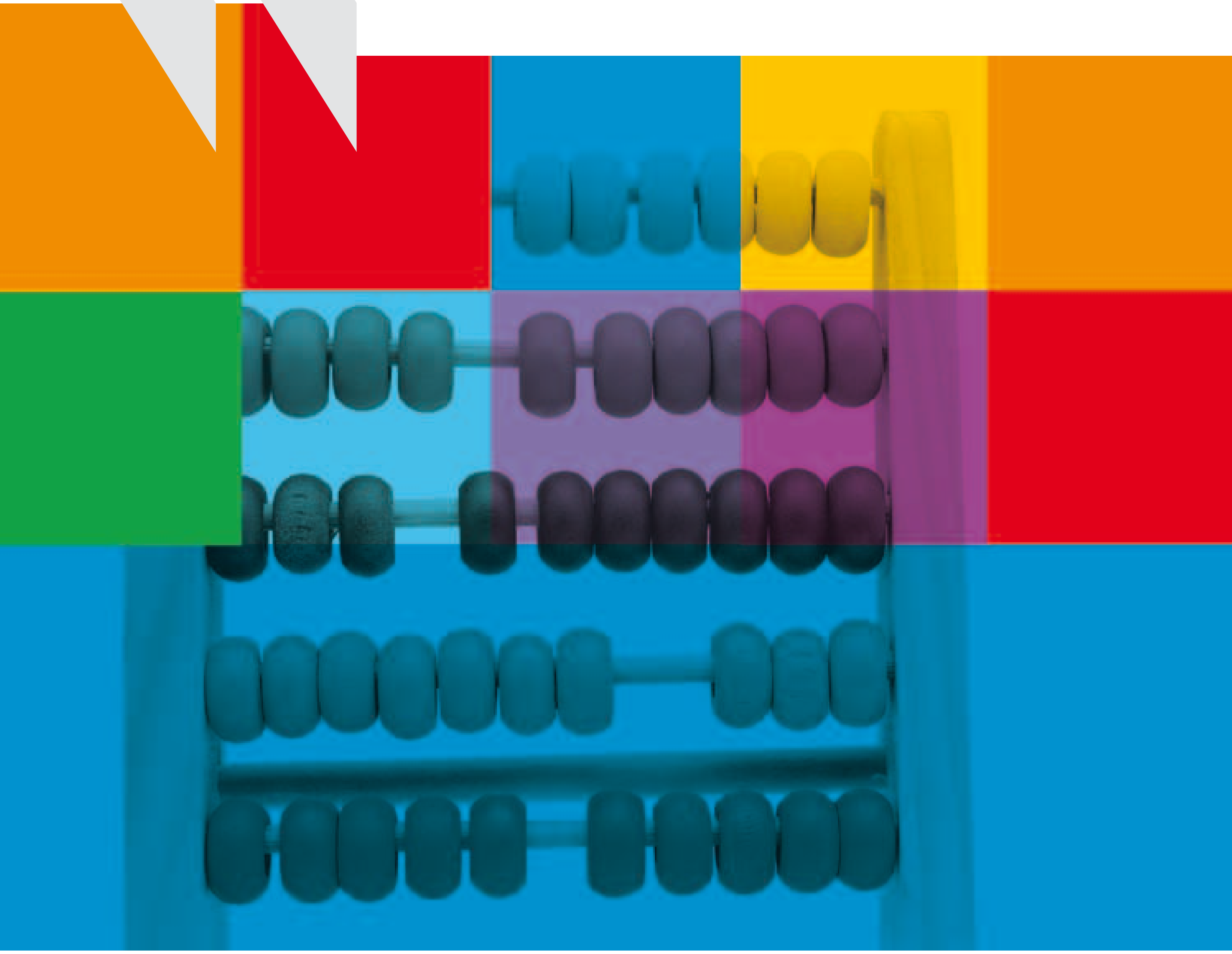
Better Aid

Managing Development Resources

THE USE OF COUNTRY SYSTEMS IN PUBLIC FINANCIAL MANAGEMENT



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Foreword

The development community has long understood that a robust public financial management (PFM) system is vital to a country's development efforts and to the effectiveness of the aid funds that support those efforts. Three years ago, the Paris Declaration on Aid Effectiveness gave new prominence to this idea, as partner countries committed to strengthen their PFM systems and donors committed to use those systems. Since then the OECD-DAC Joint Venture on Public Financial Management has been working in a range of areas to help partners and donors alike fulfil their commitments and reap the benefits of sound PFM systems.

Now, as the development community has renewed its commitments to aid effectiveness in the Accra Agenda for Action, this report takes stock of our achievements. We find that there has been progress: many countries and donors have taken positive action toward strengthening and using country PFM systems, and the Public Expenditure and Financial Accountability (PEFA) partnership has developed a performance measurement framework that can help countries determine where they need to concentrate their efforts. At the same time, the aggregate numbers on donors' use of country systems have not changed much; it is clear we still have much work to do. But as this report shows, many of the conditions on which that work must build are now in place, so there is good reason to expect that the Paris Declaration targets for 2010 can be achieved.

The report makes important recommendations for this work: partner countries need to take an enhanced role; donors need to better equip themselves to carry out their commitments; external accountability bodies (such as parliaments and civil society organisations) need to increase their demand for implementation of the Paris Declaration; and planning, communication, and dissemination and use of lessons learned are crucial. But perhaps the most important message of this report is that neither partner countries nor donors can do this work alone: now, as perhaps never before, they must strive to build mutual trust and work together in a true partnership for results.

In this spirit, we look forward to supporting the implementation of the Accra Agenda for Action and to meeting the challenges of greater aid effectiveness – together.

Riccardo Maggi
For the European Commission
Co-Chair of the Joint Venture on
Public Financial Management

Anthony Hegarty
For the World Bank
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Public Financial Management

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Riccardo Maggi and Sanjay Vani (World Bank) co-edited the report on the basis of contributions from Sara Fyson (OECD-DCD), Anthony Hegarty, Riccardo Maggi, Frans Ronsholt (PEFA Secretariat) and Sanjay Vani. Key contributions were received from Joint Venture members, particularly through the provision of case studies to support the conclusions in the report. Peer reviewers (James Brumby, Neil Cole, Bill Dorotinsky, John Muwanga, and Caroline Rickatson) provided valuable contributions and comments on previous iterations. Special thanks to Simon Mizrahi for his advice and to Patricia Rogers for her valuable editorial assistance.

The Joint Venture on PFM held a broad consultative meeting with partner countries and representatives from ministries of finance and supreme audit institutions on the Use of Country Public Financial Management on 27 May 2008. The meeting was hosted by the South African Treasury and the Collaborative Africa Budget Reform Initiative (CABRI) based in Pretoria. The meeting provided an opportunity for participants to share experiences in the use of country PFM systems between partner countries and between partners and donors, and to validate the key messages from the report on the Use of Country Systems in Public Financial Management. Special thanks to Neil Cole (South African Treasury) and Aarti Shah (CABRI) for hosting the meeting.

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Executive Summary

Successful development depends in large on the efficiency, integrity, and effectiveness with which the state raises, manages, and expends public resources. Therefore, improving the formal and informal rules and institutions that govern these activities, and strengthening the related human and technological capacities, should be a major component of any development approach. Improved Public Financial Management (PFM) is at the core of good governance and lies at the heart of the Millennium Development Goals. For this reason, in the 2005 Paris Declaration, partner countries committed to strengthen their national PFM systems, and donors committed to use those systems to the maximum extent possible. Both partners and donors agreed to accelerate and deepen these commitments during the Third High Level Forum on Aid Effectiveness held in Accra, Ghana in September 2008.

Purpose of the Report

This report reviews the progress on the Paris Declaration commitments and outlines the Joint Venture on PFM's recommendations which were a key input into the discussions at the Third High Level Forum on Aid Effectiveness and which are intended to facilitate increasing implementation toward the 2010 targets set out in the Paris Declaration and the Accra Agenda for Action (see annexes IV and V).

Progress in Strengthening and Using Country PFM Systems

In the past few years, many countries – with the support of donors – have taken steps to strengthen their PFM systems. Meanwhile, in a collaborative international effort, the Public Expenditure and Financial Accountability[1] (PEFA) initiative has developed a robust tool for measuring PFM performance and providing sound assessments of the quality of PFM systems for countries at all income levels.[2] This information is underpinning the efforts of partner countries and donors to shift from diagnosis to implementation, build country PFM capacity, and accelerate the work on strengthening country PFM systems. Over time, the PEFA assessment will provide a basis for judging progress in strengthening PFM systems.

Use of Country PFM Systems

Results from the 2008 Survey on Monitoring the Paris Declaration suggest some overall progress in the use of PFM systems since 2006, but this is well short of the rate of change required to meet the 2010 targets. While the picture varies from country to country, only a 3 percent improvement has been recorded in the aggregate (from 40% to 43%), with almost no change in country averages. At the same time, in 2008, 12 countries (of the 33 that undertook both the 2006 and 2008 Surveys) have seen progress in the quality of their country systems. This suggests that much remains to be done, building upon the many necessary elements that are now in place. The report examines important aspects of this work.

Overview of the Report

The report sets out the reasons for using country PFM systems: such use helps to improve and strengthen the systems themselves, so that they are better able to manage all the public resources available to the country. In addition, it increases alignment, reduces costs, supports sound budgeting and financial management, facilitates harmonisation, and enhances the sustainability of results. However, it also entails risks to donors as well as partner countries alike. As the report explains, many factors can affect a donor's decisions to use a country's PFM system besides expected benefits: the assessed quality of the system; the donor's legal framework, historic practices, or tolerance for risks; the partner country's own preferences; and related intangibles such as the perception of corruption or poor governance. The report describes the PEFA PFM Performance Measurement Framework and its usefulness as a diagnostic and monitoring tool. Finally, it describes and discusses what the development community has learned about how to strengthen country PFM systems when weaknesses have been diagnosed – from enforcing and implementing laws and regulations that are already adequate, to developing a country-led strategy carried out with co-ordinated donor support, prioritising and sequencing reforms, integrating them with public sector reforms, consulting widely and involving all stakeholders, and giving attention to the important political dimensions of reform.

Recommendations

Chapters 3, 4 and 5 of the report contain a number of recommendations designed to promote better practice in the specific area discussed in that chapter. In addition, the next section of this executive summary provides a set of broader, overarching recommendations, designed to deepen and accelerate the work on strengthening and using country PFM systems.

Key Messages

One of the most important messages for the development community is that a strengthened PFM system is not an end in itself; it is necessary – but not sufficient – for solid development impact. It needs to be linked to results and improved service delivery. A second important consideration is that this work takes time: it is not easy to change laws, regulations, institutions, practices, habits, and mindsets, and build capacity for new ways of doing things. Progress may sometimes take the form of incremental steps; but with continued attention by partner countries and support by donors, those steps will make a difference. And third, although this paper does not deal with issues of procurement, a country's procurement is part of the PFM system, and the quality of one affects the quality of the other. Any work on the larger PFM system needs to take procurement into account. Bearing these points in mind, this paper offers five broad recommendations to accelerate and deepen work on strengthening and using country PFM systems.

Partner countries should take an enhanced role in work on country PFM systems

It is each country's responsibility to take leadership of its development processes: assessing the PFM system, developing a credible strategy for PFM reform, linking it with the overall aid management strategy, and prioritising and implementing reforms. In addition, countries need to create an enabling environment for the use of their PFM systems by addressing such related areas as governance, corruption, and procurement.

Donors should better equip themselves to carry out their commitments related to using country PFM systems

Donors must serve as countries' true partners in this work, supporting countries' efforts to strengthen their PFM systems by aligning their interventions with the countries' own strategies. Furthermore, they should adopt internal measures and incentives that will enhance their ability to fulfil their Paris Declaration commitments to use countries' PFM systems and decrease their use of parallel project implementation units. For example, they should make their default arrangement the use of country PFM systems when circumstances permit, requiring staff to transparently explain any proposal to *not* use such systems; similarly, they should require staff either to refrain from creating a parallel project implementation unit or to explicitly justify its need. They should provide better guidance and training to give staff an understanding of the benefits of using country systems, the appropriate use of country systems in various aid modalities and various country circumstances (including fragile situations), and the appropriate assessment and management of the risks of using country systems. Management needs to guide staff in balancing the risks and benefits of using country PFM systems, and support those staff in taking decisions involving the use of country PFM systems.

Partner countries and donors need to work together to operationalise this agenda at the country level

While the international community and donor headquarters have a role to play in this agenda, it is at the country level that the real progress must be made. This is where country and donor staff need to work together in partnership by forming country PFM teams, developing mutual trust, establishing realistic goals, choosing aid modalities that promote sound budgeting and an integrated approach, and showing that they are delivering on their commitments.

The development community should develop a multi-year programme of PFM diagnostics and increase its reliance on the emerging lessons

In order to better monitor the progress of ongoing PFM reforms, it is important that partner countries, with donors' support, develop a multi-year programme PFM diagnostics, with the PEFA framework as its core assessment and monitoring tool. All parties should disclose diagnostic and monitoring information in an open and transparent way. The development community as a whole should encourage and promote South-South learning mechanisms; and the OECD-DAC Joint Venture on Public Financial Management should identify and disseminate lessons learned from work on country PFM systems.

There is a need for better communication at all levels

Partner countries and donors should work internally and within their external accountability bodies to strengthen the demand for implementation of the Paris

Declaration. At the country level, in particular, they need to collaborate in strengthening the role of supreme audit institutions, parliaments and public accounts committees, and civil society organisations. In addition, all parties should give greater attention to enhancing communications – within donor and partner organisations, among donors, between donors and partners, and with stakeholders. In this context, providing partners with regular and timely information on donors' annual and multi-annual aid flows and activities appears to be a crucial task to underpin sound planning and budgeting as well as to allow partner governments to be fully accountable to their parliaments and citizens on the use of domestic and external development resources.[3]

Conclusion

There is no easy road to strengthening and using country PFM systems. As this report discusses, systems are as varied as their countries' histories, cultures, and institutions; and donors bring a range of mandates, histories, and procedures to the effort. However, there have been some notable successes in recent years, as partner countries and donors strive to achieve their Paris Declaration commitments; and many important elements have been put in place on which to build in the coming months and years. It is hoped that the analysis and recommendations in this report will provide the impetus to further this work toward enhanced partnership for greater development impact.

Notes

1. PEFA is a partnership of the World Bank, the European Commission, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa. PEFA aims to support integrated and harmonised approaches to assessment and reform in the field of public expenditure, procurement and financial accountability.
2. In spearheading this effort, the PEFA programme has closely consulted and co-ordinated with the Joint Venture on Public Financial Management.
3. The Paris Declaration calls on donors to use country systems to the maximum extent possible. The Survey on Monitoring the Paris Declaration focuses on the use of partners' public financial management (PFM) systems when funding is provided to the government sector – that is, when ODA is disbursed in the context of an agreement with administrations (ministries, departments, agencies or municipalities) authorised to receive revenue or undertake expenditures on behalf of central government. This includes works, goods or services delegated or subcontracted by these administrations to other entities such as non-governmental organisations (NGOs), semi-autonomous government agencies (*e.g.* parastatals), or private companies.

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Chapter 1

Background, Definitions and Scope of the Report

Improved public financial management (PFM) is at the very core of good governance. Recognising this fact, the Paris Declaration in 2005 and the Accra Agenda for Action in 2008, committed partner countries to strengthen their national PFM systems and donors to use these systems to the maximum extent possible. This chapter introduces the concept of Using Country Systems in PFM as defined in the Paris Declaration (2005) and the Accra Agenda for Action (2008).

Introduction

Successful development depends in large part on the efficiency, integrity, and effectiveness with which the state raises, manages, and expends public resources. Therefore, improving the formal and informal rules and institutions that govern these activities, and strengthening the related human and technological capacities, should be a major component of any development approach. Improved Public Financial Management (PFM) is at the core of good governance and lies at the heart of the Millennium Development Goals (MDGs). Recognising this, in the 2005 Paris Declaration, partner countries committed to strengthen their national PFM systems, and donors committed to use those systems to the maximum extent possible (Box 1.1).

Box 1.1. **The Paris Declaration and the Use of Country PFM Systems**

In March 2005, participants at the Paris High-Level Forum – ministers of developed and developing countries and heads of multilateral and bilateral development institutions – resolved to take far-reaching and monitorable actions to reform the ways aid is delivered and managed. This resolution is now known as the Paris Declaration. In the Paris Declaration, partner countries committed to carry out diagnostic reviews that provide reliable assessments of country systems and procedures and undertake reforms that are necessary to ensure that national systems, institutions, and procedures for managing development resources are effective, accountable, and transparent. Donors committed to use country systems and procedures to the maximum extent possible. The Paris Declaration included a set of performance indicators to measure the progress made in implementing the commitments, setting the following targets to be achieved by 2010:

- Halve the proportion of aid flows to the government sector not reported on government's budget(s) (with at least 85% reported on budget) (Indicator 3).
- All donors use country PFM systems for partner countries with a score of 5+ on the PFM/CPIA, and 90% of donors use country PFM systems for partner countries with a score of 3.5-4.5 on the PFM/CPIA (Indicator 5a for use of country PFM systems and 2a for reliability of those systems).
- A two-thirds reduction in the percentage of aid to the public sector not using the country's PFM system for partner countries scoring 5+ on the PFM/CPIA, and a one-third reduction in the percentage of aid to the public sector not using the country's PFM system for partner countries scoring between 3.5 and 4.5 on the PFM/CPIA (Indicator 5a and 2a as above).

Objectives of this Report

Following the Accra High Level Forum, this report focuses on progress toward meeting the international community commitments relating to the use of country PFM systems. It provides analysis and recommendations to facilitate increasing implementation toward

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the 2010 targets set out in the Paris Declaration and in the Accra Agenda for Action (see Annexes IV and V). This report draws on a variety of sources, but it mainly reflects the work carried out under the auspices of the OECD-DAC Joint Venture on Public Financial Management.[1]

Definition of Public Financial Management (PFM)

Although the exact definition of Public Financial Management (PFM) may differ from donor to donor or from one partner country to another, PFM, as generally understood, includes all components of a country's budget process – both upstream (including strategic planning, medium-term expenditure framework, annual budgeting) and downstream (including revenue management, procurement, control, accounting, reporting, monitoring and evaluation, audit and oversight). Sound PFM supports aggregate control, prioritisation, accountability and efficiency in the management of public resources and delivery of services, which are critical to the achievement of public policy objectives such as the MDGs.

Definition of "Use of Country PFM Systems"

Before examining progress on the Paris commitments, it is helpful to understand what it means to "use country PFM systems." As the above definition shows, PFM systems cover the entire budget cycle from strategic planning to oversight. Accordingly, use of country PFM systems means using components of the PFM system in donor-financed activities.

Paris Declaration

For the purpose of this report, the key reference point for the operational definition of use of country PFM system is that provided by the Paris Declaration on Aid Effectiveness. This sets out the broad parameters of country PFM systems as follows: "Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management, accounting, auditing, procurement, results frameworks and monitoring" (para. 17). The guidance for the 2006 and 2008 Surveys on Monitoring the Paris Declaration outlines the definition for using a country's PFM system in more detail: using "national systems for the management of funds … established in the general legislation (and related regulations) of the country and implemented by the line management functions of the government." Indicator 5a, for the purpose of monitoring, singles out three main components relating to donors' use of country PFM systems:

- ***Budget execution.*** The funds donors provide are managed according to the national budgeting procedures established in the general legislation and implemented by the government; programmes supported by donors are subject to normal procedures for authorisation, approval, and payment.
- ***National financial reporting.*** Donors do not impose additional requirements on governments: in particular, they do not require the maintenance of a separate accounting system to satisfy their reporting requirements, or the creation of a separate chart of accounts to record their funds.
- ***National auditing requirements.*** Donors do not make additional requirements on government for auditing (except for exceptional audits) but rely instead on the audit opinions issued by the country's supreme audit institution and on the government's normal financial reports and statements.

The guidance provided for Indicator 5a does not include all components of the PFM system (as defined in section II above). However, it draws attention to those components whose use involves the core of a country PFM system. In addition, complementary indicators focus on other components of a country PFM system: Indicator 3, for instance, explicitly measures how much aid is "on budget"; indicator 5b refers to using procurement systems; and indicator 9 highlights the percentage of aid flows that are counted as programme-based approaches (many of which imply the use of country systems).

More generally, it is important to stress the relevance of timely and accurate information from donors concerning aid flows. Regardless of the actual use of downstream country PFM systems, timely and accurate information is required for the sound working of upstream PFM systems, *i.e.* planning and budgeting. Providing partners with regular and timely information on donors' annual and multi-annual aid flows and activities is therefore important to underpin sound planning and budgeting as well as to allow partner governments to be fully accountable to their parliaments and citizens on the use of domestic and external development resources.

Other Typologies

While the preceding paragraphs explain the focus of the Paris Declaration monitoring indicators, it is important to understand that PFM systems are multi-dimensional and that other reference frameworks are possible. Thus, for instance, a recent Collaborative Africa Budget Reform Initiative (CABRI) study[2] looks at how aid can be captured in eight different stages of the budget cycle (a mapping with existing indicators of use of country systems is provided in Annex I). In addition, donors may include additional components of a country's PFM system in their own typologies for the use of country systems (see Chapter 4). Thus, when assessing progress on the Paris commitments, it is important to factor in differences in the way donors construe the use of country PFM systems.

Scope and Structure of the Report

Although country procurement is part of the PFM system, the Paris Declaration distinguishes between PFM and procurement systems. Accordingly, work on procurement systems is carried out under the OECD-DAC Joint Venture on Procurement, and this report does not deal with issues of procurement. It is important to bear in mind, however, that the two areas are closely related, and work on the larger PFM system needs to take procurement into account.[3]

This report is structured as follows: following this introductory chapter, Chapter 2 explains the rationale for using country systems and reviews progress in meeting the Paris Declaration targets. Chapter 3 reviews the landscape of PFM reforms in partner countries and examines drivers of successful PFM reforms. Chapter 4 examines the factors that influence decisions to use country PFM systems, focusing on the perceived risks and their assessment and management. Chapter 5 describes the PEFA assessment, which provides information on the quality of a country's PFM system.

Notes

1. This report complements the DAC Guidelines and Reference Series publication entitled *Harmonising Donor Practices for Effective Aid Delivery*, Vol. 2 (OECD, 2005), a publication of the Joint Venture on PFM that examined how donors should support, rather than substitute for, national development efforts to strengthen PFM systems. Arguing that the delivery of aid through partner PFM systems should be at the core of donor support strategies, this volume provided a set of good practices for two particularly relevant aid modalities (budget support and support to sector-wide approaches), as well as guidance on how best to support capacity development for PFM.
2. Mokoro Ltd. (2008), *Putting Aid on Budget, Synthesis Report*, April 2008, Oxford. This study, financed by DFID, was commissioned by the Collaborative Africa Budget Reform Initiative (CABRI) in collaboration with the Strategic Partnership with Africa (SPA).
3. The report does not address in detail PFM issues at the sectoral or decentralised level.

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Chapter 2

Aid Effectiveness and the Use of Country PFM Systems: Rationale and Findings

Significant benefits arise from the use of country systems. These include: increasing alignment; focussing on common goals; supporting sound budgeting and financial management; enhancing the sustainability of results; reducing costs for partner countries; and facilitating harmonisation between donors. This chapter describes how different aid modalities support or hinder the use of country systems and highlights the evidence so far on the use and strengthening of country PFM systems.

Introduction

Donors have a responsibility to ensure that the resources they provide are used for the intended purposes. To fulfil that responsibility, they have often insulated their projects from partner countries' weak PFM systems by imposing their own financial management requirements and systems. The result was that, even if a project was implemented efficiently, the country's PFM system did not benefit and was in no better position to manage all other resources available to the country. So development, in its larger sense, was not well served. However, over the last decade the international community has come to understand that country systems, like muscles, must be exercised if they are to grow stronger. It is this realisation that led to the commitments in Paris to strengthen and use country PFM systems.

Strengthening and using country systems, therefore, is an essential component in development effectiveness.[1] Improving country systems is primarily the responsibility of partner countries, but it is the donors' job to support these efforts in an effective way. This chapter describes many of the benefits of using country PFM systems and summarises the findings on the actual use of country PFM systems from the 2008 Survey on Monitoring the Paris Declaration.[2]

Rationale for Using Country PFM Systems

When donors use a country's own PFM systems, they not only contribute to strengthening them, but they also enhance the country's sense of ownership of its development path and process, and they reflect their own respect for the country's institutions and traditions. The benefits can also go beyond PFM issues to bring a range of other gains:

- ***Increasing alignment.*** By using a country's PFM system, donors are better able to align their programmes with the country's priorities and with its policymaking and policy implementation processes. This increases the sustainability and long-term effectiveness of donor-funded initiatives.
- ***Focusing on common goals.*** Using a country's PFM system aligns donors' incentives with those of the country. In particular, the donor no longer addresses fiduciary concerns about the resources it provides principally by ring-fencing projects, but by helping to strengthening the country's PFM system. Thus both the partner country and the donor have a reason to focus on the appropriateness of the country's PFM practices, the need to ensure successful reform, and the country's capacity to implement improved practices and, ultimately, to design and implement effective policies.[3] This increased alignment in incentives can form the basis of programmes to enhance the partner country's institutional capacity and close the gap between policy and actual practice.
- ***Supporting sound budgeting and financial management.***[4] For sound budgeting and financial management, budgets must be based on as broad a set of information as possible and must be comprehensive and transparent. Failure to capture aid yields only

a partial view of the resource picture, affects the efficiency with which domestic resources are allocated, can lead to unsustainable patterns of expenditure, and means that decision-makers cannot be held fully accountable for all development resources. Therefore, donors and partner countries have a shared interest in combining aid effectively with domestic resources.

- ***Enhancing the sustainability of results.*** To ensure the efficiency, quality, and timeliness of aid interventions, donors often set up parallel project implementation units (PIUs), which may even be outside the control of the relevant government ministry. Thus the work of the parallel PIU does nothing to strengthen the ministry; and when the project is complete and the PIU is disbanded, the project results may not be sustained. Many donors have concluded that their aid interventions could have a broader impact, well beyond the activities they fund directly, if they more systematically strengthened the country's systems and practices used for all government expenditures.
- ***Reducing costs.*** Donor-specific requirements can place overwhelming demands on partner countries' scarce human and technological resources. Partner countries can realise substantial savings if donors use country systems instead of requiring countries to build and maintain parallel structures to satisfy donors' own requirements. In addition, by using countries' PFM systems rather than designing and contributing to the operation of parallel structures, donors, too, may save resources.
- ***Facilitating harmonisation.*** Donors, understanding that by imposing different system requirements they risk overwhelming the capacity of partner countries, are working to harmonise their requirements. Strengthened country PFM systems constitute a solid basis for such harmonisation.[5]

Aid Modalities and the Use of Country PFM Systems

All aid modalities can use country PFM systems (in part or in their entirety). However, because different aid instruments have different aims and allow recipients a different degree of discretion in using the resources provided, some instruments use country PFM systems more readily than others. For instance, budget support finances the overall budget, leaving the partner country discretion over the use of resources provided: funds are managed according to the recipient's budgetary procedures. Thus, by definition, budget support uses the country's PFM system. By contrast, project aid finances identified activities with identified resources to achieve identified results – a modality that often relies much less on the country's PFM system.

Donors may decide to use only part of a country's PFM system as one way to make progress toward full use of that system. They need to remember, however, that such partial use cannot achieve the full benefits outlined above.[6] For instance, partial use is less likely to increase alignment, and certain basket funds arrangements may provide considerable benefits in terms of harmonisation, but fewer in terms of changed incentives and sustainability of results. Even budget support (the aid modality that makes the fullest use of country PFM systems) may not be fully aligned to the country budgeting process – for example, when disbursement decisions are communicated too late to be factored into the budgeting process (or when volatility in disbursements and/or relatively short committed horizons limit the integration of budget support into medium-term policy frameworks). Therefore, the extent of a donor's use of a country's systems is affected both by the choice of aid modality and the design of the specific instrument.

Findings on the Use of Country PFM Systems

The 2008 Survey on Monitoring the Paris Declaration provides the latest data on the use and strengthening of country PFM systems. As noted above, the Paris Declaration monitors use of country PFM systems around three separate components: budget execution, national financial reporting, and national auditing requirements (procurement is not discussed in this report but is measured under indicator 5b in the Survey on Monitoring the Paris Declaration).

The quality of a country's PFM system is measured through indicator 2a which is derived from the World Bank's Country Policy and Institutional Assessment (CPIA).[7] The Paris Declaration sets out a target for 2010 in relation to the quality of PFM systems: half of all partner countries must move up at least one measure (0.5 percent) on the scale of performance as defined by CPIA. The 2008 Survey results show that for 42 countries, 7 scored below 3.0; 23 scored between 3.0 and 4.0; and 12 scored 4.0 or above. For some countries, therefore, real progress needs to be made in strengthening PFM systems. However, although 68% of all countries made no progress at all on the quality of their PFM systems, 36% did improve the quality of their PFM systems by at least one measure.[8] Progress on the quality of country systems, therefore, is mixed: some countries have clearly geared up and reached the targets, whilst others have not progressed and the quality of their PFM systems remains the same. The results point to the lengthy and complex nature of PFM reforms, which cannot be improved overnight (as is further discussed in Chapter 3).

Use of country systems is measured by indicator 5a (see Box 1.1 and Section III of the preceding chapter for a discussion). Findings show some substantial progress in a few countries which, in several cases (Kenya, Moldova, Peru, Vietnam and Zambia), is validated by the country qualitative assessments. In Peru, for instance, progress on the use of country PFM systems is attributed to increased alignment between aid and the *Sistema Nacional de Inversión Pública* (a recommendation from the 2006 Survey report). Others have gained from donors' increased use of budget support. However, at the aggregate level, the results show that there is only a modest improvement, as weighted averages improve by little over three percentage points and country averages barely improve at all.[9]

Evidence on the relationship between increased use of country PFM systems and the improved quality of those systems is mixed. For some countries, an improvement of country PFM systems (CPIA score from 3 to 3.5 in Zambia) may be linked to the increase in the use of country PFM systems (an increase of 25% in Zambia's case). But in others, the reverse is true (in Ghana an increase from 3.5 to 4.0 in the quality of PFM systems has been accompanied by a 11% decrease in the use of country PFM systems). As the 2008 Survey noted, the findings suggest that the slow progress is not entirely due to the slowness of improvement in country systems. Donors are continuing to make choices about when to use or not use country systems on other grounds, including their own modality preferences, headquarters policies, and organisational incentives.

In this regard, the Survey results indicate that while budget support trends influence the overall use of country systems, there are also signs of increased use of country PFM systems in other aid modalities. The 2008 survey indicates that in some countries the use of country systems continues to be restricted to budget support operations. In Rwanda, for instance, the use of PFM systems has increased from 39% to 42%, mainly on the basis of wider use of direct budget support. However, an analysis of the data underpinning

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indicators 5a and 9 shows that the proportion of non-budget support aid reported as using country systems has increased from 20% to 26%, largely because of increased reliance on country national financial reporting and auditing requirements.

Finally, indicator 3 offers a useful perspective on the extent to which aid is captured by the national budget.[10] As the 2008 Survey noted, aid is more conducive to country ownership when it is well integrated with the main instrument by which the country allocates its own resources – the national budget. In 2007, donors scheduled USD 27.5bn for disbursement to countries that participated in both surveys, while governments report USD 22bn as captured in the budget. The numbers are similar to those reported for the 2005 sample (USD 21bn v. USD 17bn). This suggests that there has not been any substantial movement towards greater aid capture by budgets: on aggregate, it remains in the region of 88-89%. The lack of progress in budget realism, therefore, points to the need for further advances in provision of timely reliable information by donors, reduced volatility of aid, and strengthened incentives for budget authorities to capture aid flows appropriately.

Conclusion

Although aggregate figures mask different developments at country level, there has been no significant progress towards the achievement of the Paris Declaration targets relating to the strengthening and the use of country PFM systems. Any improvements tend to be modest. Even when recognising that it may be too early to expect a comprehensive pattern of change to emerge, given the complexity of PFM reforms and donor practices that are linked to agreements that take several years to take effect, a much greater effort is required from both donors and partners to strengthen and use country systems in a way that would allow all potential benefits to be achieved. The next two chapters aim to provide some useful insights to support such complementary efforts.

Notes

1. A strengthened PFM system is necessary, but not sufficient, for development effectiveness: sound PFM systems need to be linked to results and improved service delivery.
2. OECD-DAC (2008), *2008 Survey on Monitoring the Paris Declaration*, Overview Report, Better Aid, OECD, Paris.
3. Conversely, the use of donor-specific channels of delivery undermines the strengthening of country PFM systems by focusing all parties' attention on the effectiveness, integrity, and efficiency of the use of the donor's resources rather than of all resources that are available for development.
4. This discussion draws the CABRI supported study, *Putting Aid on Budget*, Mokoro Ltd (2008) Putting Aid on Budget, Synthesis Report, April 2008, Oxford.
5. Donors' use of country systems may also be a signal to private investors with regard to the quality of such systems, thus facilitating capital flows to the countries, states, or municipalities concerned. This might be particularly relevant for middle-income countries that have greater access to international capital markets.
6. This, however, should not be interpreted as implying the superiority of one aid modality over others; it is not the purpose of this paper to advocate one modality over another. The point is simply that the choice of aid modalities can have consequences on the extent of use of country PFM systems and on the specific benefits arising from such use (as opposed to all the other benefits arising from the intervention in question).
7. Quality scores for procurement systems have been provided for the first time in the 2008 Survey for 16 countries that participated in a co-ordinated self-assessment exercise.

8. Scores were available for 41 countries (out of a total of 54 that participated in the 2008 Survey). CPIA scores are available only for IDA countries.
9. It is important to note that the aggregate level or country average level could belie progress in using some components of the country PFM system because of the way averages are calculated.
10. This includes donor reports on scheduled and disbursed aid to the government sector, and government reports on aid included in the budget estimates (at the beginning of the fiscal year) and in the government accounts (at the end of the fiscal year).

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Managing Development Resources
The Use of Country Systems in Public Financial Management

Chapter 3

Strengthening Country PFM Systems

In both the Paris Declaration and the Accra Agenda for Action, partner countries committed to assess and reform their national systems for managing development resources to ensure that these are effective, accountable and transparent. This chapter outlines the PFM reform trends in partner countries before turning to the key drivers of successful PFM reforms. The role of the political economy in PFM reform is crucial: without grounding these reforms in political reality, they are unlikely to be sustainable or achieve the desired results. Finally, a communication strategy for PFM reform is necessary if the reforms and their outcomes are to be communicated both across government and to external stakeholders. The chapter ends by summarising key recommendations for both donors and partner countries for ensuring successful implementation of PFM reforms.

Introduction

In the Paris Declaration, partner countries committed to assess their systems and procedures and undertake reforms to ensure that their national systems, institutions, and procedures for managing development resources are effective, accountable, and transparent. Donors committed to use strengthened country systems to the maximum extent possible and, when such use is not feasible, to ensure that additional safeguards and measures strengthen rather than undermine country systems. This chapter reviews the trajectory of PFM reforms in partner countries and examines lessons learned over the past decade in implementing PFM reforms. These are drawn from the case studies discussed by the OECD DAC Joint Venture on PFM,[1] the World Bank Independent Evaluation Group's report "Public Sector Reform Evaluation", and other reports. This report is not based on a separate detailed research study to collect and analyse evidence for factors determining the success or failure of PFM reforms; rather, it complements good practices in capacity development previously identified by the Joint Venture.[2] Looking forward, the Joint Venture may consider commissioning further research in documenting the impact of various factors on the success or failure of PFM reforms in countries.

Trajectory of PFM Reforms in Partner Countries

Until the introduction of the Heavily Indebted Poor Country (HIPC) indicators and, more recently, the PEFA indicators, there was no way to objectively and consistently measure partner countries' progress in PFM performance. The PEFA indicators, though more robust and objective than the HIPC indicators, have been in use for under three years; thus there is not yet a critical mass of repeat assessments on which to base a trend analysis in PFM performance in a broad spectrum of countries. This underlines the importance of ensuring widespread and repeated application of the PEFA monitoring framework in the years to come. For now, however, this section briefly presents the information that is currently available.

Trends in HIPC Countries

The only objective data that measure PFM performance over a period of time are from the HIPC indicator assessments. As these data cover only HIPC countries, it would be inappropriate to draw generalised conclusions from them. In 2005 a World Bank-IMF paper[3] reported that over the period 2001-04, the total number of benchmarks met by the entire sample of 23 HIPC countries increased by 10 percent – from 137 to 150 – while the average number of benchmarks met per country increased marginally. In 2004, four countries met nine or more benchmarks, compared to only one country in 2001. However, analysis of data over a longer time horizon (2001-06) but with a smaller sample size of 15 countries reveals limited progress in PFM performance (see Figure 3.1).[4] Moreover, the average masks uneven progress among the countries: some countries (*e.g.* Burkina Faso, Ghana, Guyana, Tanzania, and Zambia) made more progress than others (*e.g.* Mali, Benin,

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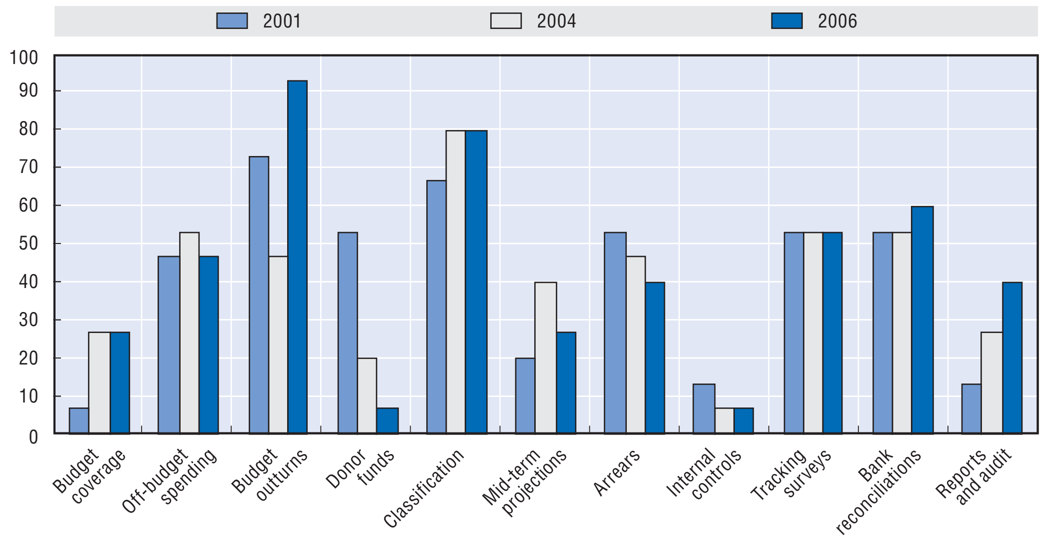
and São Tomé and Principe). The results of HIPC Assessments indicate that many countries achieved better results in the area of budget formulation than in the more difficult areas of budget execution, monitoring, and audit.

Figure 3.1. **Percentage of Benchmarks met by HIPC Indicators (2001-06)**



Regional Comparison Based on PEFA Scores

A comparison of PEFA scores for a number of countries reveals that Eastern European and Latin American countries have, in general, better PFM performance. Differences among budget dimensions are highest for Eastern Europe and Latin American countries, while they are lower in the Middle East and North Africa (MNA) – where, in fact, the dimensions of *policy-based budgeting* and *predictability and control in budget execution* receive the highest scores. In respect of the *external scrutiny and audit* dimension, Africa Region scores better than other Regions (except MNA). This comparison also suggests that countries with a higher level of income perform better in terms of the quality of their PFM systems.[5]

PFM Reforms in the Regional Context

The Central and Eastern European countries joining the European Union (EU) undertook major PFM reforms – including in the areas of internal controls and internal and external audit – to meet the requirements of the EU *acquis communautaire*. Similarly, countries forming the West African Economic and Monetary Union are spearheading efforts to establish a customs union, harmonise public financial management procedures, and monitor such key macroeconomic convergence criteria as fiscal deficits, inflation, public sector wages, and government arrears.

PFM Reforms in Response to Pressures

Over the past decade, internal crisis and outside pulls have been a major impetus for countries' overall improvement of policies. For example, the 1998 financial crisis, the EU accession requirements for the Central and Eastern European countries, and the HIPC initiative presented significant opportunities for commencing major policy reforms in the public sector, offering the prospects of gains over and beyond those directly linked to a strengthened PFM system.[6]

Key Drivers of Successful PFM Reforms

Although we do not yet have a sufficient mass of objective and consistent data to quantify in-country and cross-country improvements in countries' PFM environments, past experience, including case studies presented at the JV meetings, has pointed to a number of factors that are key to successful PFM reform. In discussing these factors, it is important to remember that countries that are emerging from conflicts or have suffered major disasters face special challenges in strengthening their PFM systems.[7]

Country-led Strategy, co-ordinated Donor Support

The Strengthened Approach developed as part of the PEFA Framework[8] and incorporated in the OECD/DAC Guidelines on Harmonising Donor Practices for Effective Aid Delivery embodies two of the most important drivers of successful PFM reforms – a country-led PFM reform strategy and action plan, and a co-ordinated multi-year programme of donor support aligned with that strategy and action plan.

Country Ownership

Country ownership and leadership are critical to success.[9] Even when external pressures or internal crisis are the main triggers PFM reforms, the starting point for real reform must be a country-owned response to such pressure in the form of a programme of reform and a country-owned structure for managing the reform process. For example, in Ethiopia, the challenge of weak capacity has moved to the forefront of the development agenda of the government. The government has created a Ministry of Capacity Building and has made capacity building a central focus in its poverty reduction strategy. In Afghanistan, the government has initiated major reforms in a challenging environment (Box 3.1).

Box 3.1. **Afghanistan: Government-Led PFM Reforms**

The government of Afghanistan initiated a reform programme outlined in the Afghanistan National Development Strategy. For example, the Budget Department in the Ministry of Finance spearheaded reforms by tightening the linkage between budget formulation and prioritisation, and expenditure accountability. It introduced a nine-month budget calendar facilitating orderly budget formulation, an improved budget classification system, and a medium-term budget framework. A recently published Public Expenditure and Financial Accountability (PEFA) report has confirmed the success of the reform programme: 18 out of 28 indicators showed substantial improvement since the previous PEFA report of April 2005, 8 indicators remained unchanged, and only 2 indicators deteriorated. In brief, budget credibility, comprehensiveness, and transparency improved significantly after the initiation of the reform programme.

With improved PFM systems, the Afghanistan authorities expect more than the current 42 % of aid to be channelled through the country Single Treasury Account (STA) Foreign aid that is not disbursed through the STA is presented in the external budget, which is submitted to Parliament, together with the core STA-financed budget for information.

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The literature on PFM is replete with stories of failed reforms that were driven by donors rather than led by the country; such reforms may initially appear to be successful, but they are unlikely to be sustained and, in the worst cases, may be reversed after the withdrawal of donor support. In Ghana, two comprehensive World Bank projects (in Public Financial Management and public sector reform) failed, because of a mismatch between country ownership of the programmes and their ambitiousness.[10] (Box 3.2 illustrates Ghana's experience.)

Box 3.2. **Lessons from Ghana**

Ghana embarked on a broad PFM reform programme (PUFMARP) in 1997 designed around nine components (including budget preparation, budget implementation, accounting, cash management, aid and debt management, revenue, procurement, and auditing). A comprehensive IT-based Integrated Financial Management Information System (IFMIS) was launched as part of this programme, but by 2004, the implementation was classified as unsatisfactory by donors as well as by government representatives. There are a number of reasons for the failure of this reform programme:

- Lack of prioritisation and sequencing: PUFMARP was not well linked to the broader public sector reforms and components were not prioritised. As a result, delays (in procurement, for instance) during the implementation of some components led to failures in others. The software systems designed to support the MTEF and the IFMIS, for example, could not "talk" to each other; whilst training for civil servants was wasted when the hardware did not arrive.
- Parallel project implementation units and overreliance on consultants: a significant number of consultants were contracted to implement the different components of the IFMIS. Disagreements between the government and contractors led to severe disruptions for all components of the broader PFM reform effort. Moreover, consultants were totally separate from normal government structures, with little institutional clout to push for significant political commitment for the reform.
- Unfavourable political environment and weak political commitment: senior figures within the administration perceived the reform as merely a highly technical project foisted on government by donors; they had little understanding of the (political) relevance of the reform in terms of improving transparency and accountability in the budget process. Widespread political patronage of private business reduced the commitment for checks and balances during the implementation process. Finally, elections in 2000 further derailed the reforms, with high staff turnover and increased internal resistance to reform.

Co-ordinated Donor Support

While donor support (technical assistance and financial resources) has played a crucial role in PFM reforms in many partner countries, country authorities often complain about receiving conflicting advice from different donors on the same subject, or having too many donors financing the same programme and starving other programmes of much-needed assistance. Country authorities, on the other hand, also often ask multiple donors for the same technical assistance or a specific diagnostic, as they do not know which donor can deliver and on what timeframe. At times two or three donors respond, duplicating work. More generally, most capacity support has remained fragmented.[11] Collaboration among donors can avoid duplication and fragmentation in donor assistance and facilitate consistency in advice. An effective donor co-ordination arrangement should streamline the dialogue between government and donors and facilitate donor support to the government's PFM reform action plan. Box 3.3 describes Mozambique's experience.

Box 3.3. **Donor Co-ordination in Mozambique**

At first, donor support for Mozambique's PFM reforms was mostly through isolated programmes. In 2002 five major donors (EC, Sweden, Norway, Denmark and UK, later also joined by Belgium) agreed to pool their support and channel it through a Common Fund, which was also cofinanced by the Government of Mozambique (GoM). The Common Fund provided predictability of funding over the medium term. The original timeframe for the funding (2002-05) has been renewed once (2006-09), and a further extension is being considered. The GoM is responsible for the execution, which is managed through a dedicated implementation unit within the Ministry of Finance.

Recently a number of other Common Funds have been set up in Mozambique to co-ordinate donor support in some specific areas of PFM (*e.g.* revenue collection and audit). This was necessary because the focus of the earlier Common Fund was too narrow to accommodate these areas. These new Common Funds pose a challenge for the overall co-ordination of the PFM reform; care will need to be taken to prioritise among different components of the PFM reform.

Guaranteed multi-year support helps ensure sufficient attention to really carry out the longer-term reforms. The 2007 SPA Budget Support Survey offers interesting evidence about practices in 13 African countries that receive general budget support. It finds that while no country has a formal multi-year calendar of diagnostics agreed between the local authorities and donors, in more than half, a decision has been taken to use repeat PEFA assessments as a central monitoring framework. In seven countries, technical co-operation for PFM is governed by a single action plan, and other countries are progressing toward this arrangement. Finally, in five countries, donors have agreed to a common financial arrangement for supporting PFM (and in four, progress is under way).

Prioritising and Sequencing

Most countries have limited capacity to implement many wide-ranging reforms all at the same time; therefore, it is essential for the government and donors to work together on establishing priorities and an appropriate sequence for the reforms. Unfortunately, no one can say with certainty what is the "right" sequence of reforms that would guarantee success: complex variables (such as demand for reforms, and stakeholder interests) and country-specific factors make it impossible to establish a sequence that would be universally applicable across different situations and a broad spectrum of countries. More is known about what does not work than what does. However, a few lessons emerge from the history of PFM reforms:

- Before introducing new rules or control procedures it is important to assess whether this would be more effective than better enforcing existing rules and procedures or developing greater capacity to operate them.
- Introducing a medium-term budget formulation tool or performance budgeting in an environment of poor budget execution is not likely to be effective.

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- Introducing an accrual accounting system is not likely to succeed where basic cash-based financial statements are prepared after much delay and/or with several unreconciled items.
- Attempting performance audit without agreed performance benchmarks and proper systems to record and track performance is unlikely to be effective.
- Implementing a sophisticated Integrated Financial Management Information System (IFMIS) without first strengthening treasury practices and control systems is likely to increase the risks of fraud and misuse.
- Abolishing control and inspection agencies/departments without first establishing a modern internal audit function is likely to increase the risks of fraud and misuse.
- It is crucial to establish and operationalise effective internal controls before giving managers broad discretion over choice of inputs and/or outputs.

The platform approach to sequencing,[12] piloted in Cambodia, aims to implement a package of measures or activities designed to achieve increasing levels ("platforms") of PFM competence over a manageable timeframe (see Box 3.4). The approach is based on the premise that a certain level of PFM competence is required before further progress can take place. Each platform is defined in terms of improved outcomes (*e.g.* delivering a credible annual budget) rather than just focusing on the completion of individual short-term measures or activities (*e.g.* implementing a new chart of accounts); and therefore each platform establishes a clear basis for launching to the next. The World Bank's IEG Report on Public Sector Reform Evaluation also concludes that modest and selected entry points can have partial success and lay the basis for later progress.

Box 3.4. **A High-Impact Approach: Cambodia's Experience**

In December 2004, after previous reform attempts ended in failure, Cambodia's Prime Minister launched the Public Financial Management Reform Programme, adopting a "platform approach" to reforming Cambodia's PFM system. Over its first three years of implementation, the programme has made major achievements: budget execution procedures have been significantly streamlined; programme budgeting has been introduced, and a new chart of accounts adopted; the amount of customs revenue collected through the banking system has increased (from zero in 2004 to nearly one-third in 2006); more than three-quarters of all Tax Department revenue is now collected through the banking system; about three-quarters of Treasury payments to suppliers in Phnom Penh and Sihanoukville are now made by check instead of cash; the stock of old expenditure arrears has been reduced by over 40 %; the procurement process has been streamlined, tightened, and made more competitive; internal audit departments have been established in a dozen line ministries; and a pilot programme has been launched to pay civil servants through commercial banks instead of by cash. Cambodia attributes its success to such factors as joint ownership between the government and donors, development of a sequenced and prioritised action plan, design and implementation of a strategy for organisational change and capacity building, and a formal co-ordination mechanism.

Given the importance of prioritisation in PFM Reforms, donors should support countries' sequencing choices not only by providing targeted of financial resources or technical expertise but also by considering the use of those components of the country PFM system that have been strengthened rather than wait until the entire PFM system is reformed.

PFM Reforms as part of Overall Public Sector Reforms

Budgetary institutions cannot be reformed in isolation. Experience indicates that PFM reforms can be better achieved and sustained if they are introduced in conjunction with broader public sector reforms. Although this may appear to contradict the earlier observations about the risk of attempting to implement several large-scale reforms simultaneously, experience shows that some public sector reforms are necessary for certain PFM reforms to succeed. For example, it has been observed that civil service reform and pay incentives are complementary and have a positive effect on PFM reforms: in Cambodia, for example, pay and employment reform raised wages for Finance Ministry staff and linked their performance to the success of the reform programme.

Demand for Reform

Improvements in the technical capacity of institutions within government are unlikely to be sustained if there is no demand for better governance and increased accountability from outside government, including parliament and civil society. Such external institutions can exert considerable pressure upon the executive to initiate and persist with reform. For example, reforms in external audit are unlikely to have a sustained impact unless parliamentary committees, such as Public Accounts Committees, are able to provide effective legislative scrutiny of audit reports. *In South Africa, the Public Sector Accountability Monitor (*PSAM*)* works closely with the legislature to track the executive branch's response to allegations of misconduct contained in the SAI's report. One of the PSAM's activities is to follow up reported cases of government corruption and misconduct. In Colombia, "Citizen Watchdog Committees" help monitor high-impact projects. The success of such initiatives demonstrates how civil society can complement scrutiny by parliament. However, while civil society can play an important role in exerting pressure on the government to reform public sector, it is also possible that certain special interest groups could pressure the government to delay certain reforms, for example, procurement reforms.

Customised Solutions

Reforms that attempt to transplant OECD country models are likely to fail if they do not take into account the enabling environment that makes them work. For example, attempting to implement New Zealand-type reform is likely to fail in developing countries, which often lack the strong formal public sector needed for management contracts to succeed.[13] A successful reform programme must consider the country's current circumstances and capacities. Implementing high-technology solutions to address basic problems – for example, implementation of state-of-the-art IFMIS solutions to address weaknesses in accounting – has failed in many countries. In Malawi, for example, committed senior officials found that the technologies used were too complex for the country's capacity and needs. "South-South" knowledge sharing is increasingly proving useful in addressing the similar problems faced by countries at similar stages of development. The Public Expenditure Management – Peer Assisted Learning (PEMPAL) initiative launched in the Europe and Central Asia Region in 2006 has created a network of public expenditure management professionals in various countries in the Region, enabling these professionals to compare their countries' PEM systems and to exchange success stories and best practices while simultaneously pursuing "peer learning." Similarly, the Collaborative Africa Budget Reform Initiative (CABRI) is a professional and autonomous network of senior government officials in ministries of finance and planning in Africa,

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which was established to share experience on reform programmes in terms of what works, why, and when.

Consultations and Stakeholder Involvement

Reforms are reversible. After the initial euphoria cools down, old practices may return or newly enacted laws may be rescinded or amended. A new government may reverse reforms and initiate new ones. Pro-reform coalitions are not static. Thus, particularly in countries with coalition governments, it might be important to engage with a wide range of stakeholders during the design of a reform strategy to help ensure broad-based support for continuing implementation of the strategy. At the same time, in some countries, well-meaning reform initiatives have been scuttled in trying to ensure wider consultation. The case of a landmark procurement code introduced in the Philippines gives an idea of the complex set of factors to be taken into account. Four potential impediments had to be overcome: first, the executive branch had to be unified in the effort; second, civil society groups had to be mobilised to lead the advocacy needed to get the legislature to act; third, the reformers within the executive branch and the civil society groups had to work together in unison; and fourth, influential legislators had to be recruited to champion the bill in their respective chambers.[14]

Deepening PFM Reforms

It has often been observed that reform processes run out of steam by the time they reach line ministries. For example, in many countries that have attempted to introduce a medium-term expenditure framework (MTEF), expertise has been concentrated in the Ministry of Finance, while line ministries continue to prepare their internal budgets on input and incremental bases. It is therefore also critical to engage line ministries and build their capacity to implement the reforms. Reform design and sequencing should take such considerations into account.

Capacity Development

Capacity is defined as "the ability of people, institutions and societies to perform functions, solve problems, and set and achieve objectives."[15] Thus capacity development denotes the process that enables partner countries to make better use of existing capacities and to further develop capacities at three levels: the individual level, the level of organisation, and the institutional/political level. Capacity development in PFM reform aims at developing rules and procedures in PFM, organising the work and providing resources (physical, human, and financial) in a way that facilitates their efficient implementation and equips people in the organisations with competencies to operate efficiently.[16] Experience has shown that countries need both adequate technical staff and effective management capacity if PFM reforms are to be sustained and move beyond changes in laws and regulations. Capacity development is a task for partner country governments, not a donor activity;[17] but donors must be prepared to support countries in carrying out this task. The World Bank's *Capacity Building in Africa: An OED Evaluation of World Bank Support* has observed that most capacity-building activities are not founded on adequate needs assessments and do not include appropriate sequencing of measures aimed at institutional or organisational change and individual skill building. Moreover, the challenges of capacity building vary across sectors as well as across countries. It is therefore important that donors customise their capacity-building approaches, including training, to country conditions. In this regard, efforts to professionalise certain work streams, such as accounting, should be encouraged. It is also important to ensure that capacity-building efforts go beyond ministries to include parliamentary committees and SAIs.

Role of the Political Economy in PFM Reforms

Unless public sector reforms are grounded in political reality, they are not likely to have much effect. For example, the World Bank evaluation of capacity building in Africa noted that shifting political forces in Malawi stalled structural adjustment and public sector reforms. Political compulsions often explain why governments may disregard technically sound and rational solutions. There must be active political leadership and support for reforms, particularly in such sensitive areas as procurement. Political will is essential for successful and sustainable reform.

Political versus *Technocratic Leadership*

An analysis of political behaviour suggests that politicians may be prepared to accept reform, even if they are not strongly persuaded by it, as long as they do not perceive it to be a threat to their own interests.[18] This observation does not contradict the desirability of strong political leadership for reforms, but it implies that political blessing may be sufficient for some reforms to succeed. The distinction is significant. If active leadership of reform by politicians is not essential, the initiative shifts to those who can motivate acceptance and sustain the absence of opposition. At times, therefore, reform-minded public officials can initiate and successfully implement technocratic reforms (those not involving policy changes) – for example, automating the treasury/accounting system, as in Bosnia Herzegovina – even without much political backing. At other times, overcoming resistance to change is essential for the reform to succeed. This then suggests a more instrumental and strategic role for technocrats in the area of major policy reforms (Box 3.5 describes Turkey's experience).

Box 3.5. **Role of Technocratic Leadership in PFM Reforms: Turkey**

The story of successful accounting reforms in Turkey illustrates the complementary roles of ministers and public officials. The Minister of Finance in 1998 envisioned accounting reforms and appointed a high-energy public official to reform the accounting system. After the departure of the minister in 1999, the incoming minister was sceptical of the reforms that were being implemented. However, the public official displayed great tact and leadership, engaging the new minister in the success of the pilot programme and organising several high-profile media events to raise public awareness. After the successful launch of the pilot, the new minister approved countrywide implementation of the programme. Turkey now has a state-of-the-art automated online accounting system, *Say2000i*, which networks more than 1500 national nodes, capturing receipts and payments as they are made.

Addressing the Politics of Reform

Although there is wide agreement on the importance of high-level commitment from politicians in initiating and leading PFM reforms, there is no agreed approach to addressing the politics of reform. The Expected Utility Stakeholder Model offers a comparatively

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rigorous methodology for analysing the effects of political incentives on the feasibility and sustainability of policy reforms.[19] The World Bank piloted this approach to analyse public sector governance reform issues in two countries in the East Asia and Pacific Region. However, because this is a complex and sensitive area, further research is needed to develop an approach for addressing the politics of reform.

Role of Parliament

A decade of research has concluded that, unless there is strong demand for accountability, most PFM reforms are unlikely to be sustained in the long run. In some cases parliaments can play a critical role in demanding and providing accountability in Public Finance Management. Legislatures participate in the governance of the budget by approving budget allocations, overseeing budget execution, and controlling budget performance. Effective and responsible parliaments can mitigate the risks of excessive executive budgetary discretion by reinforcing the countervailing mechanisms of government accountability and legislative scrutiny, and can exert pressure on the executive to improve fiscal and budgetary performance. There is thus increasing recognition of the need to work with legislatures to strengthen demand for accountability in public finances and strengthen checks and balances in public budgeting. Several initiatives, some funded by donors, have begun to strengthen the capacity of parliaments and parliamentary committees: for example, Uganda's parliamentary budget office is a model for many countries; the *African Parliamentarians Network Against Corruption* works to co-ordinate and strengthen the capacity of African parliamentarians to fight corruption and promote good governance; and the World Bank Institute's *Parliamentary Strengthening Programme* aims to enhance parliaments' capacity to effectively fulfil their legislative and executive oversight responsibilities.

Role of Supreme Audit Institutions

Supreme audit institutions (SAIs) have a unique role to play in PFM reforms, given their place in the government structure. Through various types of audit reports, SAIs can highlight areas in need of reform, and, by constantly highlighting waste of public resources, they can exert pressure on the government to strengthen national PFM systems. SAIs can efficiently discharge this responsibility if they themselves have the necessary skills and capacity. PEFA assessments and other PFM diagnostics have consistently revealed the need for strengthening SAIs in several countries. There is, therefore, a clear need for co-ordinated donor efforts to support SAIs' capacity-building initiatives on a longer-term and sustainable basis.

Communications Strategy for PFM Reforms

Many countries do not give enough attention to preparing a strategy for communicating the PFM reform programme. It is important to ensure that information about the PFM reform programme percolates to operational levels in the government and to external stakeholders such as the parliament and civil society organisations. Well-informed organs of government and external stakeholders can help ensure momentum for the implementation and sustainability of the reform process. However, care should be taken to manage the expectations of various stakeholders, as it invariably takes time for the outcomes of reforms to become visible. (Box 3.6 describes the experience of Zambia.)

Box 3.6. **Communication Strategy on PFM Reforms: An Example from Zambia**

Zambia has undertaken a comprehensive communication strategy in the wake of its public expenditure management and financial accountability programme (PEMFA). The communication literature outlines in particular what citizens can expect from PEMFA:

1. Strong financial management and reporting systems.
2. Improved links between government policy and budgets.
3. Better matching of budgeted and actual expenditure.
4. Predictable release of funds to government departments.
5. Sound debt management strategy.
6. Compatible legal provisions.
7. Solid accounting profession ethics and training.
8. Improved public sector procurement.
9. Stronger Office of the Auditor General resources and independence.
10. Greater parliamentary enforcement powers.

By setting out PEMFA's goals and explaining how citizens can benefit from the programme, the communication strategy strengthens domestic accountability mechanisms. Civil society, media, and accountability bodies are given information on the implementation plans, monitoring mechanisms, funding mechanisms, and review procedures.

Key Recommendations

Once the assessment of a country's PFM system reveals weaknesses, the donor community should support the country in addressing those weaknesses. It is important to understand that a PFM system can rarely be strengthened with a "quick fix": the process is likely to require enacting laws and regulations, implementing new systems and processes, creating new departments/units, and training staff in new skills – all processes that can take time. Therefore, it is important for the country and its development partners to remain engaged. The following table summarises key recommendations for donors and partner countries for ensuring successful implementation of PFM reforms in partner countries:

Recommendations for Donors	Recommendations for Partner Countries
Do's	**Do's**
1. Align support with the government's reform strategy and priorities.	1. Provide political leadership to support PFM reforms.
2. Increase support for capacity building in parliaments, SAIs, and civil society organisations.	2. Take leadership in preparing a PFM reform action plan, ensuring that a wide range of stakeholders are involved and drawing on lessons from experiences of peer partner countries.
3. Promote "South-South" sharing and peer learning among partner countries.	3. Design a package of measures or activities designed to achieve increasing levels ("platforms") of PFM competence over a manageable timeframe.
4. Remember that capacity development is a not a donor activity, but a task for the partner country government.	4. Undertake periodic PEFA assessments to measure progress in PFM performance.
5. Ensure that capacity-building support extends beyond the Ministry of Finance and headquarters offices to sectoral ministries and local authorities.	5. Ensure that capacity-building efforts extend beyond the Ministry of Finance and headquarters offices to sectoral ministries and local authorities.
Don'ts	**Don'ts**
1. Do not impose a reform action programme on partner countries.	1. Do not attempt to implement all PFM reforms at the same time.
2. Do not attempt to transplant international models into partner countries.	2. Do not reverse reforms when the government changes.

Notes

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3. World Bank and IMF (2005), *Update on the Assessments and Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Public Spending*, Washington D.C. 12 April 2005.
4. Paolo de Renzio and Bill Dorotinsky (2007), "Tracking Progress in the Quality of PFM Systems in HIPCs – An Update on Past Assessments using PEFA Data," PEFA. It should also be noted that 2006 results are based on PEFA assessments, whereas 2001 and 2004 results are based on HIPC assessments.
5. Although this comparison covers 56 PEFA assessments, firm conclusions on regional PFM trends cannot be drawn, as some regions had very few countries for which PEFA assessments were completed. To draw firm conclusions and establish causality would require a larger representative sample.
6. This suggests that preserving the credibility of donors' engagements under the Paris Declaration is crucial if monitoring of the commitments is ever to serve as a stimulus for PFM reform in partner countries.
7. Dealing with these special challenges goes beyond the scope of this report. However, the JV-PFM has examined issues related to technical assistance to PFM in fragile situations and participated to a complementary initiative organised by OECD GOVnet. See presentations made at the Joint Venture on PFM meetings as well as the following websites: *www.oecd.org/dac/fragilestates/pfm* as well as *http://blog-pfm.imf.org/pfmblog/2008/04/post-conflict-1.html*.
8. See *www.pefa.org*; *www.pefa.org//strengthen_approachmn.php*.
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Managing Development Resources
The Use of Country Systems in Public Financial Management

Chapter 4

Practices in the Use of Country PFM Systems

This chapter first examines the factors that influence donors' decisions about using country PFM systems, focusing in particular on donors' perceptions of risk and their approaches to managing it. Evidence suggests that the quality of the system is not the only determinant in donors' decisions about whether or not to use the country's systems. Other factors include the credibility of the country's PFM reform programme; the partner country's and the donors' own preferences; as well as the perception of corruption. Following a discussion of risks to donors in using country systems; this chapter ends by outlining donors' guidance on and incentives for the use of country PFM systems.

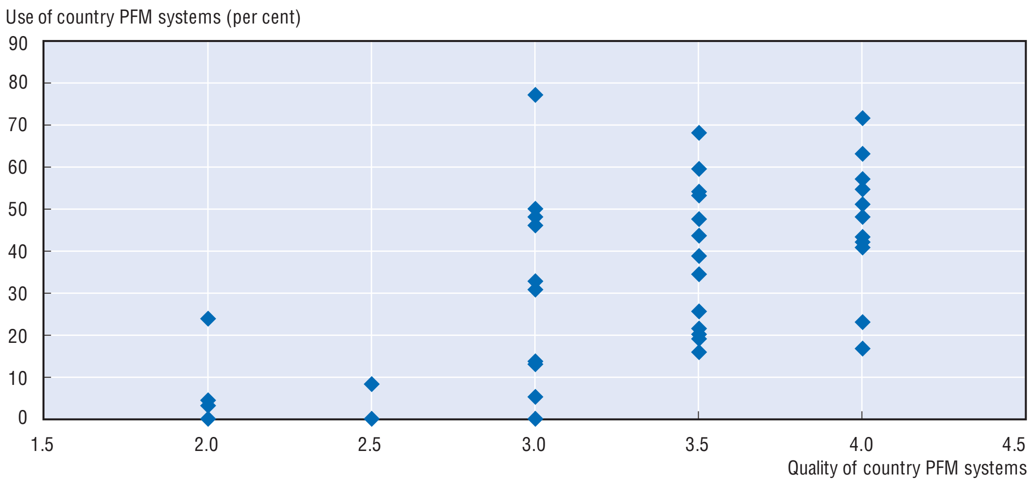
Introduction

As Chapter 2 recorded, data from the 2008 Survey on Monitoring the Paris Declaration shows that donors use partner country PFM systems for about 45% of aid flows. This chapter examines the factors that influence donors' decisions about using country PFM systems, focusing in particular on donors' perceptions of risk and their approaches to managing it.[1] It then discusses the guidance and incentives donors provide to staff on using country PFM systems.

Use of Country PFM Systems: Basic Considerations

It is widely assumed that the quality of a partner country's PFM system is the principal determinant in a donor's decision about whether or not to use that system. Data from the 2008 Monitoring Survey shows that while this is true on average, there is a great variance across countries in the use of PFM systems of the same quality (see Figure 4.1).

Figure 4.1. **The Use of Country PFM Systems and the Quality of PFM Systems**



This suggests that other factors besides quality influence these decisions. The following are some of the most important ones.

The Ambitiousness and Credibility of the Country's PFM Reform Programme

Many reform programmes exist, but not all are implemented. A credible reform programme that offers realistic prospects for tackling weaknesses in a country PFM system encourages donors to use such systems (contributing further to their strengthening).

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Partner Country Position

Partner countries do not always want all donors to use their country PFM systems for the provision of aid. In some cases, local legislation requires a differential treatment for donors' funds (often the legacy of donors' past insistence in this regard); in others, sectoral ministries may actively seek to keep aid off-budget and even off-plan to maximise resource flows to the sector by avoiding offsetting budgetary allocations;[2] alternatively, localised interests in preserving PIUs may resist a move toward greater use of country PFM systems. Finally, as a part of country risk management, the Ministry of Finance may seek to limit the use of the country's PFM system because of doubts about the benefits that would accrue from small changes in the use of the country system, because of concerns about the system's capacity to properly execute expenditures, or because of the risk of non-disbursement under (historically relatively volatile) budget support.

Perception of Corruption

Regardless of the quality of a specific country's PFM system, perceptions of corruption in the public or the private sector typically discourage donors from using it.

Donors' Own Preferences

Individual donors' stances on the use of country systems are influenced by their different objectives for aid, political mandates, understandings of the benefits of specific aid modalities and of the use of country systems, and perceptions of and appetite for risks (discussed in greater detail below). Donors' actual use can also be influenced by the sectoral distribution of their total aid flows to any given country: for instance, large infrastructure works are generally financed through project aid, while supporting the hiring of teachers by contributing to financing their salaries is more readily achieved through sector budget support that by definition uses the country's PFM system. Therefore, in a country where aid priorities focus on the building of infrastructure (or facilitating private sector development or civil society growth), donors are relatively less likely to use the PFM system than in a HIPC country that needs macroeconomic support. For these reasons, any donor's position on the use of country PFM systems may vary across countries; and many donors may take different positions even in the same partner country.

Risks to Donors in Using Country PFM Systems

When deciding whether to use country PFM systems, donors vary in the way they define, assess, manage, and monitor the risks of the approach. They also need to bear in mind that there are risks in *not* using country PFM systems; indeed, the agenda underpinning the use of country systems is, to a large extent, a response to the risks of external assistance provided exclusively through donors' own procedures. For instance, since funds are fungible, using separate procedures may provide fiduciary assurance but does not guarantee development effectiveness as the use of parallel systems entails higher transaction costs and undermines the development of the country's own systems. This section looks at the risks that donors may face in using countries' PFM systems, discusses donors' capacity to bear such risks, and examines their approaches in assessing and mitigating risks.

Risks in Providing Aid

Whenever donors provide funding, they face three main types of risks:

- ***Fiduciary risk.*** Fiduciary risk refers to the possibility that aid money may not be used as intended, or may not be used efficiently and effectively. Donors' understanding of this concept varies depending on what the scope of the intended use of funds is, whether value-for-money aspects are considered, and exactly what boundaries are drawn between fiduciary and other risks.
- ***Development risk.*** While fiduciary risk refers to the specific output of an aid intervention, development risk refers to the danger of missing the ultimate objectives of such an intervention. This category includes the risks posed by such disparate factors as an unstable macroeconomic environment, poor design and implementation of policies, lack of results monitoring, weak governance, poor co-ordination among donors, limited ownership, and failure to disburse funds.
- ***Reputational risk.*** Reputational risk refers to the possibility that events directly or indirectly related to the current aid intervention may impair the donor's ability to provide future support. It includes the possibility that fiduciary or developmental failure may rebound on the donor as a sort of second-round effect.

The use of country PFM systems is subject to all three types of risk.[3] Providing aid through a weak PFM system obviously increases fiduciary risks, and it may also reduce development impact or, in any case, entail a trade-off between immediate benefits and longer-term systemic gains. In addition, using country procedures is usually perceived to increase reputational risks because it loosens the attribution chain between a donor's input and its outcome and more readily exposes the donor to any negative event undermining the perceived quality of the country economic and political governance. Finally, different risks are related: for instance, relying on decentralised levels of governments may be seen as appropriate to foster specific development and governance goals; but if local-level PFM systems are weak, it may well increase fiduciary risks.

Donors are likely to regard relying on the country budget execution system as the riskiest option, although it is also likely to trigger the greatest benefits. It is not surprising, therefore, that donors vary greatly with regard to their readiness for this. At the same time, using one particular component of a country's PFM systems may have risk-related implications for the use of other components: for example, a donor using the country budget execution system may want to minimise fiduciary risks by having stronger assurances on the use of aid funds than the country's accounting, reporting, and auditing systems can provide.[4] This suggests the need to weigh specific benefits against specific risks when making a partial use of country PFM systems. For any given intervention, different combinations of use provide different profiles of risks and benefits. Choosing among such alternatives should, to the maximum extent possible, be done in collaboration with the partner country and take account of the sequence of reforms.

Appetite for Risk

Donors' different capacities to bear risks result from such factors as the following:

- ***Different legal frameworks and, more generally, external accountability relations.*** This has a direct impact on the assessment of risks and also on the way in which such risks are set against expected benefits. It is therefore not surprising to see differences in behaviour between, for instance, bilateral and multilateral donors and between grant-disbursing donors and development banks.

- ***Different internal incentives.*** Not all donors have reviewed their internal incentives or training programmes to ensure that they are aligned with the commitments undertaken in the Paris Declaration. Such a revision of incentives should encompass all levels, since the risks and benefits of using country PFM systems are perceived differently within an organisation. In this context, the extent and nature of management support to operational staff plays an important role.
- ***Different knowledge.*** Not all donors have the same level of knowledge about country situations and the opportunities for the use of country systems.
- ***Different experiences.*** Generally speaking, donors that have a longer (and positive) history of using country systems, or a relative specialisation in sectors that favour the use of country systems, are likely to accept a relatively higher level of risks.

Enhancing Risk Tolerance

While in the short term any donor agency's appetite for risk is a given, over the longer term donors can influence this parameter through the following kinds of actions:

- ***Better communicate the use of country systems agenda to their external accountability bodies.*** There are two pillars to such a strategy: focusing on the seriousness and rigour of the donor's process for assessing and managing risks, and highlighting the benefits of using country systems. To the extent possible, both pillars should be developed in parallel.
- ***Analyse donors' legal frameworks and accountability relations.*** Donors can transparently identify the institutional constraints to greater use of country PFM systems (and aid effectiveness more generally) to facilitate a discussion around reforms to ensure greater aid effectiveness.
- ***Align internal incentives to political commitments.*** Donor agencies should translate their strategic decisions about the use of country PFM systems into appropriate internal incentives. Management needs to adequately support those staff taking decisions involving the use of country PFM systems.
- ***Give greater importance to partner countries' PFM reform programmes.*** Paris Declaration indicators 2 and 5 recognise (but do not operationalise) the possibility of using even weak country PFM systems when the country has in place a credible and ambitious programme of reform. Consideration should be given to determining the credibility and ambitiousness of a reform programme in a way that fosters greater use of country PFM systems.
- ***Train staff to identify opportunities to use country systems in different contexts.*** Because using country PFM systems implies a significant change in the customary way of doing business, training should be put in place to help staff adapt their mindset and skill set. Donors should establish procedures to preserve local knowledge about country specificities despite the frequent rotation of staff.
- ***Share risk with other donors by pooling resources.*** Multi-donor financing of any given intervention reduces the risks to which any individual contributor is exposed. However, in some multi-donor arrangements, the selective use of country systems accommodates the needs of the more risk-averse donor rather than reflecting a jointly shared

assessment of actual PFM risks.[5] Such arrangements are, of course, legitimate, and achieving progress across as large a number of donors as possible is an important goal. Partner countries should consider whether increased harmonisation around a common fund arrangement using special procedures is preferable to a less harmonised use of country systems in which certain donors may pilot a more extensive use of country systems, potentially leading the way.

Risk Assessment

In assessing overall risk, donors must take into account very different types of risks. As detailed in a recent Department for International Development (DFID) funded study,[6] donors tend to use somewhat different methodologies in assessing risks and comparing them with benefits (Box 4.1 summarises the findings and recommendations of the DFID study). In most cases, however, donors rely on publicly available diagnostics and information; only a very few donors (notably the World Bank, International Monetary Fund, and International Financing Corporation) undertake primary research. The risk assessment process often bypasses local stakeholders, with negative consequences in terms of local initiative to address the underlying factors.

Box 4.1. **Findings and Recommendations from the DFID Stock Take on Donor Approaches to Managing Risks when Using Country Systems**

The report provides a detailed review of similarities and differences between the sample donors in:

- Their policies and guidelines for the use of country systems, and the benefits they recognise from using country systems; and
- Their approaches to each aspect of risk management: risk identification, initial risk assessment, subsequent monitoring, and strategies for addressing risks.

The Stock take concluded that:

1. Donors should review their policies and practices on addressing risk and seek to rectify unintentional biases against the use of country systems. In the light of the Paris Declaration, the onus should be to justify not using country systems.
2. There is scope for:

- More collaboration in standardising terminology and developing assessment methodologies concerning fiduciary risks, corruption, and other aspects of governance.
- Joint learning about the better design of aid instruments that use country systems, and about using different aid instruments (*e.g.* general and sector budget support) in ways that reduce and spread risks.

Collaboration in the delivery of aid through country systems, in ways that reduce the risks that each donor faces and at the same time seek to combine forces in strengthening country systems (*e.g.* in supporting capacity building, and harmonising so as to avoid the multiplication of separate donor conditions and safeguards).

Harmonised Risk Assessment Approaches

By using different approaches to risk assessment and to the decisions that result from it, donors can cause extra transaction costs (for themselves and partner countries) as well

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as inconsistencies in risk management. Therefore, it would be useful to better harmonise both their risk categories and their approaches to risk assessment. Two efforts, in particular, could be considered:

- ***An encompassing risk-assessment diagnostic.*** Donors could work together to reach agreement on an integrated and harmonised risk assessment tool for the use of country PFM systems. Such a tool would be comprehensive, would reduce the transaction costs of pursuing separate approaches, and would lower reputational risk by allowing donors to refer to an internationally agreed methodology. However, given the diversity in donors' legal bases, procedures, and traditions, a significant amount of harmonisation would be required to agree on such a tool. Such a lengthy effort could also have the negative effect of making the topic of risks, not benefits, dominate discussions around the use of country PFM systems. Finally, it could, by default, respond more to the needs and concerns of the donors with least appetite for risks.
- ***Common pools of information.*** A different approach would avoid focusing on the method for assessing risks itself but would instead aim to generate the information required for donors to make their own assessments. Such a "common pool of information" approach is best exemplified by the PEFA PFM Performance Measurement Framework (discussed in Chapter 5),[7] which aims to provide reliable information about the performance of key elements of PFM systems that can be used for multiple processes – for example, PFM risk assessments – as well as dialogue around the design and monitoring of reforms.[8] Compared to an encompassing risk-assessment tool, such an approach would offer greater flexibility in responding to information needs and would demand less in terms of agreement among parties, although it would appear to offer less potential to reduce transaction costs. However, the fact that donors are increasingly using the PEFA framework as the backbone of their various PFM risk assessment methodologies suggests that they would find this approach useful.

Enhancing Risk Assessment

The following good practices can help donors improve their assessment of PFM risks:

- ***Use common pools of information.*** In assessing country PFM risks, donors should rely as much as possible on existing "common pool" diagnostics.
- ***Share diagnostics.*** To maximise the benefits of such common pools, donors (and partners) leading work on relevant diagnostics should provide *ex ante* information on their planned assessments, ensure the widespread credibility of their results, and achieve timely dissemination to the largest possible public. In this context, donors and partners could collaborate at the country level to agree on a multi-year plan of diagnostic works to ensure the regular update of as wide a common pool of information as possible.
- ***Do not create new diagnostics lightly.*** When proposing specific assessments, donors should first ask whether the new assessments are strictly necessary (for instance, by looking at other donors to see how they are able to do without). New studies that are still deemed necessary should impose as little burden as possible on the partner countries. If several donors require a certain type of information, it may be appropriate to launch a specific harmonisation initiative.[9]
- ***Be transparent.*** Whatever methodology is used to assess PFM risks, it should be clearly set out and shared with other donors, for possible cross-fertilisation, and with partners,

for transparency in decision-making. The results reached by applying the methodology should also be shared.

Risk Management

The extent to which any donor relies on country PFM systems depends on its capacity to manage the perceived risks. In the long term, of course, the best risk mitigation strategy is strengthening the country's PFM systems – that is, providing financial and capacity-development support for the country's reform efforts, and using the country PFM system to the extent possible. While a country is working to strengthen its PFM system – generally a long-term endeavour outlasting the lifespan of most donors' aid instruments – donors usually manage PFM risks in two ways. At the level of their country portfolio, they diversify risk by balancing sectors and aid modalities with different risk profiles. At the level of the individual operation, reducing their exposure to PFM risk is frequently the aim of safeguard measures such as the following:[10]

- ***Conditions for the disbursement of funds.*** Conditionality flags some measures (or outcomes) in the country's reform programme as being particularly crucial, and sets the minimum conditions necessary for the donor to take on the remaining PFM risk. It can also serve to strengthen the hand of reformers in the partner country.
- ***Use of special procedures.*** At times, conditionality is not regarded as sufficient to provide the necessary safeguards for a complete use of country PFM systems. In such cases, donors can rely on some part of the country's PFM system but impose the use of some special procedures such as earmarking funding to identifiable expenditures, directly channelling funds to implementing agencies, or providing for additional audit scrutiny or *ad hoc* auditing mechanisms.

Enhancing Risk Management

For the donor, such measures seem to indicate progress in tackling relevant PFM weaknesses, contributing to increased use of the country's system while preserving the support of domestic stakeholders. However, viewed against the ultimate objectives of ownership, alignment to strengthened country systems, and harmonisation, the aggregate impact of such measures is much less clear. Often fragmented and uncoordinated between different donors, such measures can be ineffective and undermine the priorities, sequencing, and implementation capacity of the local authorities. In addition, although these safeguards are meant to be temporary, there are rarely sunset clauses or deadlines for jointly reviewing their continued relevance. In sum, there is the risk that the safeguards and mitigation strategies adopted in conjunction with a greater use of country PFM systems may undermine the very benefits expected from the use of such systems. Rigorous *ex post* evaluation of specific cases would be needed to assess the extent to which this risk is actually relevant. However, the following good practices could help minimising such risk *ex ante* :

- ***Seek better alternatives.*** Before using a safeguard, donors should be sure that it is the best way to address their particular concerns. This requires a clear understanding of the nature of the risks that need to be managed. For instance, little risk is involved in providing the information required for aid to be on plan and at least reflected in budgets. If reputational concerns are important, risk management at the level of the individual

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aid operation should be accompanied by a more comprehensive effort to tackle the underlying reputational factors.

- ***Clearly communicate the reasons for any safeguard, and its exit strategy.*** Safeguards should remain in place as long as – and only as long as – they are necessary. Accordingly, safeguards should be reviewed regularly and/or designed with a specific exit strategy.[11] Donors should explicitly declare their willingness to move to greater use of country systems if the country addresses their stated specific concerns.
- ***Respect country ownership.*** Safeguards should be designed with country ownership in mind. Thus, conditionality should be drawn from the authorities' reform programme rather than introducing donor-specific requirements.
- ***Ensure that safeguards add up to a coherent whole.*** To be effective, safeguards need to be designed in a balanced and proportionate way – not only in themselves but in terms of how they fit into the overall picture. Careful attention needs to be given to the interaction between short-term safeguards and ongoing medium- to long-term reform programmes.[12] Partner countries can facilitate this task by exerting strong leadership in the design of credible and well-prioritised reform programmes. Donors need to co-ordinate and, preferably, harmonise. At the minimum, information about required safeguards should be transparently available.
- ***Remain focussed on the final objective.*** Both in designing safeguards and more generally in supporting PFM reforms, donors should not lose sight of the primary aim – to support partner countries in achieving development results rather than simply mitigating their own risks. This requires a considerable effort, as donors will assess and manage risks according to their own accountability.

Donors' Guidance on and Incentives for the Use of Country PFM Systems

Reasons for donors' varying readiness to use country PFM systems can be found by analysing their internal guidance and incentives in the area.

Definitions

Only a few donors have adopted a definition of the use of country PFM systems; and these definitions tend to differ. Thus, for instance, in the World Bank's operational policies, country PFM systems include "budgeting; accounting; internal control; funds flow; financial reporting; and auditing arrangements of the entity or entities responsible for implementing Bank-supported operations." The African Development Bank includes budget formulation in its typology, while other donors, such as the Netherlands, include procurement. When talking and reporting about use of country PFM systems, therefore, donors may well be using somewhat different definitions. At a minimum, care is needed to avoid misunderstandings.

Guidance

Only a few donors – for example, the World Bank – provide general guidance on the use of country PFM systems. For donors that have no explicit definition of or guidance on the use of country systems, guidance can often be found in guidelines relating to budget support.[13] Yet the use of country systems extends beyond the use of budget support: project and technical assistance can also rely on local PFM systems. Some donors – such as Germany, the Netherlands and the United Kingdom – have guidance that allows them to use country systems for such aid modalities as project support that can be channelled through a government's budget or treasury systems; common funds; and non-budget-support programme-based approaches. The World Bank covers the use of country PFM systems in its guidance on Sector-Wide Approaches (SWAps), which are treated as investment operations rather than as pure budgetary support operations. European Commission guidance for SWAps includes detailed provisions for the choice of different financing modalities (and thus the related use of country PFM systems).

Requirements on Justifying the Use of Country Systems

The onus of justifying the use of country systems differs from donor to donor. Some donors (such as the MDBs, DFID, and the Swedish International Development Agency) consider the use of country systems to be the default operational policy, while others (United States) perceive it as an exceptional rather than a routine practice. Three donors (the Netherlands, the United Kingdom, and the European Commission) have expressly stated that general (or sector) budget support is their preferred aid modality. Importantly, in all of these cases, the use of country PFM systems (or budget support) as a delivery modality is envisaged whenever conditions allow it. Setting the use of country systems as a default position, therefore, does not make such use an automatic decision but forces donors to analyse in detail why such use may not be opportune. This supports the transparent identification of the areas of strength and weakness in the partner country's PFM system, thus facilitating partial use of the system, the design of safeguard measures, and the targeting of capacity development and reform efforts. In a major push for use of country systems, the EU has recently recommended to its member states the systematic use of country systems when conditions allow (see Box 4.2).

Box 4.2. **Moving Toward the Use of Country PFM Systems as a Default Position**

On 27 May 2008, the EU General Affairs and External Relations Council agreed to emphasise "the importance of using country systems to strengthen ownership and alignment, and for their potential for reinforcing capacity development towards transparent and accountable state institutions and developing local markets. The Council welcomes the positive results achieved so far in channelling increasing amounts of aid through budget support and reaffirms its past commitments in this respect. In order to facilitate further progress, the Council calls upon Member States to systematically use country systems, where conditions allow, and adapt their aid modalities accordingly".

Balancing Risks and Benefits

Finally, whether explicit or implicit, whether extensive or referring only to budget support, donors' guidance on the use of country PFM systems eventually revolves around comparing the benefits and the risks of using country PFM systems. This has some important implications:

- As donors may have different objectives when providing aid and different appreciations/experiences of the benefits of using country PFM systems, their readiness to use country PFM systems varies regardless of perceived risks.
- If the use of country PFM systems is expected to yield high benefits, donors may be willing to use them even if they are weak; conversely, donors may not be interested in

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using even stronger country PFM systems if the benefits of doing so are perceived to be low.[14] Thus donors may be more likely to use country PFM systems in post-conflict situations when it is urgent to provide funds to finance the basic functions of the state and avoid reversing economic and political stabilisation, and less likely to use them in a country with relative advanced systems and little aid, where using the country PFM system may not bring great benefits.

- To a certain extent, the case for using country systems has been built on avoiding the costs incurred during the many years when aid by-passed country systems. As experience in this area is still relatively recent, a more positive case built on strong and substantial evidence of the benefits of using country PFM systems can only be tentatively made. In addition, the benefits of using country systems tend to be long-term and diffuse in nature, while risks are much more immediate and donor-specific. These factors may lead to a bias against the use of country systems in practice, depending on the complex interaction of a large number of factors, including donors' internal administrative arrangements and incentive structures.
- Facilitating the use of country PFM systems for non-budget-support modalities may require a greater unpacking of the specific benefits and the specific risks attached to the use of each component of a PFM system. While this report and CABRI (2008) offer some insights in this regard,[15] it is an area that may be worth future investigation.

Enhancing Guidance and Incentives

To advance the use of country PFM systems, donors should take the following steps:

- ***Greater common understanding.*** Donors should work with partner countries to agree on a clearer and more precise definition of the use of country PFM systems. At both the international and local levels, such a common understanding would increase transparency, facilitate rigorous monitoring, and provide a joint basis for dialogue among donors and between donors and partners.
- ***Donors should better integrate the use of country systems in their operational guidance.*** Use of country PFM systems should be explicitly addressed either through stand-alone guidance or in guidance for all aid modalities.
- ***Donors should adopt a default position on the use of country systems where circumstances permit.*** This would not by itself change individual donors' decisions about the use of PFM systems in any specific situation, but it would compel aid managers to identify the reasons why country systems should *not* be used. It would create an incentive to reconsider long-established practices and would provide much greater transparency to donors' decisions. Assessing the development effectiveness of the proposed use of country PFM systems would also encourage donors to undertake more evaluations jointly with partner country authorities and stakeholders.
- ***Partner countries should take the lead.*** Partner countries should draw the necessary links between their aid effectiveness strategies and their strategies for strengthening PFM systems. They should exercise leadership by developing PFM strategies that will increase the chances that donors will use their PFM systems – for example, developing a planning and budgeting calendar, outlining when donor inputs are required, and ensuring that the chart of accounts and budget classifications enable sources and uses of funds to be clearly identified.

Conclusions

This chapter has flagged some of the constraints and challenges in using country PFM systems in the provision of development aid. This is a particularly difficult issue because country systems are both part of the solution and part of the problem. Thus, there is a natural tension between the need for short-term results and the sustained support required to accompany long-term processes, and between the desire to achieve the benefits of using country systems and the need to ensure protection from weak financial management systems. However, strengthening country systems is a joint objective for both partner countries and donors, because corruption, fiduciary, development, and reputational risks apply to countries' whole envelope of available resources and not just to donors' funds. Donors and partners therefore have a commonality of interests on which to build to move closer to the Paris Declaration targets within the parameters set by different accountability relations.

Notes

1. The discussion on risk draws upon the findings of "A Stock Take on Donor Approaches to Managing Risk When Using Country Systems", a DFID-funded study undertaken by Mokoro Ltd. under the work programme of the Joint Venture on PFM.
2. To the extent possible, of course, the sectoral minister then offsets donors' targeted interventions by changing intrasectoral budget allocations.
3. In addition, widespread corruption increases all three types of risk.
4. Similar considerations apply to the interaction between the use of PFM and procurement systems, which since may pose risks for the efficient use even of funds that are used for the intended purposes.
5. Strategic Partnership for Africa (2008), "SPA Sector Budget Support (SBS) in Practice, Synthesis and Comparative Analysis of Four Case Studies in Benin, Burkina Faso, Cameroun and Senegal, Ecorys, Netherlands"; and Williamson T. and Agha, Z. (2008), "Building Blocks or Stumbling Blocks? The effectiveness of new approaches to aid delivery at the sector level", Advisory Board for Irish Aid and the Overseas Development Institute, London.
6. CIPFA and Mokoro Ltd (2008), *Stocktake on Donor Approaches to Managing Risk when Using Country Systems*, March, Oxford.
7. The "benchmarking and assessment methodology for public procurement" is another example of the same concept. IMF economic surveillance also frequently serves the same purpose for the assessment of macroeconomic risks.
8. The PEFA assessment does not attempt to provide all the information any donor could consider relevant; for instance, it does not assess corruption vulnerability, quality of the authorities' reform plans, human capacities for operating the PFM systems, or value for money. Since many donors consider these to be relevant factors in their decision to use country PFM systems, they could be the object of specific specialised "common pool" diagnostics.
9. It is, however, important to caution against a mushrooming of PEFA-like initiatives, since the resources available at all relevant levels are limited.
10. This discussion draws from DFID, "How-to-Note: Managing fiduciary risk in DFID bilateral aid programmes", 2008, and PEFA, "Study on measures used to address weaknesses in public financial management systems in the context of policy-based support", 2003. Both studies contain other, more extensive typologies of safeguard measures.
11. The exit strategy should be designed within the framework set out by a country's reform programme. Also, this should not be interpreted as additional conditions for disbursement but rather as a transparent indication of the steps necessary to increase the use of country systems.
12. DFID (2008), "How-To-Note: Managing fiduciary risk in DFID bilateral aid programmes", How-To-Note, January 2008, London.

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13. Under general budget support, funds are channelled directly through the partner country's budgeting system, and its systems are used for reporting and accounting purposes; therefore, using general budget support automatically qualifies as using country systems.
14. This helps explain the lack of a strong correlation between use of country PFM systems and perceived system quality.
15. CABRI, (2007) "Are We Asking the Right Questions? Embedding a Medium-Term Perspective in Budgeting", 4th Annual CABRI Seminar 13-15 December 2007, Accra, Ghana.

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Chapter 5

Measuring the Performance of Country PFM Systems

The Paris Declaration and the Accra Agenda for Action committed partner countries and donors to jointly assess the quality of country systems using mutually agreed diagnostic tools. This chapter describes the Public Expenditure and Financial Accountability programme (PEFA) developed to provide a shared pool of information on PFM that can facilitate dialogue on reform priorities among domestic and external stakeholders. The chapter describes its global adoption and the role of PFM assessments in the use of country PFM systems before outlining the challenges ahead for the enhanced use of the PEFA tool.

Introduction

In the Paris Declaration, partner countries and donors committed to: *a)* work together to establish mutually agreed frameworks that provide reliable assessments of the performance, transparency, and accountability of country systems; *b)* implement harmonised diagnostic reviews and performance assessment frameworks in public financial management; and *c)* integrate the diagnostic reviews and performance assessment frameworks into country-led strategies for capacity development. In the area of PFM, the PFM Performance Measurement Framework, developed and supported by the Public Expenditure and Financial Accountability programme (PEFA) in consultation with the Joint venture on PFM, is a leading example of how these commitments are being met. This chapter describes the PEFA initiative and explores the linkages between PEFA-based assessments and donors' needs for information to inform their decisions on the level and modality of financial support to partner countries. It also identifies a few key measures to better exploit the potential of the PEFA tool.

The PEFA Framework

During the 1990s, with the support of the international donor community and financial institutions, developing countries undertook very significant work to reform and build the capacity of their PFM systems. However, towards the end of the decade, evaluation work revealed that it was impossible to measure changes in PFM performance over time at the country level and globally; that overlapping PFM analytic studies, not co-ordinated by donors, caused heavy transaction costs; and that without country ownership, reforms had little effect.

To address this situation, the PEFA programme was established in December 2001 as a multi-donor partnership[1], committed to a set of core values linked to a Strengthened Approach to Supporting PFM Reform. This Strengthened Approach[2] comprises three components:

- A country-led agenda – that is, a government-led reform programme for which the analytic work, reform design, implementation, and monitoring reflect country priorities and are integrated into the government's institutional structures.
- A co-ordinated programme of support from donors and international financial institutions, including analytic work, financing for reform, and technical support for implementation, as the country requests.
- A shared pool of information on PFM – for example, information on PFM systems and their performance that is commonly accepted by country-level stakeholders.

A major result of the PEFA programme is the PFM Performance Measurement Framework (the PEFA Framework), which, following two years of development, consultation, and testing, was officially launched in June 2005.[3] The PEFA Framework is a high-level analytic instrument, designed to provide a shared pool of information on PFM that can facilitate

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dialogue on reform priorities among domestic and external stakeholders. Donors may also use assessments based on the PEFA Framework in relation to their internal aid decision processes, but the PEFA Framework is not a fiduciary assessment tool.

The PEFA Framework consists of a set of 31 performance indicators and a supporting PFM Performance Report. It provides an overview of the performance of all parts of a country's PFM systems,[4] covering all stages of the budget cycle, and embraces international standards and codes in its structure (see Annex II for a detailed list of all indicators). The indicators are scored on the basis of specific evidence, using transparent and objective rating criteria. Repeat assessments can demonstrate performance changes over time. While the PEFA assessment provides a robust framework for measuring the performance of PFM systems, it does not, as mentioned earlier, measure service delivery performance or the state of governance in a country.

The Framework focuses on central government, but it may also be used at the sub-national government level. PEFA assessments do not immediately result in recommendations for reform actions and capacity-building measures, which need to be identified through further work in the areas selected as reform priorities.

While the PEFA Framework directly replaced some earlier PFM analytic tools (*e.g.* the Heavily Indebted Poor Countries (HIPC) indicators), other PFM diagnostic tools continue to be used in a complementary manner: for example, the World Bank's Public Expenditure Reviews (PERs) and Country Financial and Accountability Assessments (CFAAs), as well as diagnostics specifically designed to drill down into specific dimensions (*e.g.* the debt management assessment tool, DeMPA, developed by the World Bank in 2007, and the OECD-DAC procurement assessment indicators). These diagnostics have different objectives and scope; when they are implemented within the framework of the Strengthened Approach and a calendar of diagnostics, including regular PEFA assessments, the sum of the parts is expected to reduce transaction costs and lead to greater effectiveness in PFM.

There are different PFM indicator sets in addition to PEFA. Reflecting different objectives, these different indicators sets operate at varying levels of aggregation depending on whether they cover PFM only as one of many aspects, focus entirely and comprehensively on PFM, or concentrate on the details of a selected aspect of PFM. The PEFA framework encapsulates the entire financial management cycle. Indicator 2a of the Paris Declaration relies on data generated by the World Bank's Country Policy and Institutional Assessment (CPIA). This covers broader criteria than PEFA and includes: *a)* economic management; *b)* structural policies; *c)* policies for social inclusion and equity; and *d)* public sector management and institutions. The CPIA criteria focus on the quality of country's current policies and institutions, which are the main determinant of aid effectiveness prospects, while PEFA indicators focus on the performance of a country's PFM systems. Results from the PEFA assessments, where available, are generally used in rating CPIA indicators: Question 13 (Quality of Budget and Financial Management) and Question 14 (Efficiency of Revenue Mobilisation). See Annex III for further details on the linkages between PEFA and CPIA.

Global Adoption

In any country, the government and other potential users (typically international financial institutions and donor agencies) decide whether, when, and how to use the PEFA

Framework. Global adoption took off rapidly in 2005, and since then assessments based on the PEFA Framework have rolled out at a steady rate of about three per month. By March 2008 some 83 PFM performance assessments – based entirely on or significantly incorporating the PEFA Framework – had been finalised or substantially completed. These assessments covered 72 countries and also included some repeat assessments for central governments and assessments at the sub-national government level. Country coverage has been particularly high in Sub-Saharan Africa and in the Caribbean, where more than 80 % of countries have carried out PEFA-based assessments, but there has also been significant coverage (40-60% of countries) in Eastern Europe, Asia, the Pacific, and Latin America.

Government interest and engagement in the performance assessment work is growing rapidly. While governments provided data and other information for the assessments and reviewed the draft report for virtually all the assessments, government initiative to lead the assessment process or to implement a technical self-assessment was initially sporadic. Today, however, governments are increasingly seeking to obtain thorough training of staff in applying the PEFA Framework, especially in countries where a repeat assessment is being planned. Zambia was the first country to show strong initiative in leading the performance assessment work (see Box 5.1), but it has been followed by many other governments: for example, the national governments of Belarus, Bolivia, and Nepal, and the subnational governments of Maharashtra State (India) and Bogotá (Colombia).

Box 5.1. **A Joint Assessment Process Led by the Government**

In 2005, Zambia's donor group was planning its biannual evaluation of the government's PFM reform programme. Concerned about having another purely external evaluation of the PFM system (given the number of similar exercises that had been undertaken in previous years), the government proposed that the evaluation should be a government-led exercise with external facilitation. The development partners accepted this suggestion on the understanding that the evaluation would conform to the standards and procedures of the PEFA programme. It was agreed that the main objective of the exercise should be to establish a baseline for monitoring the progress of the reform programme in terms of performance impact – an objective directly in the government's own interest.

The government formed an assessment team of four staff, mostly from the Ministry of Finance and National Planning; and two international consultants, recommended by the development partners, were retained to assist and coach the government team.

A draft report was prepared and sent for review to the donor group, which also solicited the comments of the PEFA Secretariat. Following additional work to incorporate the comments received, the final report was accepted by all parties, issued in December 2005 as a government document, and posted on the Internet.

The Zambia government now has trained officials who can contribute to monitoring the impact of PFM reforms, using the PEFA methodology. The government has also shown strong ownership of the assessment, using it as a platform for dialogue about the reform programme with the donors and other domestic stakeholders, including Parliament. The monitoring and evaluation unit of the reform programme secretariat in the Ministry of Finance is preparing a repeat assessment for 2008 to gauge performance progress since 2005.

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The usefulness of the PEFA assessment in high-income countries is now substantiated by the self-assessment undertaken by Norway (see Box 5.2).

Box 5.2. **PEFA assessment in a High-Income Country: The Case of Norway**

In 2007-08 Norway – one of the richest countries in the world, with a very highly perceived standard of governance – undertook a self-assessment of its PFM system performance using the PEFA Framework. The work was co-ordinated by a PEFA-experienced staff member of Norad in collaboration with officials from the Ministry of Finance and the National Audit Office, among others. As Norway is a resource-rich country, a special section on the management of the Norwegian petroleum revenue was included, as the PEFA guidelines suggest capturing a comprehensive picture of PFM performance. This special section was drafted on the basis of the methodology and information underpinning an ongoing IMF survey of Norway on fiscal transparency in resource revenue management.

Confirming widespread expectations about the quality of Norway public governance, 22 indicators were rated at A or B level. However, 8 indicators (or indicator dimensions) were rated at C and D level, demonstrating that even in a high-income country, some areas of PFM performance may not meet generally accepted international standards.

Importantly, the government actively responded to the report and its findings. In particular, for the areas obtaining lower ratings, it was decided that:

- Procurement practices, legislative scrutiny of external audit reports and follow-up to external audit report findings needed to be improved.
- An appropriate assessment of the availability of information at the service unit level would require expanding the assessment work to the municipal level.
- Three areas of low performance rating were not to be considered priorities for improvement in the Norwegian context.

Source: Norway PFM Performance Report, June 2008; *www.norad.no/default.asp?V_ITEM_ID=12361*.

More than 20 donor agencies and international financial institutions have been active in supporting the use of the PEFA Framework. Two agencies have been particularly instrumental in the rollout of the PEFA Framework: the World Bank, which led the support to PEFA assessments for about half of the assessments, and the EC, which led for about one-third of the assessments. In a majority of instances, donor agencies have collaborated with the government in carrying out the assessment.

Role of PFM Assessments in the Use of Country PFM Systems

Undertaking a periodic performance assessment of a country's PFM system is one of the key elements in donors' decisions to use that system in the delivery of their aid. The findings from a study of donor approaches to managing risk when using country PFM systems[5], suggest that the PEFA Framework provides a useful starting point for carrying out a PFM risk assessment and that most donors use it for this purpose. The World Bank, for example, often incorporates PEFA indicator assessments into its Country Financial Accountability Assessment (CFAA) reports or adds PEFA assessments to Public Expenditure Review (PER) work. In some countries, it undertakes a detailed procurement assessment – through a Country Procurement Assessment Report – as part of the same process.

Several donor agencies are incorporating the use of PEFA assessments – and in particular, the indicator assessments and ratings – into their internal guidelines, although in different ways. For example, DFID considers PEFA indicator ratings across all indicators to be a key input to the fiduciary risk analyses it conducts to gradually replace its risk benchmarks. France has approved, and Germany has drafted, guidelines for fiduciary risk assessment that base their analyses on the PEFA ratings for selected PEFA indicators. World Bank guidelines do not specifically refer to PEFA-based PFM assessments, but a number of the World Bank's country fiduciary assessments in recent years have incorporated a selection of PEFA indicators as part of the assessment, though not always the same selection in all countries. In revising its risk assessment for project and programme support, the World Bank is now considering a direct link to a selection of PEFA indicators. The European Commission uses the PEFA assessment as its diagnostic of choice for monitoring progress in PFM reforms, itself a crucial component for the assessment of countries' eligibility for budget support as well as for the design of programmes supporting strengthening of PFM and economic governance.

In all cases, however, donors recognise that the PEFA Framework was not designed as a financial risk assessment tool, but rather as an element of the Strengthened Approach, intended to support the strengthening of country PFM systems. While the PEFA performance assessment provides technical information on the functioning of the PFM system, it does not give a value judgment on other risks related to PFM factors – such as funds not being used to finance agreed policies, the level of corruption linked to financial management operations, the existence of a credible PFM reform programme, or the effectiveness of budgetary expenditures in terms of their developmental impact. PFM risk assessments may draw on additional information to cover such risk factors. Thus, while all donors need a general PFM systems assessment, which can be efficiently provided by a commonly available report such as the PEFA one, the information they need to complete their risk assessments varies among donors (and, as Chapter 4 mentioned, could be a subject for further harmonisation through shared analysis).

Overall, PFM assessments are crucial to donor considerations on use of country systems. Most donor agencies have recognised the PEFA Framework as a core tool to provide the basic input to the internal risk assessment, even if they add some other factors.

Impact of PEFA-based PFM Assessments

In late 2007, a first attempt was made to evaluate the effect of the PEFA Framework on achieving the objectives of the Strengthened Approach.[6] The study analysed the experiences of 12 countries representing all regions where a substantial number of assessments have been implemented (Figure 5.1 shows some of the results).

The study found evidence that PEFA assessments have had an effect on both governments and donors, even in the relatively short time since many of the assessments were carried out. In a number of countries the PEFA assessments led to a direct change in governments' PFM reform programmes (Ghana, Madagascar, and Zambia). In these and most other case study countries, PEFA assessments provided governments with a comprehensive view of PFM strengths and weaknesses in a single document, as well as an evidence-based perspective on the achievements and challenges of the PFM system. They also allowed governments to share their experiences with peers.

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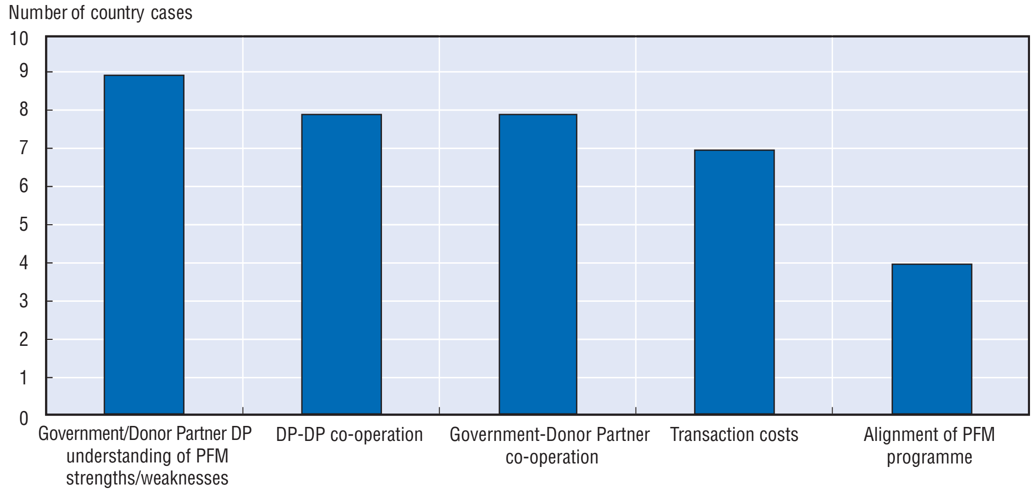
Figure 5.1. **Impact of PEFA Performance Assessments**



Several factors contributed to the positive effects: *a)* active government engagement in the assessment (the factor most frequently mentioned); *b)* a genuine openness to reform on the part of the government; *c)* a perception that the exercise was not a development partner requirement (*e.g.* for provision or continuation of budget support) but was intended to assist the government; and *d)* the quality of the process, including a participatory methodology with active and comprehensive stakeholder preparation of the exercise from the early planning stages.

For donors, the most important factors in whether they used the assessment as a common source of information on PFM systems was the strength of the existing co-operation among donors and the extent of an existing joint framework for dialogue with government. In some cases, this joint framework was centred around a PFM programme or project. While joint cooperation on PEFA assessments was also found to be important, it did not necessarily substitute for donor cooperation in implementing PFM reforms. Less important factors were donors' policy on using PEFA assessments in their internal monitoring processes, and donors' management of the process for finalising the PFM Performance Report.

However, there were also factors that limited the effect of the assessments – for example, capacity constraints that hindered some governments in undertaking both the performance measurement work and the strategic analysis necessary to translate the lessons of strengths and weakness into an appropriately prioritised and sequenced reform programme (whether new or revised). It must also be remembered that direct attribution of PFM reforms to PEFA assessments is difficult when there are ongoing PFM reform programmes and projects, supported by previous assessments that indicate similar strengths and weaknesses. In addition, institutional decision-making processes can take time; many of the action plans following PEFA assessments have only recently been produced, so the extent of government ownership and sustainability will only be evident over time.

The extent to which use of the PEFA Framework has led to reduced transaction costs for government in relation to PFM analytic work may be gleaned from the SPA 2007 Budget Support Survey.[7] The survey shows that in countries where a PEFA assessment had been concluded or was under way, the average number of PFM diagnostics was slightly lower than for the whole sample. More importantly, in countries undertaking a PEFA assessment in 2006, other PFM analytic work focused on different issues (for example, the PER might focus on policy issues, and audits on compliance in the use of earmarked funds), reducing the extent of duplicative work. Given the short track record of PEFA application, however, these welcome findings should be regarded as tentative and in need of future confirmation.

Overall, both governments and development partners appear to value the PEFA instrument for its transparency, its clear criteria for the indicators, its use of international standards, and its applicability across countries. The quality of assessment reports in the initial stages of the PEFA rollout did present a challenge, given the paucity of knowledgeable experts to conduct PEFA assessments. However, with the increasing pool of experts and enhanced quality review mechanism including, on request, peer review by the PEFA Secretariat, the quality of assessments has significantly improved.

Challenges for Enhanced Use of the PEFA Tool

If the PEFA assessments are to continue producing benefits, country-level stakeholders will need to understand and appreciate the assessments' quality and purposes. To maintain and strengthen the quality of the assessments, the PEFA programme continues to address a range of technical quality issues through guidance notes, training material, assessment report reviews, and *ad hoc* advice to assessment mangers and assessors. In addition, process factors will continue to influence the overall quality of PEFA assessments and their use by all stakeholders.[8] Further improvements are desirable in the following areas:

- Country-level planning of PFM analytic work – on both on an annual and medium-term basis – to avoid duplication of work and missions. This planning, which needs to involve all stakeholders, should consider not only the frequency and coverage of PEFA assessments but also the use of complementary analytic tools such as drill-down in selected areas to support partner countries in addressing identified PFM reform priorities.
- Active engagement of the government in the assessment process to facilitate its ownership of the findings and, therefore, its potential use of the report and willingness to share information from the report widely.
- Development of government capacity to use and respond to the assessment, to use the report for setting reform priorities and sequencing actions, to embed the PFM performance indicators in the monitoring and evaluation frameworks for the government's reform programs, and to collect and process the relevant data as well as undertake regular reviews of progress.
- Satisfactory co-ordination among donors and provision of adequate resources for financing the assessments, particularly for small countries; this may require further training of donor staff at headquarters and country offices.
- Establishment of country-specific quality assurance mechanisms, beginning with the early planning stage, with all main stakeholders involved. This is particularly important where the status of the PEFA assessment within the leading agency is unclear and where internal guidelines do not require the involvement of external actors in the quality assurance process.

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- Timely completion of the assessments and sharing of the final reports. Donors need information on PFM system performance for their decisions about using country PFM systems, so it is essential that they have access to recent PEFA assessments. Because most donors need access to the same information, they can best gain the access they need if the assessment reports are, for instance, posted on a generally accessible website on the Internet. In addition, governments desire access to other countries' assessment reports so that they may compare their performance and learn from developments among more advanced reformers. Important progress in finalising assessment reports and posting them on the Internet was made during 2007, but further progress is needed.

Over time, as more repeat PEFA assessments are conducted, the development community will need to learn how best to use these repeat assessments, comparing ratings to track progress in PFM performance over time. An early study, conducted during 2007, demonstrates the ability of PEFA assessments to track performance changes by tracking progress in HIPCs between 2001 and 2006, using former HIPC assessments and recent PEFA reports in 15 countries.[9] It will be important to follow up these early findings with more in-depth work.

Measures to Enhance the Use of PEFA Assessments

The PEFA Framework offers a unique opportunity for country governments and their development partners to jointly measure the performance of country PFM systems against transparent and objective criteria. The Framework can facilitate key elements of the Paris Declaration and has already been widely adopted.

Recommendation

Therefore, it is recommended that all signatories to the Paris Declaration officially adopt the PEFA Framework as the core tool for measuring and monitoring PFM performance; that they strive to minimise the number of separate PFM diagnostics; and that they improve public access to PFM assessment reports by, for example, posting them on the Internet – so that the information becomes a truly shared pool for both internal and external stakeholders.

Effective implementation of this recommendation would require mutual commitment by country government and development partners in at least three areas:

- Country governments should work with their development partners to establish and implement multi-year country-level plans for PFM analytic work, to ensure effective coverage and sequencing of analytic work and avoid unnecessary transaction costs from duplicative work.
- Country governments' capacity to take a leading role in the assessment work should be strengthened by wide dissemination of information on the PEFA Framework and assistance in carrying out self-assessments – including provision of training opportunities for government staff.
- The quality and the credibility of PEFA assessments should be regularly monitored to ensure that findings are credible and that country authorities can use them in designing a robust PFM reform programme.

Notes

1. PEFA is a partnership programme of the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Norwegian Ministry of Foreign Affairs, and the International Monetary Fund. It works in close collaboration with the OECD-DAC Joint Venture for PFM and the Strategic Partnership for Africa.
2. See OECD (2006), *Harmonising Donor Practices for Effective Aid Delivery*, DAC Guidelines and Reference Series, Vol. 2, OECD, Paris.
3. Consultations included focus groups comprising PFM practitioners from partner governments, OECD-DAC members, professional associations, and academia, as well as specialist PFM consultants. Testing was undertaken in 25 countries covering all regions.
4. The PEFA Framework does not assess a country's fiscal and expenditure policies.
5. CIPFA and Mokoro Ltd (2008), *Stocktake on Donor Approaches to Managing Risk when Using Country Systems*, March 2008, Oxford
6. De Renzio, P. and Dorotinsky, W. (2007), "Tracking Progress in the Quality of PFM Systems in HIPCs: An Update on Past Assessments Using PEFA", Washington D.C.
7. An annual survey covering 14 countries in sub-Saharan Africa.
8. PEFA (2008), Monitoring Report 2007 Part I, March 2008, PEFA, Washington D.C.
9. Paolo de Renzio and Bill Dorotinsky, "Tracking Progress in the Quality of PFM Systems in HIPCs – An Update on Past Assessments using PEFA Data," PEFA (November 2007). It should also be noted that 2006 results are based on PEFA assessments, whereas 2001 and 2004 results are based on HIPC assessments.

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*Presentations (Joint Venture on PFM Meetings 2005-2007)**

The following presentations given at Joint Venture meetings between 2005 and 2008 contributed to the report findings:

Stephen Sharples (DFID), *PFM Reform: Experience from Ghana*, June 2006.

Wim Ulens (BTC Maputo), *Harmonising Donor Practices for Effective Aid Delivery: The Case of PFM Capacity Building in Mozambique*, December 2006.

Dag Aarnes (Assist Consulting, Norway), *PFM Reforms: Support to Supreme Audit Institutions in Malawi and Zambia*, December 2006.

Frans Ronsholt (PEFA), *Rolling out of the PEFA Performance Measurement Framework*, December 2006.

Pierre Ewenczyk (IMF), *IMF Experience in Rebuilding Fiscal Institutions in Post-Conflict Countries*, July 2007.

François Zoundi (Burkina Faso), *Aperçu sur le cadre national des reformes PFM : Présentation du document de stratégie de renforcement des finances publiques*, July 2007.

Stephen Lister (Mokoro Ltd), *SPA-CABRI Project on Putting Aid on Budget Presentation*, July 2007.

Christine Walker (CIDA), *CIDA's Draft Financial Risk Assessment Framework*, December 2007.

Hakon Mundal (Norad), *PEFA Assessment*, Norway, December 2007.

David M. Walker (GAO) and Ahmed Al-Midaoui (Cour des Comptes, Maroc), *Partnering for Progress: Working Together to Strengthen Supreme Audit Institutions*, December 2007.

Frederick Stapenhurst (World Bank Institute), *Strengthening Country PFM Systems: The Role of Parliament*, December 2007.

Sanjay Vani (World Bank), *Use of Country Systems in World Bank Supported Projects: A Case Study (Ukraine)*, December 2007.

David Gray (DFID), *Case Study on PFM Reforms in Bangladesh*, December 2007.

**Selected presentations are available on the JV on PFM website: *www.oecd.org/dac/effectiveness/pfm*.

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ANNEX I

Components of PFM Systems and Indicators of their Use

The table below maps the components of PFM systems and the scope for their aid capture as identified in the CABRI/SPA aid on budget report (Mokoro Ltd (2008)) with indicators measuring the extent to which aid flows use country systems utilised in the monitoring of the Paris Declaration and in the PEFA framework. The PEFA framework also contains specific high level indicators measuring the strength of individual PFM components (see Annex II).

SPA/CABRI Definition aid on budget report	Paris declaration 2008 monitoring survey definition	PEFA
On Plan Programme and project aid spending integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind the budget submissions.	**Indicator 3:** Aid flows are aligned to national priorities. Although there is no specific indicator to measure progress in reflecting programme and project aid into strategic plans and MTEF, indicator 3, to some extent, requires alignment of aid flows with national priorities.	**Indicator D2:** Financial information provided by donors for budgeting and reporting on project and programme aid. In order to score A for this indicator: All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's classification system.
On budget External financing, including programme and project financing, and its intended use reported in the budget documentation.	**Indicator 5a:** Use of budget execution procedures The 2008 Survey on Monitoring the Paris Declaration set out four criteria, of which donors needed to meet three to record their aid as using country PFM systems.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures means that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds. **Indicator PI-7 (ii):** Extent of unreported government operations: Income/expenditure information on donor-funded projects which is included in fiscal reports.
On parliament (or "through budget") External financing included in the revenue and appropriations approved by parliament.	**Indicator 5a:** Use of budget execution procedures (as above). • Under the first criterion, funds need to be included in the annual budget that is approved by the country legislature.	**No specific PEFA indicator:** However, D3 to some extent mirrors the intention of the "On Parliament" typology.
On treasury External financing disbursed into the main revenue funds of government and managed through government's systems.	**Indicator 5a:** Use of budget execution procedures (as above). • Under the second criterion, funds need to be subject to established country budget execution procedures. • Under the third criterion, funds are to be both deposited and disbursed through the established country treasury system. Under the fourth criterion, separate bank accounts should not be opened for donor funds.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures mean that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.

SPA/CABRI Definition aid on budget report	Paris declaration 2008 monitoring survey definition	PEFA
On accounting External financing recorded and accounted for in government's accounting system, in line with government's classification system.	**Indicator 5a:** Use of national financial reporting. The criteria for the 2008 Survey indicate that: • donors should not require separate accounting systems to satisfy their own requirements; and • financial reports prepared using the country's established financial reporting arrangements should be the only reports required.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures mean that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds. Indicator PI-7 (ii): Extent of unreported government operations: Income/expenditure information on donor-funded projects which is included in fiscal reports.
On audit External financing audited by government's auditing system.	**Indicator 5a:** Use of national auditing requirements. To qualify, donors should not make additional requirements on government for auditing (except for exceptional audits) but rely instead on the audit opinions issued by the country's supreme audit institution and on the governments' normal financial reports and statements. In the 2008 Survey definitions, • funds need to be subject to audits carried out under the responsibility of the supreme audit institution (SAI). Moreover, under normal circumstances, additional audit arrangements are not requested. Donors must meet at least one of the following criteria: • there is no requirement to have audit standards that are different from those adopted by the SAI; and • the SAI is not required to change its audit cycle to audit the donor funds.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures mean that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.
On report External financing included in *ex post* reports by government.	**Indicator 5a:** Use of national financial reporting. The criteria for the 2008 Survey indicate that • donors should not require separate accounting systems to satisfy their own requirements; and • financial reports prepared using the country's established financial reporting arrangements should be the only reports required.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures mean that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.
On procurement Externally-financed procurement follows the government's standard procurement procedures	**Indicator 5b:** Use of country procurement systems. Donors use national procurement procedures when the funds they provide for the implementation of projects and programmes are managed according to the national procurement procedures as they were established in the general legislation and implemented by government. This means that donors do not make additional, or special, requirements on governments for the procurement of works, goods, and services.	**Indicator D3:** Proportion of aid that is managed by use of national procedures. The use of national procedures mean that the banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.

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ANNEX II

Overview of the PEFA PFM/High-Level Performance Indicator Set

A. PFM OUT-TURNS: Credibility of the budget	
PI-1	Aggregate expenditure out-turn compared to original approved budget
PI-2	Composition of expenditure out-turn compared to original approved budget
PI-3	Aggregate revenue out-turn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency	
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation
PI-7	Extent of unreported government operations
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities
PI-10	Public access to key fiscal information
C. BUDGET CYCLE	
C(i) Policy-Based Budgeting	
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
C(ii) Predictability and Control in Budget Execution	
PI-13	Transparency of taxpayer obligations and liabilities
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
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls
PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure
PI-21	Effectiveness of internal audit
C(iii) Accounting, Recording and Reporting	
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
C(iv) External Scrutiny and Audit	
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports
D. DONOR PRACTICES	
D-1	Predictability of direct budget support
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid
D-3	Proportion of aid that is managed by use of national procedures

ANNEX III

PEFA linkage with the CPIA Questions

The three dimensions of CPIA Q.13 each correspond to the specific PEFA indicators as follows (although the calibration differs substantially):

CPIA Q.13 (a): PEFA PI-5, PI-6, PI-7, PI-11, PI-12, PI-27.

CPIA Q.13 (b): PEFA PI-1, PI-2, PI-4, PI-16 (ref. notes *i* and *iii*).

CPIA Q.13 (c): PEFA PI-22, PI-24, PI-25, PI-26 (ref. note *ii*).

For CPIA Question 14 the links are as follows:

CPIA Q.14 (b): PEFA PI-13, PI-14, PI-15

Note (*i*): PI-16 is the best approximation to "budget monitoring" in the CPIA calibration without overlapping with "in-year fiscal reports" in CPIA Q.13(c). Budget control systems are referred to only for CPIA scores of "3" and "4".

Note (*ii*): Requirements corresponding to PI-10 kick in only for a score of "6" in the CPIA rating, which no country is reaching.

Note (*iii*): PI-20 (i) would have been appropriate to include but was excluded because of the inappropriateness of the other dimensional scores.

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ANNEX IV

Joint Progress Toward Enhanced Aid Effectiveness

Harmonisation, Alignment, Results

High Level Forum

Paris ■ February 28 – March 2, 2005

The Paris Declaration on Aid Effectiveness

Ownership, Harmonisation, Alignment, Results and Mutual Accountability

I. STATEMENT OF RESOLVE

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

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

Scale up for more effective aid

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6. In following up the Declaration, we will intensify our efforts to provide and use development assistance, including the increased flows as promised at Monterrey, in ways

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that rationalise the often excessive fragmentation of donor activities at the country and sector levels.

Adapt and apply to differing country situations

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

Specify indicators, timetable and targets

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

9. As a further spur to progress, we will set targets for the year 2010. These targets, which will involve action by both donors and partner countries, are designed to track and encourage progress at the global level among the countries and agencies that have agreed to this Declaration. They are not intended to prejudge or substitute for any targets that individual partner countries may wish to set. We have agreed today to set five preliminary targets against indicators as shown in Section III. We agree to review these preliminary targets and to adopt targets against the remaining indicators as shown in Section III before the UNGA Summit in September 2005; and we ask the partnership of donors and partner countries hosted by the DAC to prepare for this urgently.[1] Meanwhile, we welcome initiatives by partner countries and donors to establish their own targets for improved aid effectiveness within the framework of the agreed Partnership Commitments and Indicators of Progress. For example, a number of partner countries have presented action plans, and a large number of donors have announced important new commitments. We invite all participants who wish to provide information on such initiatives to submit it by 4 April 2005 for subsequent publication.

Monitor and evaluate implementation

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

11. At the international level, we call on the partnership of donors and partner countries hosted by the DAC to broaden partner country participation and, by the end of 2005, to propose arrangements for the medium term monitoring of the commitments in this

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

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

II. PARTNERSHIP COMMITMENTS

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

OWNERSHIP

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

14. **Partner countries** commit to:

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

15. **Donors** commit to:

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

ALIGNMENT

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

Donors align with partners' strategies

16. **Donors** commit to:

- Base their overall support – country strategies, policy dialogues and development co-operation programmes – on partners' national development strategies and periodic reviews of progress in implementing these strategies[3] (**Indicator 3**).
- Draw conditions, whenever possible, from a partner's national development strategy or its annual review of progress in implementing this strategy. Other conditions would be

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included only when a sound justification exists and would be undertaken transparently and in close consultation with other donors and stakeholders.

- Link funding to a single framework of conditions and/or a manageable set of indicators derived from the national development strategy. This does not mean that all donors have identical conditions, but that each donor's conditions should be derived from a common streamlined framework aimed at achieving lasting results.

Donors use strengthened country systems

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

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

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

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

20. **Partner countries** commit to:

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

21. **Donors** commit to:

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

Partner countries strengthen development capacity with support from donors

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

23. **Partner countries** commit to:

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

24. **Donors** commit to:

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

Strengthen public financial management capacity

25. **Partner countries** commit to:

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

26. **Donors** commit to:

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

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

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

Strengthen national procurement systems

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

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

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

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30. **Donors** commit to:

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

Untie aid: getting better value for money

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

HARMONISATION

Donors' actions are more harmonised, transparent and collectively effective

Donors implement common arrangements and simplify procedures

32. **Donors** commit to:

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

Complementarity: more effective division of labour

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

34. **Partner countries** commit to:

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

35. **Donors** commit to:

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

Incentives for collaborative behaviour

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

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

Delivering effective aid in fragile states[5]

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

38. **Partner countries** commit to:

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

39. **Donors** commit to:

a) Harmonise their activities. Harmonisation is all the more crucial in the absence of strong government leadership. It should focus on upstream analysis, joint assessments, joint strategies, co-ordination of political engagement; and practical initiatives such as the establishment of joint donor offices.

b) Align to the maximum extent possible behind central government-led strategies or, if that is not possible, donors should make maximum use of country, regional, sector or non-government systems.

c) Avoid activities that undermine national institution building, such as bypassing national budget processes or setting high salaries for local staff.

d) Use an appropriate mix of aid instruments, including support for recurrent financing, particularly for countries in promising but high-risk transitions.

Promoting a harmonised approach to environmental assessments

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

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

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

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

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MANAGING FOR RESULTS

Managing resources and improving decision-making for results

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

44. **Partner countries** commit to:

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

45. **Donors** commit to:

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

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

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

MUTUAL ACCOUNTABILITY

Donors and partners are accountable for development results

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

48. **Partner countries** commit to:

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

49. **Donors** commit to:

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

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

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

III. INDICATORS OF PROGRESS

To be measured nationally and monitored internationally

<table>
<tr><th colspan="2">OWNERSHIP</th><th colspan="2">TARGET FOR 2010</th></tr>
<tr><td>1</td><td>Partners have operational development strategies – Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.</td><td colspan="2">At least 75% of partner countries have operational development strategies.</td></tr>
<tr><th colspan="2">ALIGNMENT</th><th colspan="2">TARGETS FOR 2010</th></tr>
<tr><td>2</td><td>Reliable country systems – Number of partner countries that have procurement and public financial management systems that either a) adhere to broadly accepted good practices or b) have a reform programme in place to achieve these.</td><td colspan="2">a) Public financial management – Half of partner countries move up at least one measure (i.e., 0.5 points) on the PFM/ CPIA (Country Policy and Institutional Assessment) scale of performance.
b) Procurement – One-third of partner countries move up at least one measure (i.e., from D to C, C to B or B to A) on the four-point scale used to assess performance for this indicator.</td></tr>
<tr><td>3</td><td>Aid flows are aligned on national priorities – Percent of aid flows to the government sector that is reported on partners' national budgets.</td><td colspan="2">Halve the gap – Halve the proportion of aid flows to government sector not reported on government's budget(s) (with at least 85% reported on budget).</td></tr>
<tr><td>4</td><td>Strengthen capacity by co-ordinated support – Percent of donor capacity-development support provided through co-ordinated programmes consistent with partners' national development strategies.</td><td colspan="2">50% of technical co-operation flows are implemented through co-ordinated programmes consistent with national development strategies.</td></tr>
<tr><td rowspan="8">5a</td><td rowspan="8">Use of country public financial management systems – Percent of donors and of aid flows that use public financial management systems in partner countries, which either a) adhere to broadly accepted good practices or b) have a reform programme in place to achieve these.</td><td colspan="2">PERCENT OF DONORS</td></tr>
<tr><td>Score*</td><td>Target</td></tr>
<tr><td>5+</td><td>All donors use partner countries' PFM systems.</td></tr>
<tr><td>3.5 to 4.5</td><td>90% of donors use partner countries' PFM systems.</td></tr>
<tr><td colspan="2">PERCENT OF AID FLOWS</td></tr>
<tr><td>Score*</td><td>Target</td></tr>
<tr><td>5+</td><td>A two-thirds reduction in the % of aid to the public sector not using partner countries' PFM systems.</td></tr>
<tr><td>3.5 to 4.5</td><td>A one-third reduction in the % of aid to the public sector not using partner countries' PFM systems.</td></tr>
<tr><td rowspan="8">5b</td><td rowspan="8">Use of country procurement systems – Percent of donors and of aid flows that use partner country procurement systems which either a) adhere to broadly accepted good practices or b) have a reform programme in place to achieve these.</td><td colspan="2">PERCENT OF DONORS</td></tr>
<tr><td>Score*</td><td>Target</td></tr>
<tr><td>A</td><td>All donors use partner countries' procurement systems.</td></tr>
<tr><td>B</td><td>90% of donors use partner countries' procurement systems.</td></tr>
<tr><td colspan="2">PERCENT OF AID FLOWS</td></tr>
<tr><td>Score*</td><td>Target</td></tr>
<tr><td>A</td><td>A two-thirds reduction in the % of aid to the public sector not using partner countries' procurement systems.</td></tr>
<tr><td>B</td><td>A one-third reduction in the % of aid to the public sector not using partner countries' procurement systems.</td></tr>
<tr><td>6</td><td>Strengthen capacity by avoiding parallel implementation structures – Number of parallel project implementation units (PIUs) per country.</td><td colspan="2">Reduce by two-thirds the stock of parallel project implementation units (PIUs).</td></tr>
<tr><td>7</td><td>Aid is more predictable – Percent of aid disbursements released according to agreed schedules in annual or multi-year frameworks.</td><td colspan="2">Halve the gap – Halve the proportion of aid not disbursed within the fiscal year for which it was scheduled.</td></tr>
<tr><td>8</td><td>Aid is untied – Percent of bilateral aid that is untied.</td><td colspan="2">Continued progress over time.</td></tr>
</table>

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	HARMONISATION	TARGETS FOR 2010
9	*Use of common arrangements or procedures* – Percent of aid provided as programme-based approaches.	**66% of aid flows** are provided in the context of programme-based approaches.
10	*Encourage shared analysis* – Percent of *a)* field missions and/or *b)* country analytic work, including diagnostic reviews that are joint.	***a)* 40% of donor missions** to the field are joint**.** ***b)* 66% of country analytic work is joint.**
	MANAGING FOR RESULTS	**TARGET FOR 2010**
11	*Results-oriented frameworks* – Number of countries with transparent and monitorable performance assessment frameworks to assess progress against *a)* the national development strategies and *b)* sector programmes.	**Reduce the gap by one-third –** Reduce the proportion of countries without transparent and monitorable performance assessment frameworks by one-third.
	MUTUAL ACCOUNTABILITY	**TARGET FOR 2010**
12	*Mutual accountability* – Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.	**All partner countries** have mutual assessment reviews in place.

Important Note: In accordance with paragraph 9 of the Declaration, the partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) comprising OECD/DAC members, partner countries and multilateral institutions, met twice, on 30-31 May 2005 and on 7-8 July 2005 to adopt, and review where appropriate, the targets for the twelve Indicators of Progress. At these meetings an agreement was reached on the targets presented under Section III of the present Declaration. This agreement is subject to reservations by one donor on *a)* the methodology for assessing the quality of locally-managed procurement systems (relating to targets 2b and 5b) and *b)* the acceptable quality of public financial management reform programmes (relating to target 5a.ii). Further discussions are underway to address these issues. The targets, including the reservation, have been notified to the Chairs of the High-level Plenary Meeting of the 59th General Assembly of the United Nations in a letter of 9 September 2005 by Mr. Richard Manning, Chair of the OECD Development Assistance Committee (DAC).

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

Notes

1. In accordance with paragraph 9 of the Declaration, the partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) comprising OECD/DAC members, partner countries and multilateral institutions, met twice, on 30-31 May 2005 and on 7-8 July 2005 to adopt, and review where appropriate, the targets for the twelve Indicators of Progress. At these meetings an agreement was reached on the targets presented under Section III of the present Declaration. This agreement is subject to reservations by one donor on *a)* the methodology for assessing the quality of locally-managed procurement systems (relating to targets 2b and 5b) and *b)* the acceptable quality of public financial management reform programmes (relating to target 5a.ii). Further discussions are underway to address these issues. The targets, including the reservation, have been notified to the Chairs of the High-level Plenary Meeting of the 59th General Assembly of the United Nations in a letter of 9 September 2005 by Mr. Richard Manning, Chair of the OECD Development Assistance Committee (DAC).
2. The term `national development strategies' includes poverty reduction and similar overarching strategies as well as sector and thematic strategies.
3. This includes for example the Annual Progress Review of the Poverty Reduction Strategies (APR).
4. Such as the processes developed by the joint OECD-DAC – World Bank Round Table on Strengthening Procurement Capacities in Developing Countries.
5. The following section draws on the draft Principles for Good International Engagement in Fragile States, which emerged from the Senior Level Forum on Development Effectiveness in Fragile States (London, January 2005).

APPENDIX A

Methodological Notes on the Indicators of Progress

The Indicators of Progress provides a framework in which to make operational the responsibilities and accountabilities that are framed in the Paris Declaration on Aid Effectiveness. This framework draws selectively from the Partnership Commitments presented in Section II of this Declaration.

Purpose – The Indicators of Progress provide a framework in which to make operational the responsibilities and accountabilities that are framed in the Paris Declaration on Aid Effectiveness. They measure principally **collective behaviour at the country level.**

Country level *vs.* global level – The indicators are to be **measured at** the **country level** in close collaboration between partner countries and donors. Values of country level indicators can then be statistically aggregated at the **regional or global level**. This global aggregation would be done both for the country panel mentioned below, for purposes of statistical comparability, and more broadly for all partner countries for which relevant data are available.

Donor/Partner country performance – The indicators of progress also provide a **benchmark against which individual donor agencies or partner countries can measure their performance** at the country, regional, or global level. In measuring individual donor performance, the indicators should be applied with flexibility in the recognition that donors have different institutional mandates.

Targets – The targets are set at the global level. Progress against these targets is to be measured by aggregating data measured at the country level. In addition to global targets, partner countries and donors in a given country might agree on country-level targets.

Baseline – A baseline will be established for 2005 in a panel of self-selected countries. The partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) is asked to establish this panel.

Definitions and criteria – The partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) is asked to provide specific guidance on definitions, scope of application, criteria and methodologies to assure that results can be aggregated across countries and across time.

Note on Indicator 9 – Programme-based approaches are defined in Volume 2 of *Harmonising Donor Practices for Effective Aid Delivery* (OECD, 2005) in Box 3.1 as a way of engaging in development cooperation based on the principles of co-ordinated support for a locally owned programme of development, such as a national development strategy, a sector programme, a thematic programme or a programme of a specific organisation. Programme-based approaches share the following features: *a)* leadership by the host country or organisation; *b)* a single comprehensive programme and budget framework; *c)* a formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement; *d)* Efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation. For the purpose of indicator 9 performance will be measured separately across the aid modalities that contribute to programme-based approaches.

APPENDIX B

List of Participating Countries and Organisations

Participating Countries

Albania	Australia	Austria
Bangladesh	Belgium	Benin
Bolivia	Botswana	[Brazil]*
Burkina Faso	Burundi	Cambodia
Cameroon	Canada	China
Congo D.R.	Czech Republic	Denmark
Dominican Republic	Egypt	Ethiopia
European Commission	Fiji	Finland
France	Gambia	Germany
Ghana	Greece	Guatemala
Guinea	Honduras	Iceland
Indonesia	Ireland	Italy
Jamaica	Japan	Jordan
Kenya	Korea	Kuwait
Kyrgyz Republic	Lao PDR	Luxembourg
Madagascar	Malawi	Malaysia
Mali	Mauritania	Mexico
Mongolia	Morocco	Mozambique
Nepal	Netherlands	New Zealand
Nicaragua	Niger	Norway
Pakistan	Papua New Guinea	Philippines
Poland	Portugal	Romania
Russian Federation	Rwanda	Saudi Arabia
Senegal	Serbia and Montenegro	Slovak Republic
Solomon Islands	South Africa	Spain
Sri Lanka	Sweden	Switzerland
Tajikistan	Tanzania	Thailand
Timor-Leste	Tunisia	Turkey
Uganda	United Kingdom	United States of America
Vanuatu	Viet Nam	Yemen
Zambia		

* To be confirmed.

More countries than listed here have endorsed the Paris Declaration. For a full and up to date list please consult *www.oecd.org/dac/effectiveness/parisdeclaration/members*.

Participating Organisations

African Development Bank	Arab Bank for Economic Development in Africa
Asian Development Bank	Commonwealth Secretariat
Consultative Group to Assist the Poorest (CGAP)	Council of Europe Development Bank (CEB)
Economic Commission for Africa (ECA)	Education for All Fast Track Initiative (EFA-FTI)
European Bank for Reconstruction and Development (EBRD)	European Investment Bank (EIB)
Global Fund to Fight Aids, Tuberculosis and Malaria	G24
Inter-American Development Bank	International Fund for Agricultural Development (IFAD)
International Monetary Fund (IMF)	International Organisation of the Francophonie
Islamic Development Bank	Millennium Campaign
New Partnership for Africa's Development (NEPAD)	Nordic Development Fund
Organisation for Economic Co-operation and Development (OECD)	Organisation of Eastern Caribbean States (OECS)
OPEC Fund for International Development	Pacific Islands Forum Secretariat
United Nations Development Group (UNDG)	World Bank

Civil Society Organisations

Africa Humanitarian Action	AFRODAD
Bill and Melinda Gates Foundations	Canadian Council for International Cooperation (CCIC)
Comité Catholique contre la Faim et pour le Développement (CCFD)	Coopération Internationale pour le Développement et la Solidarité (CIDSE)
Comisión Económica (Nicaragua)	ENDA Tiers Monde
EURODAD	International Union for Conservation of Nature and Natural Resources (IUCN)
Japan NGO Center for International Cooperation (JANIC)	Reality of Aid Network
Tanzania Social and Economic Trust (TASOET)	UK Aid Network

ANNEX V

Accra Agenda for Action

Ministers of developing and donor countries responsible for promoting development and Heads of multilateral and bilateral development institutions endorsed the following statement in Accra, Ghana, on 4 September 2008 to accelerate and deepen implementation of the Paris Declaration on Aid Effectiveness (2 March 2005).

This is a moment of opportunity

1.1.1.1. We are committed to eradicating poverty and promoting peace and prosperity by building stronger, more effective partnerships that enable developing countries to realise their development goals.

1.1.1.2. There has been progress. Fifteen years ago, two out of five people lived in extreme poverty; today, that figure has been reduced to one in four. However, 1.4 billion people – most of them women and girls – still live in extreme poverty,[1] and access to safe drinking water and health care remains a major issue in many parts of the world. In addition, new global challenges – rising food and fuel prices and climate change – threaten the advances against poverty many countries have made.

1.1.1.3. We need to achieve much more if all countries are to meet the Millennium Development Goals (MDGs). Aid is only one part of the development picture. Democracy, economic growth, social progress, and care for the environment are the prime engines of development in all countries. Addressing inequalities of income and opportunity within countries and between states is essential to global progress. Gender equality, respect for human rights, and environmental sustainability are cornerstones for achieving enduring impact on the lives and potential of poor women, men, and children. It is vital that all our policies address these issues in a more systematic and coherent way.

1.1.1.4. In 2008, three international conferences will help us accelerate the pace of change: the Accra High Level Forum on Aid Effectiveness, the United Nations High Level Event on the MDGs in New York, and the Financing for Development follow-up meeting in Doha. Today at Accra, we are leading the way, united in a common objective: to unlock the full potential of aid in achieving lasting development results.

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We are making progress, but not enough

1.1.1.5. Learning from our past successes and failures in development co-operation and building on the 2003 Rome Declaration on Harmonisation, in March 2005 we adopted an ambitious set of reforms: the Paris Declaration on Aid Effectiveness. In the Paris Declaration, we agreed to develop a genuine partnership, with developing countries clearly in charge of their own development processes. We also agreed to hold each other accountable for achieving concrete development results. Three and one-half years later, we are reconvening in Accra to review progress and address the challenges that now face us.

1.1.1.6. Evidence shows we are making progress, but not enough. A recent evaluation shows that the Paris Declaration has created powerful momentum to change the way developing countries and donors work together on the ground. According to the 2008 Monitoring Survey, a large number of developing countries have improved their management of public funds. Donors, in turn, are increasingly improving their co-ordination at country level. Yet the pace of progress is too slow. Without further reform and faster action we will not meet our 2010 commitments and targets for improving the quality of aid.

We will take action to accelerate progress

1.1.1.7. Evidence shows that we will need to address three major challenges to accelerate progress on aid effectiveness:

1.1.1.8. *Country ownership is key.* Developing country governments will take stronger leadership of their own development policies, and will engage with their parliaments and citizens in shaping those policies. Donors will support them by respecting countries' priorities, investing in their human resources and institutions, making greater use of their systems to deliver aid, and increasing the predictability of aid flows.

1.1.1.9. *Building more effective and inclusive partnerships*. In recent years, more development actors – middle-income countries, global funds, the private sector, civil society organisations – have been increasing their contributions and bringing valuable experience to the table. This also creates management and co-ordination challenges. Together, all development actors will work in more inclusive partnerships so that all our efforts have greater impact on reducing poverty.

1.1.1.10. *Achieving development results – and openly accounting for them – must be at the heart of all we do*. More than ever, citizens and taxpayers of all countries expect to see the tangible results of development efforts. We will demonstrate that our actions translate into positive impacts on people's lives. We will be accountable to each other and to our respective parliaments and governing bodies for these outcomes.

1.1.1.11. Without addressing these obstacles to faster progress, we will fall short of our commitments and miss opportunities to improve the livelihoods of the most vulnerable people in the world. Therefore, we are reaffirming the commitments we made in the Paris Declaration and, in this Accra Agenda for Action, are agreeing on concrete and monitorable actions to accelerate progress to meet those commitments by 2010. We commit to continuing efforts in monitoring and evaluation that will assess whether we have achieved the commitments we agreed in the Paris Declaration and the Accra Agenda for Action, and to what extent aid effectiveness is improving and generating greater development impact.

STRENGTHENING COUNTRY OWNERSHIP OVER DEVELOPMENT

1.1.2. Developing countries determine and implement their development policies to achieve their own economic, social and environmental goals. We agreed in the Paris Declaration that this would be our first priority. Today, we are taking additional steps to turn this resolution into a reality.

We will broaden country-level policy dialogue on development

1.1.2.1. We will engage in open and inclusive dialogue on development policies. We acknowledge the critical role and responsibility of parliaments in ensuring country ownership of development processes. To further this objective we will take the following actions:

a) Developing country governments will work more closely with parliaments and local authorities in preparing, implementing and monitoring national development policies and plans. They will also engage with civil society organisations (CSOs).

b) Donors will support efforts to increase the capacity of all development actors – parliaments, central and local governments, CSOs, research institutes, media and the private sector – to take an active role in dialogue on development policy and on the role of aid in contributing to countries' development objectives.

c) Developing countries and donors will ensure that their respective development policies and programmes are designed and implemented in ways consistent with their agreed international commitments on gender equality, human rights, disability and environmental sustainability.

Developing countries will strengthen their capacity to lead and manage development

1.1.2.2. Without robust capacity – strong institutions, systems, and local expertise – developing countries cannot fully own and manage their development processes. We agreed in the Paris Declaration that capacity development is the responsibility of developing countries, with donors playing a supportive role, and that technical co-operation is one means among others to develop capacity. Together, developing countries and donors will take the following actions to strengthen capacity development:

a) Developing countries will systematically identify areas where there is a need to strengthen the capacity to perform and deliver services at all levels – national, sub-national, sectoral, and thematic – and design strategies to address them. Donors will strengthen their own capacity and skills to be more responsive to developing countries' needs.

b) Donors' support for capacity development will be demand-driven and designed to support country ownership. To this end, developing countries and donors will *i)* jointly select and manage technical co-operation, and *ii)* promote the provision of technical co-operation by local and regional resources, including through South-South co-operation.

c) Developing countries and donors will work together at all levels to promote operational changes that make capacity development support more effective.

We will strengthen and use developing country systems to the maximum extent possible

1.1.2.3. Successful development depends to a large extent on a government's capacity to implement its policies and manage public resources through its own institutions and systems. In the Paris Declaration, developing countries committed to strengthen their systems[2] and donors committed to use those systems to the maximum extent possible. Evidence shows, however, that developing countries and donors are not on track to meet these commitments. Progress in improving the quality of country systems varies considerably among countries; and even when there are good-quality country systems, donors often do not use them. Yet it is recognised that using country systems promotes their development. To strengthen and increase the use of country systems, we will take the following actions:

a) Donors agree to use country systems as the first option for aid programmes in support of activities managed by the public sector.

b) Should donors choose to use another option and rely on aid delivery mechanisms outside country systems (including parallel project implementation units), they will transparently state the rationale for this and will review their positions at regular intervals. Where use of country systems is not feasible, donors will establish additional safeguards and measures in ways that strengthen rather than undermine country systems and procedures.

c) Developing countries and donors will jointly assess the quality of country systems in a country-led process using mutually agreed diagnostic tools. Where country systems require further strengthening, developing countries will lead in defining reform programmes and priorities. Donors will support these reforms and provide capacity development assistance.

d) Donors will immediately start working on and sharing transparent plans for undertaking their Paris commitments on using country systems in all forms of development assistance; provide staff guidance on how these systems can be used; and ensure that internal incentives encourage their use. They will finalise these plans as a matter of urgency.

e) Donors recollect and reaffirm their Paris Declaration commitment to provide 66% of aid as programme-based approaches. In addition, donors will aim to channel 50% or more of government-to-government assistance through country fiduciary systems, including by increasing the percentage of assistance provided through programme based approaches.

BUILDING MORE EFFECTIVE AND INCLUSIVE PARTNERSHIPS FOR DEVELOPMENT

1.1.3. Aid is about building partnerships for development. Such partnerships are most effective when they fully harness the energy, skills and experience of all development actors – bilateral and multilateral donors, global funds, CSOs, and the private sector. To support developing countries' efforts to build for the future, we resolve to create partnerships that will include all these actors.

We will reduce costly fragmentation of aid

1.1.3.1. The effectiveness of aid is reduced when there are too many duplicating initiatives, especially at country and sector levels. We will reduce the fragmentation of aid by improving the complementarity of donors' efforts and the division of labour among donors, including through improved allocation of resources within sectors, within countries, and across countries. To this end:

a) Developing countries will lead in determining the optimal roles of donors in supporting their development efforts at national, regional and sectoral levels. Donors will respect developing countries' priorities, ensuring that new arrangements on the division of labour will not result in individual developing countries receiving less aid.

b) Donors and developing countries will work together with the Working Party on Aid Effectiveness to complete good practice principles on country-led division of labour. To that end, they will elaborate plans to ensure the maximum co-ordination of development co-operation. We will evaluate progress in implementation starting in 2009.

c) We will start dialogue on international division of labour across countries by June 2009.

d) We will work to address the issue of countries that receive insufficient aid.

We will increase aid's value for money

1.1.3.2. Since the Paris Declaration was agreed in 2005, OECD-DAC donors have made progress in untying their aid. A number of donors have already fully untied their aid, and we encourage others to do so. We will pursue, and accelerate, these efforts by taking the following actions:

a) OECD-DAC donors will extend coverage of the 2001 DAC Recommendation on Untying Aid to non-LDC HIPCs[3] and will improve their reporting on the 2001 DAC Recommendation.

b) Donors will elaborate individual plans to further untie their aid to the maximum extent.

c) Donors will promote the use of local and regional procurement by ensuring that their procurement procedures are transparent and allow local and regional firms to compete. We will build on examples of good practice to help improve local firms' capacity to compete successfully for aid-funded procurement.

d) We will respect our international agreements on corporate social responsibility.

We welcome and will work with all development actors

1.1.3.3. The contributions of all development actors are more effective when developing countries are in a position to manage and co-ordinate them. We welcome the role of new contributors and will improve the way all development actors work together by taking the following actions:

a) We encourage all development actors, including those engaged in South-South co-operation, to use the Paris Declaration principles as a point of reference in providing development co-operation.

b) We acknowledge the contributions made by all development actors, and in particular the role of middle-income countries as both providers and recipients of aid. We recognise the importance and particularities of South-South cooperation and acknowledge that we can learn from the experience of developing countries. We encourage further development of triangular co-operation.

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c) Global funds and programmes make an important contribution to development. The programmes they fund are most effective in conjunction with complementary efforts to improve the policy environment and to strengthen the institutions in the sectors in which they operate. We call upon all global funds to support country ownership, to align and harmonise their assistance proactively, and to make good use of mutual accountability frameworks, while continuing their emphasis on achieving results. As new global challenges emerge, donors will ensure that existing channels for aid delivery are used and, if necessary, strengthened before creating separate new channels that risk further fragmentation and complicate co-ordination at country level.

d) We encourage developing countries to mobilise, manage and evaluate their international cooperation initiatives for the benefit of other developing countries.

e) South-South co-operation on development aims to observe the principle of non-interference in internal affairs, equality among developing partners and respect for their independence, national sovereignty, cultural diversity and identity and local content. It plays an important role in international development co-operation and is a valuable complement to North-South co-operation.

We will deepen our engagement with civil society organisations

1.1.3.4. We will deepen our engagement with CSOs as independent development actors in their own right whose efforts complement those of governments and the private sector. We share an interest in ensuring that CSO contributions to development reach their full potential. To this end:

a) We invite CSOs to reflect on how they can apply the Paris principles of aid effectiveness from a CSO perspective.

b) We welcome the CSOs' proposal to engage with them in a CSO-led multistakeholder process to promote CSO development effectiveness. As part of that process, we will seek to *i)* improve co-ordination of CSO efforts with government programmes, *ii)* enhance CSO accountability for results, and *iii)* improve information on CSO activities.

c) We will work with CSOs to provide an enabling environment that maximises their contributions to development.

We will adapt aid policies for countries in fragile situations

1.1.3.5. In the Paris Declaration, we agreed that aid effectiveness principles apply equally to development co-operation in situations of fragility, including countries emerging from conflict, but that these principles need to be adapted to environments of weak ownership or capacity. Since then, Principles for Good International Engagement in Fragile States and Situations have been agreed. To further improve aid effectiveness in these environments, we will take the following actions:

a) Donors will conduct joint assessments of governance and capacity and examine the causes of conflict, fragility and insecurity, engaging developing country authorities and other relevant stakeholders to the maximum extent possible.

b) At country level, donors and developing countries will work and agree on a set of realistic peace- and state-building objectives that address the root causes of conflict and fragility and help ensure the protection and participation of women. This process will be informed by international dialogue between partners and donors on these objectives as prerequisites for development.

c) Donors will provide demand-driven, tailored and co-ordinated capacity-development support for core state functions and for early and sustained recovery. They will work with developing countries to design interim measures that are appropriately sequenced and that lead to sustainable local institutions.

d) Donors will work on flexible, rapid and long-term funding modalities, on a pooled basis where appropriate, to *i)* bridge humanitarian, recovery and longer-term development phases, and *ii)* support stabilisation, inclusive peace building, and the building of capable, accountable and responsive states. In collaboration with developing countries, donors will foster partnerships with the UN System, international financial institutions and other donors.

e) At country level and on a voluntary basis, donors and developing countries will monitor implementation of the Principles for Good International Engagement in Fragile States and Situations, and will share results as part of progress reports on implementing the Paris Declaration.

DELIVERING AND ACCOUNTING FOR DEVELOPMENT RESULTS

1.1.4. We will be judged by the impacts that our collective efforts have on the lives of poor people. We recognise that greater transparency and accountability for the use of development resources – domestic as well as external – are powerful drivers of progress.

We will focus on delivering results

1.1.4.1. We will improve our management for results by taking the following actions:

a) Developing countries will strengthen the quality of policy design, implementation and assessment by improving information systems, including, as appropriate, disaggregating data by sex, region and socioeconomic status.

b) Developing countries and donors will work to develop cost-effective results management instruments to assess the impact of development policies and adjust them as necessary. We will better co-ordinate and link the various sources of information, including national statistical systems, budgeting, planning, monitoring and country-led evaluations of policy performance.

c) Donors will align their monitoring with country information systems. They will support, and invest in strengthening, developing countries' national statistical capacity and information systems, including those for managing aid.

d) We will strengthen incentives to improve aid effectiveness. We will systematically review and address legal or administrative impediments to implementing international commitments on aid effectiveness. Donors will pay more attention to delegating sufficient authority to country offices and to changing organisational and staff incentives to promote behaviour in line with aid effectiveness principles.

We will be more accountable and transparent to our publics for results

1.1.4.2. Transparency and accountability are essential elements for development results. They lie at the heart of the Paris Declaration, in which we agreed that countries and donors would become more accountable to each other and to their citizens. We will pursue these efforts by taking the following actions:

a) We will make aid more transparent. Developing countries will facilitate parliamentary oversight by implementing greater transparency in public financial management, including public disclosure of revenues, budgets, expenditures, procurement and audits. Donors will publicly disclose regular, detailed and timely information on volume, allocation and, when available, results of development expenditure to enable more accurate budget, accounting and audit by developing countries.

b) We will step up our efforts to ensure that – as agreed in the Paris Declaration – mutual assessment reviews are in place by 2010 in all countries that have endorsed the Declaration. These reviews will be based on country results reporting and information systems complemented with available donor data and credible independent evidence. They will draw on emerging good practice with stronger parliamentary scrutiny and citizen engagement. With them we will hold each other accountable for mutually agreed results in keeping with country development and aid policies.

c) To complement mutual assessment reviews at country level and drive better performance, developing countries and donors will jointly review and strengthen existing international accountability mechanisms, including peer review with participation of developing countries. We will review proposals for strengthening the mechanisms by end 2009.

d) Effective and efficient use of development financing requires both donors and partner countries to do their utmost to fight corruption. Donors and developing countries will respect the principles to which they have agreed, including those under the UN Convention against Corruption. Developing countries will address corruption by improving systems of investigation, legal redress, accountability and transparency in the use of public funds. Donors will take steps in their own countries to combat corruption by individuals or corporations and to track, freeze, and recover illegally acquired assets.

We will continue to change the nature of conditionality to support ownership

1.1.4.3. To strengthen country ownership and improve the predictability of aid flows, donors agreed in the Paris Declaration that, whenever possible, they would draw their conditions from developing countries' own development policies. We reaffirm our commitment to this principle and will continue to change the nature of conditionality by taking the following actions:

a) Donors will work with developing countries to agree on a limited set of mutually agreed conditions based on national development strategies. We will jointly assess donor and developing country performance in meeting commitments.

b) Beginning now, donors and developing countries will regularly make public all conditions linked to disbursements.

c) Developing countries and donors will work together at the international level to review, document and disseminate good practices on conditionality with a view to reinforcing country ownership and other Paris Declaration Principles by increasing emphasis on harmonised, results-based conditionality. They will be receptive to contributions from civil society.

We will increase the medium-term predictability of aid

1.1.4.4. In the Paris Declaration, we agreed that greater predictability in the provision of aid flows is needed to enable developing countries to effectively plan and manage their development programmes over the short and medium term. As a matter of priority, we will take the following actions to improve the predictability of aid:

a) Developing countries will strengthen budget planning processes for managing domestic and external resources and will improve the linkages between expenditures and results over the medium term.

b) Beginning now, donors will provide full and timely information on annual commitments and actual disbursements so that developing countries are in a position to accurately record all aid flows in their budget estimates and their accounting systems.

c) Beginning now, donors will provide developing countries with regular and timely information on their rolling three- to five-year forward expenditure and/or implementation plans, with at least indicative resource allocations that developing countries can integrate in their medium-term planning and macroeconomic frameworks. Donors will address any constraints to providing such information.

d) Developing countries and donors will work together at the international level on ways of further improving the medium-term predictability of aid, including by developing tools to measure it.

LOOKING FORWARD

1.1.5. The reforms we agree on today in Accra will require continued high level political support, peer pressure, and co-ordinated action at global, regional, and country levels. To achieve these reforms, we renew our commitment to the principles and targets established in the Paris Declaration, and will continue to assess progress in implementing them.

1.1.6. The commitments we agree today will need to be adapted to different country circumstances – including in middle-income countries, small states and countries in situations of fragility. To this end, we encourage developing countries to design – with active support from donors – country-based action plans that set out time-bound and monitorable proposals to implement the Paris Declaration and the Accra Agenda for Action.

1.1.7. We agree that, by 2010, each of us should meet the commitments we made on aid effectiveness in Paris and today in Accra, and to reach beyond these commitments where we can. We agree to reflect and draw upon the many valuable ideas and initiatives that have been presented at this High Level Forum. We agree that challenges such as climate change and rising food and fuel prices underline the importance of applying aid effectiveness principles. In response to the food crisis, we will develop and implement the global partnership on agriculture and food swiftly, efficiently and flexibly.

1.1.8. We ask the Working Party on Aid Effectiveness to continue monitoring progress on implementing the Paris Declaration and the Accra Agenda for Action and to report back to the Fourth High Level Forum on Aid Effectiveness in 2011. We recognise that additional work will be required to improve the methodology and indicators of progress of aid effectiveness. In 2011, we will undertake the third round of monitoring that will tell us whether we have achieved the targets for 2010 agreed in Paris in 2005.[4] To carry forward

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this work, we will need to develop institutionalised processes for the joint and equal partnership of developing countries and the engagement of stakeholders.

1.1.9. We recognise that aid effectiveness is an integral part of the broader financing for development agenda. To achieve development outcomes and the MDGs we need to meet our commitments on both aid quality and aid volumes. We ask the Secretary General of the United Nations to transmit the conclusions of the Third High Level Forum on Aid Effectiveness to the High Level Event on the MDGs in New York later this month and the Financing for Development Review meeting in Doha in November 2008. We welcome the contribution that the ECOSOC Development Co-operation Forum is making to the international dialogue and to mutual accountability on aid issues. We call upon the UN development system to further support the capacities of developing countries for effective management of development assistance.

1.1.10. Today, more than ever, we resolve to work together to help countries across the world build the successful future all of us want to see – a future based on a shared commitment to overcome poverty, a future in which no countries will depend on aid.

Notes

1. These figures are based on a recent World Bank study that found the poverty line to be USD1.25 a day in 2005 prices.
2. These include, but are not limited to, systems for public financial management, procurement, audit, monitoring and evaluation, and social and environmental assessment.
3. The 2001 DAC recommendation on Untying ODA to the Least Developed Countries (LDCs) covers 31 so-called Heavily Indebted Poor Countries (HIPCs). The OECD Development Assistance Committee (DAC) at its 2008 High Level Meeting agreed to extend the 2001 Recommendation to cover the remaining eight countries that are part of the HIPC initiative: Bolivia, Cameroon, Côte d'Ivoire, Ghana, Guyana, Honduras, Nicaragua and Republic of Congo.
4. We will have that information available for the Fourth High Level Forum on Aid Effectiveness in 2011, along with comprehensive second phase evaluations of the implementation of the Paris Declaration and the Accra Agenda for Action as of 2010. Attention will also be paid to improving and developing communications on aid effectiveness for long-term development success and broad-based public support.

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Better Aid

Managing Development Resources

THE USE OF COUNTRY SYSTEMS IN PUBLIC FINANCIAL MANAGEMENT

Successful development depends in large part on the efficiency, integrity and effectiveness with which the state raises, manages and expends public resources. Improving the rules and institutions governing these activities should be a major component, therefore, of any development approach. Given that strengthening Public Financial Management (PFM) is at the heart of the Millennium Development Goals, and good governance more generally, the Paris Declaration (2005) seeks to promote joint efforts in this area between donors and partner countries. In the Paris Declaration, partner country authorities committed to strengthening their PFM systems and donors committed to using those systems to the maximum extent possible. The Joint Venture on Public Financial Management, bringing together donors and partner authorities, was created to facilitate the implementation of the Paris Declaration as it relates to PFM.

As part of the Joint Venture's ongoing work in this area, *Managing Development Resources* takes stock of progress and provides recommendations on how best to facilitate achieving the 2010 targets set out in the Paris Declaration. It:

- Sets out the benefits of and rationale for using country systems.
- Assesses progress in meeting the Paris Declaration targets.
- Reviews the landscape of PFM reforms in partner countries.
- Looks at drivers of successful PFM reforms.
- Examines the factors that influence decisions to use country PFM systems, focusing on the perceived risks and their assessment and management.
- Describes the PEFA (Public Expenditure and Financial Accountability) assessment, which provides information on the quality of a country's PFM system.

This publication shows that now, as perhaps never before, partner countries and donors must strive to build mutual trust and work together in a true partnership for results.

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