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Public Financial Management Reform in the Middle East and North Africa: An Overview of Regional Experience

Part II
Individual Country Cases

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Abstract

This report surveys the experience of Middle East and North Africa countries on the topic of public financial management reform. Drawing upon a variety of sources, including Public Expenditure and Financial Accountability (PEFA) assessments, Country Financial Accountability Assessments, Public Expenditure Reviews, and other documents and reports—and augmented as necessary by interviews with leading reformers—the report seeks to address several major questions. How do MENA countries compare with other comparable countries at similar levels of development with regard to their PFM systems and practices? What has been the substantive content and thrust of PFM reforms in MENA over the last decade? Where have these reforms done well, and where have they struggled? What were the key ingredients for success or failure? Are there lessons in how these reforms were implemented that will be of value to other countries and the donor community?

Abbreviations

ACCT	Treasury Central Accounting Unit (Algeria)
AfDB	African Development Bank
AFMIS	Accounting-based Financial Management System
AGES	Automated Government Expenditure System
AP	Autorisations de Programme
ARABOSAI	Arab Organization of Supreme Audit Institutions
ASOSAI	Asian Organization of Supreme Audit Institutions
BCC	Budget Call Circular
BdL	Central Bank of Lebanon
BSA	Board of Supreme Audit (Iraq)
BSMP	Budget System Modernization Project (Algeria)
CACI	Central Inspection Agency (Syria)
CAO	Compliance Advisor Ombudsman
CBE	Central Bank of Egypt
CBI	Central Bank of Iraq
CBY	Central Bank of Yemen
CDR	Council for Development and Reconstruction
CFAA	Country Financial Accountability Assessment
CGED	General Control of Expenditures Commitment
CGSP	Public Services Audit Office (Tunisia)
CIB	Central Inspection Board (Lebanon)
CMU	Cash Management Unit
CNED	National Fund of Equipment for Development
CoA	Chart of Accounts (Jordan)/Court of Accounts (Lebanon)
COCA	Central Organization of Control and Audit (Yemen)
COFC	Central Organization for Financial Control (Syria)
COFOG	Classification of the Functions of Government
COG	Central Government
COI	Commission of Integrity (Iraq)
COR	Council of Representatives (Iraq)
CP	Credits de Paiement
CPA	Coalition Provisional Authority (Iraq)
CPAR	Country Procurement Assessment Report
CPI	Corruption Perception Index
CPIA	Country Policy and Institutional Assessment
CSMP	Civil Service Modernization Project (Yemen)
CST	Central Sales Tax
DA	Algerian Dinar
DB	Budget Directorate
DFID	Department for International Development (United Kingdom)
DGCP	General Directorate for Public Accounting (Tunisia)
DMFAS	Debt Management Financial Analysis System
DPL	Development Policy Loan
DPM	Deputy Prime Minister
DPPR	Development Plan for Poverty Reduction

DPR	Detailed Project Report
EC	European Commission
EdL	Electricité du Liban
EFMIS	Emergency Fiscal Management Reform Implementation Support
ESW	Economic and Sector Work
EU	European Union
FAD	Fiscal Affairs Department
FE	Forward Estimate
FMIS	Financial Management Information Systems
FRR	Revenue Regulation Fund (Algeria)
FY	Fiscal Year
GBD	General Budget Directorate (Jordan)
GBO	Budget Management by Objectives (Tunisia)
GCC	Gulf Cooperation Council
GCF	Financial Audit Office (Tunisia)
GDDS	Government Data Dissemination Standard
GDP	Gross Domestic Product
GFSM	Government Finance Statistics Manual
GFMIS	Government Financial Management Information System
GFS/COFOG	Government Finance Statistics/ Classification of the Function of Government
GID	Integrated Expenditure Control System
GoE	Government of Egypt
GoI	Government of Iraq
GoJ	Government of Jordan
GoL	Government of Lebanon
GoY	Government of Yemen
GPC	General Party Congress (Yemen)
GTZ	German Technical Cooperation
GU	Governmental Unit
HCCAF	High Commission for Administrative and Financial Audit (Tunisia)
HIPC	Heavily Indebted Poor Countries
HRC	Higher Relief Commission (Lebanon)
ICI	International Compact for Iraq
ICR	Implementation Completion Report
ICRG	International Country Risk Guide
ID	Iraqi Dinar
IDA	International Development Association
IDF	Institutional Development Fund
IFMCA	Institutional Financial Management Capacity Assessments
IFMIS	Iraq Financial Management Information System
IGF	Inspectorate- General of Finance
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISDT	Income and Sales Tax Department

ITD	Income Tax Department
ITF	Iraq Trust Fund
JD	Jordan Dinar
KRG	Kurdistan Regional Government (Iraq)
LOLF	Loi Organique Relative aux Lois de Finances (Morocco)
LTO	Large Taxpayer Office
MDCI	Ministry of Development and International Cooperation (Tunisia)
MDG	Millennium Development Goals
MED	Ministry of Economic Development
MEF	Ministry of Economy and Finance (Morocco)
MENA	Middle East and North Africa
MMSP	Ministry of Public Sector Modernization (Morocco)
MOF	Ministry of Finance
MOH	Ministry of Health
MOLA	Ministry of Local Administration (Yemen)
MOP	Ministry of Panning
MOPDC	Ministry of Planning and Development Cooperation (Iraq)
MOPIC	Ministry of Planning and International Cooperation
MSAD	Ministry of State of Administrative Development (Egypt)
MTEF	Medium Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
MTO	Medium Taxpayer Office
NGO	Non-Government Organization
NFTI	National Fiscal Training Institute
NRA	National Reform Agenda
NSSF	National Social Security Fund
OBL	Organic Budget Law
ODPM	Office of the Deputy Prime Minister
OECD	Organization for Economic Cooperation and Development
OPM	Office of the Prime Minister
PA	Palestinian Authority
PAL	Public Accounting Law (Lebanon)
PARL	Public Administration Reform Loan
PARP	Public Administration Reform Program
PCSC	Complementary Plan for Support to Growth (Algeria)
PDD	Public Debt Department
PEFA	Public Expenditure and Financial Accountability
PEIA	Public Expenditure and Institutional Assessment
PEM-TA	Public Expenditure Management - Technical Assistance
PER	Public Expenditure Review
PFM	Public Financial Management
PFMAU	Public Financial Management Advisory Unit
PIF	Palestinian Investment Fund
PIU	Project Implementation Unit

PLC	Palestinian Legislative Council
PPP	Purchasing Power Parity
PRDP	Preparation of a Development Plan
PSA	Production Share Agreement
PSR	Public Sector Reform
ROB	Results-Oriented Budgeting
ROSC	Report on the Observance of Standards and Codes
SAACB	State Audit and Administrative Control Bureau (West Bank & Gaza)
SAI	Supreme Audit Institutions
SDDS	Special Data Dissemination Standards
SIGIR	Special Inspector General for Iraqi Reconstruction
SOE	State Owned Enterprise
SONATRACH	Société Nationale pour la Recherche, la Production, le Transport, la Transformation, et la Commercialisation des Hydrocarbures s.p.a. (Algeria)
SNG	Sub-National Government
SPC	Special Planning Commission (Syria)
STA	Special Treasury Account
STD	Sales Tax Department
SU	Spending Units
TGR	Kingdom General Treasury (Morocco)
TSA	Treasury Single Account (Egypt)
UNCAC	United Nations Convention Against Corruption
UNDP	United Nations Development Program
U.S.AID	United States Agency for International Development
VAT	Value Added Tax
WBG	West Bank & Gaza
WGI	World Governance Indicators
YER	Yemeni Riyal

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Table of Contents

TABLES

BOXES

Overview and Description of Country Templates

by
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The World Bank's MENA region consists of 19 countries with a combined population of 356 million and a combined GDP of just over US$2 trillion in 2008. This analysis examines a sub-set of 10 of them: Algeria, Egypt, Iraq, Jordan, Lebanon, Morocco, Syria, Tunisia, the West Bank & Gaza (WBG) and Yemen. Combined, the countries selected cover just under 70 percent of MENA's population and around 30 percent of its GDP.

These countries were selected for a variety of reasons. Collectively, they offer a representative sample of the region as a whole. Their GDPs vary, with Lebanon at the top with an estimated per capita GDP of US$7,051, to Yemen at the bottom with an estimated per capita GDP of US$1,009 in 2008. They come from a variety of administrative traditions. Five countries (the three Maghreb countries plus Lebanon and Syria) have been heavily influenced by French administrative law and practice. The others come generally from within the British tradition, although occasionally displaying a complex mixture of French and Ottoman law as well. With the exception of the WBG, they also represent countries that have been independent for decades and have accumulated considerable experience in managing their financial affairs. Finally, these are countries where donors have been extensively involved, producing a significant body of technical work on Public Financial Management (PFM) issues upon which this broader, cross-cutting analysis is based.

This analysis has not focused extensively on the GCC countries for a variety of reasons. The unique PFM challenges of small, high income states whose revenues are largely derived from petrochemicals, combined with the heavy presence of expatriate advisors in a number of these countries, argued for treating them separately. In addition, much of the background analytic work used for the case studies is proprietary in these countries, raising questions about the extent to which it could become part of a public study.

General Overview

The country templates used in this analysis draw upon a variety of data, and a detailed bibliography is provided at the end. Information utilized in conducting this analysis include standard Bank and Fund analytic work on PFM issues, including Public Expenditure Reviews (PERs); Country Financial Accountability Assessments (CFAAs); Country Procurement Assessment Report (CPARs); Public Expenditure and Financial Accountability (PEFA) Assessments; and IMF Report on Standards and Codes (ROSCs). They also draw upon a variety of other sources, including background reports and policy documents on various PFM issues prepared by the World Bank, IMF and other donors; mission aide memoires, case studies, activity completion reports and the like.

The sections on the implementation of reforms and the broader political economy of PFM reform are drawn from interviews with Bank staff and consultants with extensive first-hand knowledge of the unique issues and challenges involved in these countries. In some cases, such as the discussion of reforms in the WBG, the analysts were able to draw upon detailed case studies that have been prepared on the reform process. In others, they were able to draw upon their own extensive experience in working on PFM reforms in that country, which was then cross-checked and validated with other knowledgeable experts to ensure objectivity.

The case template pursued three general lines of inquiry, which are discussed in greater detail below: (1) what is the substantive nature of the PFM reform agenda within that particular country; (2) how have the PFM reforms been implemented; and (3) what is the broader political economy of PFM reform in that country?

Substantive Reform Agenda

This section provides a broad overview of PFM reform priorities and an assessment of progress to date utilizing the PEFA framework. A variety of PEFA assessments have already been completed in seven of the ten countries utilized in this study, with Algeria, Lebanon and Tunisia being the outliers. (A PEFA assessment of Tunisia is currently underway, and the Egypt PEFA assessment has been completed but not yet finalized.) In other cases, the PEFA framework was utilized in presenting the analysis. The PEFA framework utilizes 28 indicators within a framework of six broader categories:

- Credibility of the budget
- Comprehensiveness and transparency
- Policy-based budgeting

- Predictability and control in budget execution
- Accounting, recording and reporting
- External scrutiny and audit

Where appropriate, PEFA scores have been provided and the date of the PEFA assessment noted. The cases have also considered whether there have been any major changes since the PEFA assessment took place.

Beyond these issues, the substantive assessment sought to address several other questions. Are there any particularly impressive successes and/or failures? Were reforms sustained over time? How large does the scope and comprehensiveness of the reform agenda loom in its success or failure? Are small, discrete reforms involving one agency typically more successful than broad agendas that cross multiple agencies?

Implementation Strategies for Reform

Turning away from the "what" of the reform agenda, this section seeks to address "how" reforms were implemented. What can we learn about the way in which reforms are implemented that holds important lessons for similar reforms in the future? What processes are used to manage PFM reforms? Is there an agreed upon grand strategy? Was the reform process systematically following a prescribed path or was the order of reform determined opportunistically as circumstances unfolded? How effective are strategies for piloting reforms in certain agencies or departments?

This section also seeks to draw some conclusions regarding how reforms are managed. Is there a designated manager in charge of implementation? Are there procedures for regular updates and progress reports? How was progress monitored? Were incentives provided to civil servants to encourage them to support the reforms? Were these considered to be effective?

Finally, this section seeks to determine if reforms are more likely to be successful if they are "self reinforcing" (i.e. a one step transition that, once done, needs to be followed again each year, such as a reform in budget classification) as opposed to reforms that require constant inputs and attention (such as detailed sectoral analysis of expenditure composition and efficiency)?

Political Economy of Reform

The political economy analysis has sought to step back from the specific reform agenda and way it was being implemented to better understand the role of various actors in advancing or hindering the PFM reform agenda. It seeks to address how the broader political environment has shaped the dynamics of the reform process, including the role of international and domestic political developments, elections, cabinet stability, ministerial tenure and longevity, etc.

A variety of questions are addressed under this rubric. Which stakeholders within and outside of government have been most active in championing various PFM reform efforts, how influential were they and why? Within government, were champions found among the most senior political leadership? Were reforms driven primarily by ministers or senior civil servants within the ministries of finance or planning? What was the depth of understanding of the reform agenda, and was it internally owned or supported largely through external prodding? What has been the role of line ministries and departments? Of parliament and the general public? Which stakeholders have tended to oppose PFM reforms, what is the source of their opposition, and how influential were they?

Finally, the study seeks to examine the role of international actors in supporting PFM reform. Is the country heavily aid dependent? How influential are the Bank and other donors? Has membership in peer organizations, such as ARABOSAI or INTOSAI, played a role? How influential are the emergence of cross-country comparative governance indicators, such as PEFA, in shaping the reform process?

ALGERIA

by
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General Overview

Algeria is a lower middle income country with a population of 33.8 million (2008 estimate). GDP per capita in 2007 is estimated at US$6,538 (PPP) and US$3,903 (nominal).[1] Algeria achieved independence from France in 1962 and its PFM and public administration systems are derived from the French administrative tradition.

Since independence, Algeria has endured considerable political turbulence, including a prolonged civil war that ended only in 1998. Lingering political instability has continued and Islamic fundamentalism remains a threat as reflected in a major upsurge in violence in 2007. While there are been a general move in recent years to open up the political process, significant restrictions remain on freedom of expression. Since 1994, Algeria has moved from central economic planning to greater liberalization of the economy, designed to improve the business climate and attract foreign investment.

Algeria has a system of strong executive government focused on the President who appoints the Prime Minister and Cabinet. Parliament is relatively weak, though growing in influence. Algeria is a multi party state but all parties must be approved by the Ministry of the Interior. The 48 provinces (*wilayas*) play a significant role in service delivery, such as health, education and water. Each province has its own elected assemblies and its budget. However, the governor (*wali*) who is the head of the executive of the *wilaya* has extensive powers. The *wali* is the representative of the central government. He is appointed by the President and reports to the Ministry of Interior. Each province has its own budget, for which the *wali* is the authorizing officer.

Only limited and dated PFM diagnostic information is available, including a 2005 IMF Fiscal ROSC and a 2007 Bank PER. No PEFA assessment has been undertaken or is planned.

Algeria has a clear legal and administrative framework for PFM and a reasonably functioning PFM system which provides for a satisfactory degree of financial control and external audit. Algeria has reasonable PFM staff capacity. However, the PFM system has major weaknesses in budget formulation and execution. The investment budget lacks credibility, comprehensiveness and transparency. As discussed later, many technical weaknesses exist and antiquated procedures need to be reformed, particularly in budget execution. The main weaknesses in PFM are more institutional in nature rather than technical issues.

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[1] IMF data

The 2007 PER measured Algeria's PFM practices against the 16 indicators formulated jointly by the Bank and the IMF for the Heavily Indebted Poor Countries (HIPC) exercise, on which much of the subsequent PEFA performance indicators are based. It concluded that Algeria met only 5 of the 16 benchmarks, which was below the performance of the average HIPC country.

In 2001, Algeria embarked on an ambitious PFM modernization program supported by a US$23.7 million World Bank Loan to support a Budget System Modernization Project (BSMP) covering central government expenditures and using international consultants. There were two main components, the first comprising reforms to the budget system (including performance-based budgeting, a medium-term expenditure framework, expenditure management systems and a strengthened expenditure control system) and the second comprising the development of an integrated budget management information system. However progress was moderately unsatisfactory, with limited government commitment during the first five years. It also appears that the inclusion of the IT component may have led to perceptions that the project was primarily of a technical rather than an institutional nature. In 2006, the Loan was reduced in amount to US$18.4 million and extended by three years, closing in February 2009. The IT component was limited to studies, software development and pilots. The key player in PFM reform is the Ministry of Finance, through the Directorate of Budget Systems Modernization created in 2008.

The budget remains highly dependent on oil revenues, which represent around 80 percent of total budget revenues. Using substantially increased oil revenues in recent years, Algeria has embarked on a large public investment program known as the Complementary Plan for Support to Growth, or PCSC. This large expenditure has given rise to a need for better prioritization of investment spending. Investment expenditure is generally considered to perform poorly and there are increasing concerns that all of these funds are being used as intended. The Bank has provided assistance for the establishment of a new state agency (CNED) to better implement major infrastructure projects in the PCSC.

Since the 2000 supplementary budget law, oil revenue in excess of budget law projections is allocated to a special treasury account, the Revenue Regulation Fund (*Fond de Regulation des Recettes* or FRR), part of which has been used to make early repayments of external public debt. As a result, government debt has fallen significantly. The overall fiscal balance moved from an average deficit of 1.7 percent of GDP in 1990-95 to a surplus of 13.6 percent in 2006; 4.5 percent in 2007; and 8.1 percent in 2008. However due to the decline in oil prices, a budget deficit of around 8.4 percent of GDP is expected for 2009—the first budget deficit in a decade

The public sector is large and expensive. It employs around 12 percent of the total workforce. The government sector wage bill comprises around one third of recurrent budget expenditures. There are significant state enterprises including the state oil company SONATRACH, the electricity and gas distribution company Sonelgaz, the Algerian Development Bank and Algeria telecom.

Algeria lags on a number of governance indicators, although the general trend is one of improvement. In terms of WBI Governance indicators, there have been improvements in government effectiveness, quality of administration and service delivery. However, government accountability remains weak. Corruption remains a persistent problem, reflected in Algeria's poor ranking in many major indices.

Substantive Reform Agenda

Credibility of the budget. Budget credibility is an issue. Economic projections have been based on questionable underlying assumptions, particularly the persistent underestimation of oil prices. For example, in the 2008 budget, hydrocarbon revenues were estimated at DA 970 billion, but the actual revenue was DA 1,715 billion.

While aggregate recurrent expenditures are fairly close to budget, there are wide variations in expenditure composition as documented in the PER. Expenditures deviate from budgeted amounts by more than 20 percent in many broad categories of expenditure. Budgeted capital expenditures tend to be significantly overestimated. For example, in 2007 they were estimated in the initial budget at DA 2,049 billion compared with the actual budget expenditure of DA 1481 billion. This reflects, in part, a lack of absorption capacity or ability to spend, as well as inadequate investment planning and monitoring of project execution. In also reflects unaffordable political promises that are included in either the initial or supplementary budget.

A supplementary budget is generally adopted by midyear with sometimes significant reallocations. The 2007 and supplementary budget laws increased budgeted spending by 9.3 and 8.2 percent compared with the initial budgets. Most of the increase was capital expenditures, a considerable portion of which was not spent.

Reflecting Algeria's strong oil revenue position, expenditure arrears are low—no more than 5 percent of annual expenditures.

Comprehensiveness and Transparency. The classification system does not comply with international standards. Currently the operating and capital budgets have different classification systems. The operational budget is classified by titles, parts, chapters, articles, and paragraphs, whereas the capital budget is classified by sector and sub-sector. There is no program or functional classification. A new budget classification system and a new chart of accounts have been prepared under the BSMP and are expected to be implemented in 2011 for the 2012 budget. This system will allow reporting according to GFMS standards (but not on a full accrual basis, as it will exclude depreciation of fixed assets). It includes the Classification of the Functions of Government (COFOG) and a program classification.

The budget documents provide general information on most central government fiscal activities, but the strategic priorities of the government are not clearly articulated. The report attached to the draft annual budget law is posted on the MOF website and includes the following information: macro-economic forecasts (oil prices, GDP, inflation rate, future public expenditure and revenue, interest rates, external current account balance etc.); the proposed annual budget (figures for the main public expenditure and revenue items) and main measures of the annual budget law. Annexes provide further detail including comparisons with last year and three-year projections. However, there is no reporting on the fiscal balance or medium or long term fiscal targets or on fiscal sustainability.

The budget documents also lack essential information. Contingent or future liabilities such as civil service pensions are not reported, and there is little information on donor financial assistance, tax expenditures, earmarked revenues or financial assets. Similarly, no data is provided on the fiscal activities of local governments and of the social security funds and public enterprises except for transfers to them. As a result, the overall public sector fiscal balance is not known or monitored.

The comprehensiveness of the budget is impaired by the multiplicity and the lack of transparency of special treasury accounts (*Comptes Spéciaux du Tresor*), which are included in the budget only to the extent of transfers to them. Overall special funds separate from the budget may represent some 15 percent of budget revenues. Special Treasury Accounts (STAs) are less subject to annual budget constraints as the appropriations can be carried forward. They also circumvent the principle that revenue cannot be earmarked for particular expenditures. The 2007 PER notes that between 2000 and 2005 the number of special accounts almost doubled from 18 to 32, while the transfers to them from the budget tripled from DA 88 billion to DA 268 billion. The unspent appropriations from certain investment projects may be transferred to STAs at the end of the year to overcome lapsing of appropriations. The legislation stipulates that a complete list of STAs must be annexed to the annual draft budget law along with the projected receipts, expenditures and balances for these accounts. It does not appear that this requirement is observed.

The 2005 IMF ROSC underlines the fact that STA operations are not sufficiently transparent, as their receipts, expenditure and balances are not recorded in the annual budget laws. The only data provided is general budget allocations to certain STAs. Their use as a means of by-passing normal annual budget controls in some cases reflects a perceived need to overcome the slow pace of budget execution because of delays in closing budget execution at the end of the year and commencing budget execution for the following year, as discussed later.

The Social Security funds are not included in the budget. A significant part of the capital expenditure is executed outside the budget and accounting system. This is particularly the case for externally financed capital expenditures executed by the Algerian Development Bank and for some capital expenditure executed by the *Caisse de Mutualité Agricole*. However, the amount of externally financed expenditures is now very low. There are also significant undisclosed quasi fiscal activities by state banks and public enterprises.

The budget is formally unified, but remains dual in practice. The current organic budget law requires a separate presentation of the operating and the capital budgets. The two budgets are prepared and executed according to a similar calendar, but according to different approaches and classifications. The new budget classification addresses this latter issue but it has not yet been implemented. However the separate units within MOF managing the capital and current budgets were merged in 2008. This should contribute to unifying the expenditure programming processes.

The budget documents do not provide financial aggregate information for the whole of general government.

There is a notable degree of "de-concentration" of public expenditure in the Algerian PFM system, particularly in health, education and water. The allocation of responsibilities between different levels of government is clearly defined by law but provincial and local government autonomy is limited by their dependence on transfers from central government (namely 20 percent of VAT revenues plus considerable ad hoc transfers to individual municipalities). As mentioned above, the head of the executive of the provinces (the governor) is appointed by the President and reports to the Ministry of Interior. The provinces have their own budgets, but the governor appears to formulate them in isolation from national sectoral priorities. The budget control, monitoring and reporting frame work at the provincial and municipal level are weak and are largely administered by the Ministry of the Interior rather than MOF.

Policy-Based Budgeting. The major difficulties in developing a policy based budget arise from the political and administrative culture, which, since independence, has been focused on large infrastructure investment projects that arise from the political decision making processes and are reflected in political announcements of large investment programs made outside of regular budgeting procedures.

The budget process follows a regular timetable. However, the current budget framework law is not organic in nature and can be altered by the annual budget law. The lack of full integration of the recurrent and capital budgets makes it difficult to have a comprehensive view of the ministry resources. It limits an efficient implementation of investment projects and makes it difficult to take into account the impact of investment projects on recurrent expenditures. As mentioned above, until 2008 there were separate units in the General Budget Directorate of MOF dealing with operating and capital budgets, respectively. This Directorate is now organized on a functional basis, and a new organization chart has been implemented. Investment plans, such as the Complementary Plan for Support to Growth (PCSC), are neither based on clear government priorities nor linked to current expenditures.

The introduction of program budgeting is part of the ongoing Budget System Modernization Project (BSMP), which was supported by the Bank loan. A pilot program budgeting was carried out in 2007. It was not repeated in 2008 but is expected to resume in 2009. Full adoption of program budgeting and management is planned for the budget in 2012, if the new budget framework law (which will be an organic Law) is adapted by Parliament in time. The design of the future program budget, prepared by international consultants, is comparatively well advanced.

There is limited discussion between MOF and sectoral ministries on policies and priorities, which in any case do not appear to have been well defined at government level. None of the budget documents sets out the objectives to be reached by the ministries or options considered, as well as the related performance indicators. The recurrent budget is prepared on an incremental basis. In the investment budget, the future recurrent costs of the projects are not analyzed. The 2007 Public Expenditure Review (PER) placed considerable emphasis on improving the quality of investment spending in both budget formulation and execution. It identified poor linkage of investment expenditures with sectoral priorities, problems with programming, and delays in project execution reflecting both weak execution capacity in line ministries and over-programming of capital expenditures.

There are currently some limited elements of multi-year planning. The MOF produces three-year aggregate forecasts and multi-year macroeconomic forecasts as well as multi-year estimates of aggregate expenditure and revenue are presented in the report attached to the draft annual budget law. The budget includes commitment authorizations for multi-year investment projects (see below).

Multi-year budgeting is a key component of the Budget Systems Modernization (BSMP), but its implementation has been delayed several times. However, if the new Organic Budget Law is enacted in time, it is expected that from 2012 onwards the budget will include multi-year expenditure estimates presented together with annual appropriations and programs and broad economic categories detailed at least at the ministry level.

The creation with Bank assistance of a new state agency (CNED) to better implement major projects and the creation of a single database for public investment projects has assisted in improving project prioritization.

Predictability and Control in Budget Execution. The delay in closing the annual budget execution delays the commencement of budget execution for the new fiscal year. The supplementary budget period for closing the annual budget, known as *Journée Complémentaire,* exceeds three months. It also limits the amount of expenditure liabilities which may otherwise need to be carried over to the next year. However, arrears are not an issue in Algeria and do not exceed 5 percent of the budget.

The process for releasing funds is not timely. Once the annual budget law is enacted, the MOF issues decisions to release funding for each ministry and each province. However this allocation process is time consuming and further reduces the time available for budget implementation.

Financial control is exercised through commitment authorizations (*Autorisations de programme*, or AP), for multi-year investment projects, which set the upper limit on the expenditure that may be committed, and cash-limited appropriations *(Credits de paiements or* CP), which set the upper limit for the expenditures that may be authorized for payment or paid during the year to cover the commitments entered into. The APs are not subject to annual expiration, and the portion not authorized prior to the end of a fiscal year may therefore be carried over to the next year. In the same way, Morocco and Tunisia's budgets also include both commitment authorization and cash-limited appropriations.

A relatively complex taxation system covering income tax, VAT and customs duties exists, including complex exemptions operated with a high degree of discretion by tax officials. Information systems operated by the different tax administrations remain weak. Recent reforms have included the establishment of a Large Taxpayers Center and assistance to smaller enterprises in meeting their taxation obligations. A tax procedures code was introduced in 2003 and customs procedures have also been codified.

Accounting, Recording and Reporting. Reconciliation between fiscal and banking data is undertaken monthly, but discrepancies are not always accounted for and the reconciliation of extra budgetary accounts remains unclear. The present financial management information system is fragmented and paper based, which leads to some delays and inaccuracies. The implementation of an integrated budget execution and accounting system is part of the BSMP, but it is only at the planning stage. It will be set up both in the line-ministries and in the Treasury offices and will interface with the budget preparation system.

The accounting framework provides for a sound reporting system, although budget implementation is managed on multiple and separated databases. Following the French tradition, Algeria maintains both a budgetary accounting systems and a general accounting system. The budgetary accounting system records the commitments and the payment orders against the appropriations and makes it possible to monitor the amount of funds available. The general accounting system records all financial transactions managed by the Treasury. Under the proposed new FMIS, these separate systems would be integrated. In addition, treasury operations are recorded in a single master account at the Bank of Algeria, which provided balances on a daily basis. This data centralization ensures ongoing reconciliation of fiscal and accounting data at the Treasury's Central Accounting Unit (ACCT).

A comprehensive financial control system is in place, but focuses principally on compliance with legal procedures. The legal framework of the control and audit of the expenditures is quite clear and adequate. Internal control relies on financial controllers, government accounting officers, in-house auditors and inspectorates of specific services. Reflecting the French system, the existing system provides for strict separation of function between those responsible for commitments and payment authorization operations (the authorizing officers, who are line ministries' officers) and those in charge of revenue collection, payment of expenses and management of funds (government accounting officers, who report to the MOF). However, monitoring is limited to financial follow-up and compliance with legal procedures. There is no performance monitoring, and the technical and physical monitoring of the investment projects made by line ministries and agencies is uneven and data are not centralized. Besides, due to the lack of skills and training of their staff, the line ministry inspectorate generals are regarded as weak.

According to the 2005 IMF ROSC, the reporting of data to parliament and to the public is largely inadequate. The Treasury produces statements on a regular basis but they are not made available to the public. No information is published on STA transactions. Moreover, the budget and financial data available are limited to central government units, even though local governments, public institutions and social security agencies account for a significant part of public expenditure.

The Algerian system is not able to issue timely or sufficiently accurate annual public accounts. Nor are they audited in a timely manner. The draft financial settlement laws (*loi de règlement)* that present the final accounts are no longer presented to parliament.

External Scrutiny and Audit. The legal framework for external audit is comprehensive and well established. The members of the National Audit Court have the statute of magistrate and are guaranteed independence. The Court is entitled by the Constitution to oversee the finances of central government, local governments and state enterprises. It exercises ex-post controls; judges the work of all accounting officers; and investigates breaches of financial regulations. However, the 2005 IMF ROSC suggests that its professional capacity is not adequate. The Court reports to both the President and the parliament. However, its latest published annual report is for 1996-97, and its reports are not now publicly available despite an apparent requirement that they be published in full or in part in the Official Gazette.

Parliament receives the draft budget in detail as well as details of budget out-turn for the previous two years. Once passed, the budget is notified in the Official Gazette, which presents current expenditures aggregated by ministry and capital expenditures aggregated by sectors. Published data on the budget is therefore very aggregated. In addition, the financial settlement law is not presented to parliament even though audit reports are (although they are not publicly available), thus limiting parliament's follow up ability.

Implementation Strategies for Reform

The Government of Algeria's general approach has been to first approve changes in the Organic Budget law and then work on implementing the necessary technical reforms. This has led to a slow pace of actual reform.

Until 2006, the progress of the BMSP has been largely unsatisfactory**.** Government commitment during the initial five years of the project was uncertain. A significant number of technical tools were prepared but have not been adopted or implemented. These include a new budgetary classification, new expenditure management procedures and a computerization master plan.

The 2006 review of the Bank Loan concluded that inadequate implementation of the project was due to: (1) frequent changes in project management leading to poor oversight; (2) highly ambitious and poorly defined project objectives; and (3) lack of inter-agency coordination, including a failure by MOF to adequately engage line ministries. As a result, the Government and the Bank thoroughly reviewed the program and agreed to scale it back and break the process down into smaller building blocks. Project implementation started to become effective in 2006-07 mainly because of changes in project management.

As a result, progress has been made since 2007-08. A new organization chart for the MOF was established in November 2007. The separate Recurrent and Capital Budget units have been merged. The pilot program budgeting carried out during FY07 has been not been pursued during FY08 for unknown reasons, but it should resume in FY09. More importantly, a draft Organic Budget Law was approved in 2008 by the Council of Government (which includes all ministers and is chaired by the Prime Minister), although it has not yet been approved by the Council of Ministers, which is chaired by the President, notably because of the Presidential elections. Except for a few provisions, this new Law provides an adequate legal framework for implementing program budgeting.

A strategy for PFM reform was drafted by consultants in 2007, and its proposals are incorporated in the draft Organic Budget Law. The general approach has been a comprehensive one, with pilots used only in program budgeting. As a general rule, small, discrete reforms have not been attempted. There are difficulties in carrying out pilots or selective reforms in Algeria because of its administrative culture—which tends to favor a top-down tradition in undertaking reform based on laws and regulations rather than those that involve studies and pilots. Nevertheless the pilots have fed into the provisions of the draft Organic Budget Law and the current program budgeting work.

Other relevant factors include the central role of the MOF and a general risk aversion towards initiatives not sanctioned from the highest level. No specific incentives have been provided to individuals or organizations to promote or accept the reforms.

The scope of the reform is potentially broad. The February 2009 final supervision mission for the BSMP Loan indicated that important elements for future reform are ready for adoption. The new Organic Budget Law already approved by the Council of Government sets out the reform direction. It includes a new program classification, multi-year budgeting, performance monitoring, the definition of the content of the budget documents, a new chart of accounts and partial accrual based accounting (but not budgeting). Various studies on budget execution procedures have been prepared by the consultants, but no decision on changes has been made. There may be a concern that relaxing inputs controls would be seen as encouraging corruption.

A directorate within the MOF is in charge of the reform program, but the arrangements to supervise the preparation of the new FMIS are unclear. The BSMP coordinator (recently appointed as director of the new Budget Reform Directorate in MOF) has been the de facto manager in charge of implementation. Planning and implementation of BSMP activities has been based on the Bank project and more or less followed, although with significant delays.

There have been no overall reform strategies in line ministries. Real ownership of the multi-year approach and performance budgeting pilots by the line ministries is uncertain. Likewise ownership by the *wali* is also questionable. However, the draft Organic Budget Law was extensively discussed with line ministries before finalization.

Political Economy of Reform

The complex nature of Algerian society means there are many conflicting forces in public sector reform. Within the bureaucracy, there are differences between MOF technical staff who are interested in recent European (and particularly French reforms), and the *wali* or governors who wish to retain their traditional power and influence over expenditure. Other prominent players include the line ministries, powerful state enterprises who are keen to preserve their autonomy and the army. A further division occurs in society between the westernized and the traditional point of view, which at its highest level is reflected in the views of whoever is the Prime Minister at any point in time. All this makes reform difficult and complex. In addition, Algeria has not shown interest in demonstrating to external parties such as the EC and the financial markets that it attaches priority to PFM reforms. This likely reflects its healthy oil revenues and the expectation that they will continue.

Overall, the broader political environment has hindered reforms. Other political priorities after the war with terrorism and a general lack of political and technical commitment explain the lack of progress from 2001 to 2005. There was no director of the Budget General Directorate in place for several years, only an acting director. The appointment of a new Minister of Finance and then a new Prime Minister in 2006-07, who had some interest in and support for the reforms, has been important in the improved progress since then. The heads of the General Budget Department and the Public Accounting Department have also been supporting the reforms.

In 2007, the main opposition to the reforms came from the governors, who feared that the program-budget approach would reinforce the role of sector ministries and diminish their financial powers. This issue is quite important in Algeria, given the high degree of de-concentration and the power of governors. As a result, the Ministry of the Interior and governors tried to slow down the reforms. A meeting was held at the highest political level to resolve this issue, and the draft Organic Budget law reflects a compromise. It stipulates that a part of the commitment appropriation may be allotted to governors. However, it appears that this conflict has not yet been fully resolved, which may delay the approval of the draft Organic Budget Law.

Within line ministries, some think that the reforms will not bring any enduring change. Some see an opportunity to regain control over the sector policy, which tends currently to be defined by other players such as the governors. Others may perceive increased transparency or streamlining of budget execution controls as a threat to their private interests.

As mentioned earlier, the reform is focusing on policy based budgeting, as provided for in the new Organic Budget law, rather than the more difficult area of streamlining budget execution.

The country is not aid dependent and donors have very little influence on government decision making. While government technocrats may need external expertise to modernize the PFM system, they are more influenced by the need to comply with the prevailing political priorities. At the political level, Algeria clearly prefers to handle PFM reforms in its own way without involvement of donors.

Algeria's membership of peer organizations has not been a significant factor influencing its reforms. Comparisons with Sub-Saharan Africa countries may be counter-productive, but there appears to be interest in comparisons with the other Maghreb countries. The French budgetary reform and discussions on the Canadian budget system with the consultants have encouraged reformers within the MOF and some line ministries.

Key Conclusions

Increased transparency and better budgeting process are needed but, as noted, these are not mere technical issues. Therefore, the question is whether the reform measures will be able to make the institutional processes more transparent and to improve policy decision making.

An important lesson is related to the period 2001-05. Launching a PFM project needs clear government ownership and agreement on the objectives of reforms. Including a significant IT component may help to facilitate agreement on the project, but the project may, in turn, be seen as a primarily technical exercise rather than one which seeks to change the way policy decisions on revenues and expenditures are made. In a country like Algeria, project implementation is unlikely to be successful if the project objectives are not appropriately defined.

EGYPT

by
David Biggs

General Overview

The Arab Republic of Egypt is composed of 26 administrative divisions, known as governorates. It is governed in terms of its 1971 Constitution which has subsequently been amended in 1980, 2005 and, most recently, March 2007. The Executive Branch of Government comprises a Head of State, President Mohammed Hosni Mubarak (who has held office since 14 October 1981) and a Head of Government, Prime Minister Ahmed Nazif (since 9 July 2004).The legislative branch takes the form of a bicameral system consisting of the People's Assembly, or *Majlis al-Sha'b*, and the Advisory Council, or *Majlis al-Shura*, which functions only in a consultative role. The legal system is based on English common law, Islamic law, and the Napoleonic codes. Judicial review is provided by the Supreme Constitutional Court, whereas the Council of State oversees validity of administrative decisions.

On most global governance indices, Egypt is ranked below the regional average and behind states at similar levels of economic development. One of the toughest governance challenges for Egypt is its weak government accountability. Egypt falls in the 20th lowest percentile bracket on WBI's World Governance Indicators (WGI) world-wide scale, and it compares unfavorably within MENA and when compared to similar-income countries. One bright spot has been Egypt's improvement in the Open Budget Index. [2] In 2006, Egypt was classified among countries that "provide scant or no budget information to its citizens," placing it in the company of regimes as Chad, Angola, and Nigeria. Significant recent improvements in fiscal transparency, including making the full approved budget publicly available, developing a user-friendly summary of the budget and issuing a new monthly publication containing fiscal data by the Ministry of Finance, have boosted Egypt's ranking in 2008 to "provides some information"—a jump of two categories that places Egypt in the company of Bosnia and Costa Rica. Egypt has also made considerable progress in improving its *Doing Business* rankings, and was named the leading reformer by *Doing Business* in 2008.

With this background in mind, it is encouraging that public financial management (PFM) reform and modernization has occupied a prominent place on Egypt's policy agenda over the past decade. The reforms have covered a range of areas, including revenue administration, financial information systems, cash management, financial decentralization and internal financial control. Despite the wide ranging issues being considered, there has not been an overall strategy and an action plan guiding the reform process.[3] Capacity development at the institutional, organizational and individual levels has been an element of the reforms, albeit a rather piecemeal and fragmented feature.[4]

Support for this wide-ranging program has been forthcoming from a range of multilateral and bilateral sources, including the United States, Netherlands, European Commission, International Monetary Fund and the World Bank. The largest donor by far has been the United States, which has invested heavily in improving PFM. Among the issues supported by the United States Agency for International Development (U.S.AID) have been tax policy and administrative reform, financial management information systems, introduction of the Treasury Single Account (TSA), budget reform and organizational development of the Ministry of Finance (MoF). The Government of the

[2] See www.openbudgetindex.org.
[3] It is understood that a PFM reform strategy has now been drafted and is currently under consideration by the Ministry of Finance.
[4] The Minister of Finance, recognizing the need for a more systematic approach to capacity development, has recently decided that a Ministry of Finance training center be established as a vehicle for more effective training planning and implementation.

Netherlands has also been a strong supporter of PFM, its engagement having included tax reform, medium-term financial planning and capacity development.

Substantive Reform Agenda

Work is currently being finalized on a Public Expenditure and Financial Accountability (PEFA) assessment, led by the European Commission and supported by the World Bank. An initial draft of the PEFA report was completed in October 2009, but it has not been published because the Government has not endorsed a number of the findings.

Budget Credibility. The assessment of the overall budget credibility in Egypt was based on information for fiscal years 2005/06 through 2007/08. While the aggregate revenue out-turn compared to the budget is very good, there are major variances from the original budget for both aggregate expenditures and the composition of expenditure out-turn. The aggregate deviation in primary expenditures (difference between actual primary expenditure and the originally budgeted primary expenditure) is significant for two of the three years under examination. This appears to have been primarily due to inaccurate estimates of expenditure on energy subsidies in 2006 and unexpected increases in international commodity prices in 2008. In addition, expenditure arrears appear to exist but there is no reliable system for recording and controlling them.

Budget Transparency and Effectiveness. The functional, economic and administrative classifications for the formulation, execution and reporting of the budget have been substantially upgraded in recent years, and broadly meet international standards, being compliant with the methodology prescribed in the GFSM 2001. In addition, the budget documentation for the draft budget law that is submitted to the Peoples' Assembly is comprehensive and detailed. Furthermore, public access to key fiscal information has improved, and, in particular, monthly in-year budget execution reports are now available. There are many sources of public expenditure that are outside the budget, and/or for which the final accounts are not audited. These include many of the Economic Authorities, the National Investment Bank and the Social Insurance Fund.

Policy Based Budgeting. The PEFA assessment found that the budget process is orderly and adheres to a fixed budget calendar. The budget itself was approved before the end of the Fiscal Year (FY) during the last three fiscal years, FY2006/07 - 2008/09. However, while the budget circular is extremely detailed, it has no budget ceilings. The budget is technically prepared within a medium-term perspective. However, no forward estimates of macroeconomic or fiscal aggregates are presented in budget documents submitted to the People's Assembly. Moreover, the overall medium-term outlook has insufficient impact on the budget formulation process as the fiscal forecasts are not used to set expenditure ceilings in the budget circular. In addition, although economic development strategies and plans exist for several major sectors including education and health, they are not all fully costed.

A number of reviews of Egypt's PFM system have commented on the issue of coordination of the current and investment budgets. As in many other countries in the region, preparation of the investment component of the budget is the responsibility of the Ministry of Planning, whereas the responsibility for the current budget rests with the Ministry of Finance. The World Bank's Policy Note on Budget Construction concluded that there appeared to be good co-operation on budget issues between the two ministries at both ministerial and official levels. But it also mentioned anecdotal reports of inadequate links between recurrent and capital expenditure, specifically in terms of insufficient finance being available to maintain or operate some capital assets. This common problem in situations of "dual budgeting" was also noted by the Bank's CFAA which remarked that there was "little inter-ministerial co-operation in the development of the two components of the budget." Institutional rivalry over "turf" typically stands in the way of this problem being resolved through ensuring that the MOF has primacy over all budgeting issues. The PEFA assessment also noted weaknesses in the appraisal of capital investments both in terms of the application of relevant techniques and the completeness of the analysis due to inadequate integration of the recurrent and investment budget management systems.

Tax and Customs Administration. One of the most successful reforms in recent years is generally recognized to be the modernization of taxation policy and administration. In a 2008 report entitled "Egypt: Modernizing Tax Administration—Current Status and Next Steps," the IMF recognized that significant progress had been achieved in addressing the weaknesses of Egyptian tax administration and developing a major modernization program. The report cited a number of major achievements:

- The successful implementation of self-assessment for income tax;
- The creation of the Egyptian Tax Authority, as a vehicle for tax administration modernization; and
- The establishment of a large taxpayer center and a pilot medium-size taxpayer center in Cairo.

Other significant tax reforms have occurred in the area of customs. These have included legislative approval of revised customs law and the approval of implementing regulations; a new organizational structure for the Egyptian Customs Authority; the establishment of modern customs centers that consolidate and streamline the customs clearance process; and completion of standardized customs manuals.

Predictability and Control of Budget Execution. On the expenditure side, the PEFA found that, in general, the monitoring and management of cash balances at the CBE is good. The MoF has attempted to further improve the monitoring and control of cash by establishing a Treasury Single Account (TSA). In 2006, the basic Accounting Law was amended to give the Ministry of Finance (MOF) authority over commercial bank accounts held by government agencies without its approval. The law also empowered the MOF to consolidate most cash resources under a TSA (which became operational on 30 November 2006). As a result, the MOF was able to close 3,150 accounts and transfer the funds to the Central Bank of Egypt (CBE), thereby improving government liquidity by over 32 billion Egyptian pounds ($5.8 billion) as of the end of February 2009. The World Bank has described the establishment of the TSA as "a major move in improving cash and debt management and the transparency of public finances."[5] However, in 2008 the IMF pointed out that the funds transferred to the CBE had not been brought under the control of the MOF, but were still under the various agencies outside the TSA. Moreover, these agencies continue to be paid interest by the MOF in compensation for the lost interest at the commercial banks—and in the absence of a budget allocation. More recently, the IMF has reported progress with this reform.

According to the PEFA assessment, internal and external debt data are fairly comprehensive, complete and of good quality. However, there are some gaps in the debt data as well as no connection between stock and flows. The People's Assembly is responsible for the authorization of the government's contracting of loans and issuance of guarantees, but the decisions are not made on the basis of clear guidelines, criteria or overall ceilings.

[5] World Bank, *Egypt Country Financial Accountability Assessment*, 2008.

Overall payroll controls are fairly effective, as payroll audits are carried out though they are not comprehensive. The personnel database is decentralized at the level of each entity of the public sector and changes in data are automatically reflected on payroll. In addition, the rules and procedures for changes to personnel records and the payroll are clear.

No data are currently available to assess methods used for public procurement awards. Also, the existing complaint mechanism to be used during the bidding process is poorly designed and not efficient, and there is no complaint mechanism during the execution of the contracts. Despite these constraints, when non-competitive procurement methods are used, they are justified in accordance with clear regulatory requirements.

Accounting, Recording and Reporting. The PEFA assessment considered that bank reconciliations are regular and timely. However, there is no routine process of collecting information on the receipt and use of resources by service delivery units, such as primary schools and health clinics. Special surveys to establish the amount of resources received by the latter have not been undertaken either. In-year budget reports are timely but they have limited scope and the quality of the data is only fair. Annual financial statements are submitted on time and the auditing standards used are good. They omit a few non-significant items.

Until recently, one of the more disappointing reforms has concerned the automation of the financial management information systems, which would have supported improved accounting and reporting. A key problem has been the multiplicity of information technology initiatives that have been undertaken with little apparent rationale or coordination. However, a number of these deficiencies appear to have been addressed, and recent assessments by the IMF suggest that the development of a new computerized financial management information system, under a project being managed by Booz Allen, is well on track.

A potentially significant reform for the accounting system occurred with the introduction of a new Chart of Accounts based on GFS 2001. Since July 2008, the MOF and part of the rest of the budgetary sector, has started using the new chart of accounts, whose main new feature is the introduction of codes for assets and liabilities that were lacking in the previous chart of accounts. However, the IMF has recently commented that the chart is "beset with flaws" and "ignores the cash basis of accounting mandated by the new law Accounting Law 127 as amended by No. 139 of 2006." Accrual accounts "of questionable utility" persist, as well as a variety of memorandum accounts. In addition, it does not capture the off-budget financial operations of budgetary organizations. In the IMF's view, the accounting system fails to provide assurance of integrity, and the accuracy of final accounts as well as monthly financial reports is open to doubt. Notably, instead of one unified General Ledger, there are five separate ledgers covering revenues, expenses, debtors, creditors and "regular" accounts.

As in many other countries, decentralization has become a major policy issue.[6] Egypt has embarked on a program of decentralization that will eventually provide sub-national government decision makers with more freedom to manage their budgetary allocations to suit local priorities. This will be achieved by giving government service delivery units like schools the power of "virement" (transfers) of budgetary allocations within, though not between, chapters. As a pilot initiative, three governorates—Luxor, Ismailia and Faiyum—have been selected as the vehicle for testing the decentralization of these spending authorities.

[6] As long ago as 2005/06, the budget circular referred to "jump-starting" the decentralization policy and maximizing the role of localities.

External Scrutiny and Audit. The PEFA assessment found weaknesses in internal and external audit functions. Recent reforms have made only modest progress in improving accountability and transparency through audit, accountability and oversight institutional arrangements. There remains no modern internal audit function in Egypt, although the Ministry of Finance has recently taken steps to improve capacity in this area. The CFAA 2008 concluded that the absence of an effective internal audit function constituted a "significant fiduciary risk" to the Government's PFM system.[7]

A number of problems also exist with regard to Egypt's external audit arrangements. The CAO's independence is compromised by its reporting to the President, and public accountability is not served by the fact that the CAO and parliament do not routinely publish audit reports. In the words of the CFAA, "CAO reports are in practice treated as confidential documents by the CAO, the Executive and the Legislature." Moreover, the CAO is excessively focused on ex ante expenditure controls and compliance at the expense of the audit of the consolidated government accounts.

The CAO is a member of the regional branch of the International Organization of Supreme Audit Institutions (INTOSAI) known as ARABOSAI, but this seems to have had little impact on its status and the way in which the organization reports on its work. INTOSAI standards on independence, transparency, accountability, and issuance of opinions on financial statements are not met.

The PEFA assessment found that the People's Assembly receives the audited final accounts and only a small proportion of all the other annual audit reports produced by the CAO. An effective and timely formal response and follow up is made on the audited annual financial statements. However, there is no evidence of response or follow up on other audit reports.

There are, however, some encouraging signs of parliament becoming more active in its oversight role. Good examples have been provided by recent aggressive debates over the report of the CAO and the changes made to the Government's 2007-2008 budget proposals. This involved amendments to the Constitution to provide authority for parliament to increase expenditure in any chapter of the budget, provided this is offset by reductions elsewhere in the budget or by providing for increased revenue. Given that the authority to change the draft budget rested previously with the Minister of Finance, in consultation with the affected line minister, this development represents a change in the balance of power over public resource allocation in favor of the Legislature at the expense of the Executive.

Institutional Arrangements for PFM Reform

The institutional arrangements for implementation center on the Ministry of Finance, and particularly upon the Minister himself, who is the prime mover for reform. The Minister is supported by an active group of reformers within the MOF, and it is this group that appears to have a broad view of the reforms. (The extent to which ownership for the reform agenda extends throughout the MOF is uncertain.) A striking feature of the reform process is the way in which Minister Boutros Ghali has introduced "new blood" into the Ministry. The Minister has surrounded himself with a group of "outsiders," some of whom have been brought in from the private sector, while others came from the Ministry of Trade. Effectively, this well-qualified group represents a specialist cadre that is well paid and falls outside the "normal" civil service.[8] There has been a practice of donors, especially the United States, paying the salaries of these officials as a means of

[7] It is understood that the GoE has already decided to establish a modern internal audit system but this reform appears to be delayed while plans for institutional reform of the MOF are being finalized.
[8] This practice is found in many parts of the Egyptian civil service.

stimulating reform. This has created a dichotomy between donor-financed staff and government-financed staff. The risk is that the latter—often very experienced—may feel marginalized and lack motivation, as outsiders have been brought with better access and on more favorable terms and conditions. In some cases, the two groups have worked well together; in others, obtaining and maintaining commitment and buy-in has presented a major management challenge.

Other relevant constraining factors include ineffective communication and capacity weaknesses. The World Bank's 2008 CFAA comments that "information on the MOF initiatives to improve PFM is not adequately communicated to ministries and their staff." It further notes that PFM training is "fragmented" and that "the lack of regular training threatens the success of (reform) initiatives." It emphasizes that the MOF needs to "assume full responsibility for the financing, training and development of all financial staff in Government." Similarly, there is no evidence of appropriate incentives being provided to staff as a means of generating their active support as part of the change management process.

While the reform of taxation is one of the success stories in Egypt, there have been a number of political economy issues raised by the reform that are worthy of mention. Commentators have remarked on the flaws in the ways that officials have applied new laws without any real accountability to society in terms of some form of contract with the public. There has been no taxpayers' charter, and an opportunity was lost when the 2005 Tax Law created a Supreme Council of Taxes as a societal watchdog, but this has never become a reality. There have been periodic clashes both with tax collectors—for example, real estate tax collectors went on strike over salaries, and the Minister of Finance is still experiencing difficulties with reforms he desires—and with taxpayers' groups, a very recent example being when the pharmacists called a nationwide strike and took to the street in protest against a decision by the Ministry of Finance to alter retroactively a previously agreed arrangement.

Finally, it is not clear that to date regional collaboration has been an important factor supporting the reforms. However, Egypt has recently assumed a leading role in the formation of a MENA regional group of senior budget officials that is modeled on the OECD arrangement and follows the example set by several other regions of the world. Egypt hosted the first meeting of the regional group in Cairo in November 2009. Countries of the region will come together periodically to learn about each other's experiences and discuss topical PFM issues of importance to budget officials. It is too early to say what the added value of these meetings will be, but if OECD experience is anything to go by, they have the potential to strengthen regional collaboration and support valuable PFM reform lesson-learning.

Key Conclusions

Egypt's experience during the past decade clearly illustrates that successful implementation of PFM reform is much more than a technical exercise. With the support of donors, and under the leadership of the Ministry of Finance, Egypt has tackled many of the crucial dimensions of PFM. Progress has undoubtedly been made—particularly in the area of tax and customs reform—where the lessons from Egypt's experience will no doubt be valuable to other countries embarking upon similar reforms. Yet it has not been uniform. Looking forward, the Government may wish to give attention to several areas:

1. Developing an overarching strategic framework, within which reforms can be planned, prioritized, sequenced, costed, evaluated for feasibility and monitored.

2. Ensuring that Egypt's PFM capacity is not stretched too thinly to cope effectively with the myriad reform initiatives that have been initiated.

3. Making sure that adequate resources are allocated to implement reforms.

4. Ensuring that project managers are appointed with appropriate delegated authority.

5. Thinking more carefully about developing effective change management processes and skills, and communicating the case for and benefits of reform to promote real understanding and ownership.

IRAQ

by
David Biggs

General Overview

The Republic of Iraq is composed of eighteen administrative divisions, known as governorates, three of which comprise the Kurdistan Regional Government (KRG). It is governed in terms of its October 2005 Constitution, which commits Iraq to become a federal state. The executive branch of Government comprises a Head of State, President Jalal Talabani (since April 2005) and a Head of Government, Prime Minister Nuri al-Maliki (since May 2006). The legislative branch consists of a unicameral Council of Representatives or *Mejlis Watani* (consisting of 275 members elected by a closed-list, proportional-representation system). The judicial branch and legal system include a Supreme Court appointed by the Prime Minister, confirmed by the Presidency Council.

The past six years have been dominated by the overthrow of the Saddam Hussein regime and its replacement with a fledgling democracy. Security has been a major concern, inhibiting the efforts by the Government of Iraq (GoI) and its international partners to modernize Iraqi social, economic and political life. Nevertheless, the GoI has engaged with the international community and produced an International Compact which acts as a kind of partnership agreement between Iraq and its international supporters. Prominent in the Compact is the need to improve governance, including public financial management (PFM). The latter is particularly important in the context of Iraq given its huge oil reserves and revenues that place a premium on the efficient and effective management of public resources.

A major feature of the PFM reform process since 2003 has been the considerable emphasis placed on budget execution, where there have been major problems in the implementation of capital projects. New control and accountability organizations, notably the Commission of Integrity (COI) and the Inspectors General, have been created. Like more established organizations, they have major capacity development challenges.

Support for PFM has been forthcoming from a range of multilateral and bilateral sources, including the United States, the United Kingdom, European Commission, International Monetary Fund and the World Bank. By far the largest individual donor has been the United States, which has invested heavily in improving PFM. Various parts of the U.S. Government, including the Treasury, State Department and United States Agency for International Development (U.S.AID) have financed accounting reform, budget formulation and implementation, the introduction of a financial management information system and the strengthening of accountability and financial control. In a number of these areas, the United States has worked alongside the UK's Department for International Development (DFID). Both the IMF and the World Bank have provided technical assistance and support for capacity development. The EC has financed a US$20 million PFM reform project under the aegis of the World Bank administered Iraq Trust Fund (ITF) that became active in 2009.

Substantive Reform Agenda

In partnership with the Government of Iraq, the World Bank completed a Public Expenditure and Financial Accountability (PEFA) assessment in 2008 as part of its Public Expenditure and Institutional Assessment (PEIA). A summary of the performance indicator scores is at Annex 1 to this study. A summary of the analysis is provided below.

Budget Credibility. Overall, the originally approved GoI budget is a rather unreliable instrument of government policy. In all three years reviewed, the variance between actual expenditure and budgeted expenditure exceeded 15 percent of budgeted expenditure. Revenues have been consistently exceeding budgeted amounts by a significant margin, whereas actual expenditure—particularly in regard to capital investments—has consistently been well below budget. The inevitable consequence was large budget surpluses in 2006 and 2007, leading to a big increase in the stock of cash reserves in the Development Fund for Iraq held in New York. In addition, better monitoring of expenditure payment arrears is required.

Comprehensiveness and Transparency. The PEFA assessment examines which of nine pieces of "good practice" information are included in the budget documentation submitted to the Parliament. In Iraq, four of these were found to be included in the GoI budget papers, but they tended to be partial rather than complete (for example, key budget tables are frequently missing)**.** These four elements are: (1) key macroeconomic assumptions; (2) fiscal balance; (3) consistent reporting of current and budget year; and (4) summarized data for revenue and expenditure. There is a significant level of unreported government operations and weak oversight of fiscal risk arising from the activities of other public sector entities. A particular problem relates to donor activities that are generally not covered in the budget. GFS-based economic classifications are now being used during budget formulation in addition to primary administrative classifications. While a functional classification was absent at the time of the assessment, it is being developed, and is included at an aggregate level in the 2010 budget.

Policy-Based Budgeting. Although the budgetary process is fairly orderly, there is room for improvement in a number of areas. These include improving the budget strategy and the Budget Call Circular; introducing the use of budget ceilings that reflect government policy priorities and avoid work on the production of unrealistically high budget submissions by ministries and other government agencies; strengthening the co-ordination of the recurrent and capital components of the budget; and the development of a multi-year perspective in financial planning and budgeting.

Predictability and Control in Budget Execution. This dimension covers a wide range of PFM issues, including tax administration, budget releases, cash and debt management, procurement, internal financial and payroll controls and internal audit. With the exception of tax collection, tax administration was relatively sound. But payroll controls were found to be weak, and internal controls (including internal audit) were of limited effectiveness. Procurement procedures are non-transparent and lack competition. In an environment of extensive reconstruction, this is one of the factors contributing to allegations of corruption in Iraq.

Accounting, Recording and Reporting. This was generally a weak area with no available information on the resources received by service delivery units are and deficiencies in the quality and timeliness of annual financial statements. There was a need to document the Iraqi government accounting framework so as to create greater certainty and understanding of the legal and regulatory requirements on the part of finance and accounting staff.[9] There were problems with the quality and timeliness of both in-year budget reports and annual financial statements. Both were hampered by the lack of a functioning financial management information system.

External Scrutiny and Audit. Weaknesses exist in terms of timely submission of audit reports to the Council of Representatives and follow-up on audit recommendations. Parliamentary scrutiny of the budget needs to be strengthened by the establishment of a well-resourced budget office.

Donor Assistance. The performance of the Iraqi PFM system has not been helped by the operations of donors, who do not score well against the PEFA indicators. The financial information they provide is untimely, incomplete and not delivered in line with the GoI's budget cycle or in a breakdown consistent with the Government's classification system. In addition, national procedures are bypassed for almost all development assistance projects and programs.

Summary of Substantive Reforms. The impact of these PFM weaknesses may be assessed against the three standard objectives of PFM systems: macro-fiscal discipline, strategic allocation of resources, and operational or technical efficiency. These three objectives are linked. Fiscal discipline is the basis without which neither a strategic allocation of resources nor operational efficiency is possible.

For a few years, high world oil prices enabled the GoI to generate much higher revenues than budgeted. Consequently, during that period which ended in the second half of 2008, the GoI experienced no difficulty in financing a growing level of public expenditure. On the contrary, it was able to accumulate significant reserves of foreign currency through its budget surpluses. While oil prices remained buoyant, maintaining macro-fiscal discipline posed few problems, but now the situation has changed dramatically. Even before the collapse of oil prices, measures needed to be taken to contain recurrent expenditure and achieve a higher level of capital investment budget execution.

Strategic resource allocations in Iraq suffer from the lack of a medium term perspective to budgeting and financial planning. Although a strategic medium term fiscal perspective exists in conjunction with the International Compact for Iraq (ICI), it is difficult to see the connection between this and annual resource allocations. Budgeting continues to be primarily an annual exercise. The problem is compounded by the lack of effective integration between the recurrent and investment budgets both at the aggregate level and at the sectoral level.

A major issue in Iraq over the last few years has been the low budget execution rate for capital investment, which has prevented the effective development of essential public services. The difficult security situation has clearly been an important factor, but there are also systemic PFM issues associated with budget formulation and implementation. While at times there have been problems with the release of allocations that have limited the accessibility of budget funds to ministries and governorates, there is also a major issue in terms of the inefficient use of funds that have been released but have remained idle in the bank accounts of spending units.

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[9] This has now been done by means of a co-operative process between the GoI, the UK, USA and World Bank.

PFM Reform Priorities. Having spent many years largely isolated from the international community, Iraq's PFM system inevitably has required and continues to require reform and modernization across all its major dimensions. Since 2003, support for a demanding reform agenda has been forthcoming from a number of external parties, but progress has generally been slow and difficult due to a range of factors that include the difficult security situation, the loss of significant numbers of experienced and qualified staff leading to low capacity in the system, inadequate reform program design, and the absence of a coherent reform strategy and action plan that all Iraq's development partners can support.

Much donor support has been devoted to improving Iraq's budgeting practice, especially with a view to raising capital budget execution rates. The United States has been particularly keen to see the GoI making better use of its own budgeted resources as well as those provided in aid. Since 2003, Iraq has made some progress in reforming public expenditure management. This appears to have had a positive impact on capital budget execution rates, which are reported to have risen from 49 percent in 2005 to 60 percent in 2007. However, there are still many issues that need to be addressed if capital budget performance is to be optimized. The PEIA identified a range of bottlenecks in the capital investment budgeting system, stretching from procurement and contract management through commitment, verification, and payment to oversight. Wide divergences had also been observed in budget execution rates between ministries and between governorates. Only the relatively stable and more secure region of Kurdistan had been able to achieve a high level of budget implementation.

Budget preparation reform is also a priority. Among the improvements necessary are:

- A better process and content for Iraq's budget strategy;
- A revised Budget Call Circular (BCC) that includes priority-based, sectoral budget ceilings in order to facilitate the submission of realistic budget proposals by government departments and agencies;
- Better integration of the recurrent and capital components of the budget formulation processes, including institutional reform measures;
- Development of a medium-term perspective as a framework for the annual budgeting exercise;
- Introducing a functional classification of the budget as a step towards the eventual use of a program classification;
- Expanding the scope of the information contained in the budget papers to improve transparency and accountability;
- Incorporating donor-financed activities in the national budget; and
- Closer adherence to the BCC.

Some progress has been made in modernizing government accounting and reporting, but the work is far from complete. A new GFS-compliant economic classification system and complementary chart of accounts have been developed and introduced, but implementation remains a work-in-progress and requires a considerable amount of training and capacity development. The legal requirements for government accounting are poorly understood with considerable confusion in the minds of government finance staff over the respective status of the Financial Management Law introduced by the Coalition Provisional Authority in 2005 and previously extant legislation. In order to clarify the situation, a working group was established by the GoI charged with the responsibility of documenting the government accounting framework. With the support of the U.S. and the U.K. Governments, as well as the World Bank, this exercise has been more or less completed with the drafting of a comprehensive accounting user manual that can as a source of reference for accounting practitioners.

One of the main obstacles to improved financial reporting continues to be the absence of a properly functioning government financial management information system (FMIS). Despite the fact that the development and implementation of such a system was the subject of heavy investment by the United States, progress has been mixed. The program was close to being abandoned when in 2008 a Memorandum of Understanding was signed between the United States and the GoI to restart the program. U.S.AID hired BearingPoint to re-launch the IFMIS project. (See **Box 1**).

Box 1: The Iraq Financial Information Management System (IFMIS)

Recognizing the importance of an automated financial reporting system, GoI attempted, with the support of the U.S. Government, to develop and implement the Iraq Financial Management Information System (IFMIS). U.S.AID-contracted consultants who worked with GoI counterparts to develop and implement the system using a Free Balance Financials software package, and hardware was centralized within the MOF in Baghdad. The IFMIS was an automated accounting system intended initially to improve budget execution. Other modules were to be added as part of a gradual move towards a more complete financial management information system. Several reviews of the system were conducted, including those undertaken by the IMF/World Bank in 2005 and that of the U.S. Government's Special Inspector General for Iraqi Reconstruction (SIGIR) in 2007.

The joint Bank/IMF mission in 2005 reported problems with the project that needed to be addressed in the next few months notwithstanding the difficult conditions under which both the consultants and GoI officials were working. Most notable perhaps was the absence of a conceptual design document, which international experience shows to be a key requirement if project risk is to be contained. This would have helped define the high level functional requirements with participation from major stakeholders, like the accounting and other key directorates in the MOF, including the budget department and MOPDC, as well as major line agencies. It would have also assisted in deciding on the workable systems architecture and hardware and communication requirements and training needs leading to a relevant IT strategy for the project implementation. Crucially, it would have increased understanding and ownership of the project on the part of system users.

The PEIA workshop in 2007 elicited from participating GoI officials the assessment that more work was needed to establish the preconditions necessary for reform. The Bank's analysis identified the following six main obstacles:

- Unsatisfactory project supervision and contract management arrangements;
- Lack of support for and recognition of Project Management Teams;
- Insufficient or inappropriate incentives to promote the Government's PFM reform agenda;
- Inadequate consultative, coordination and co-financing arrangements to support high levels of ownership, effective partnerships and high degrees of commitment from key stakeholders;
- Poor FMIS design and more specifically the planning process to set the FMIS implementation strategy; and
- The absence of a medium-term PFM reform program that informs the prioritization and sequencing of specific PFM reform measures including development and roll-out of an FMIS.

The reengineering work practices, provision of a working environment that encourages reform, training and enhanced stakeholder engagement (including both users and steering committee members) were all seen as areas where a revised implementation strategy might focus. There was a general perception that design was weak, with insufficient level of stakeholder engagement during the design phases. It was also noted that management arrangements could be improved. Security considerations also interfered, and the project was interrupted by the kidnapping of an international consultant. Collectively, such factors contributed to a suspension in implementation.

Implementing a FMIS in a conflict-ridden country was always going to be a difficult and complicated challenge. The project was not a total failure, as a reasonable amount of progress was made in connecting a good proportion of nationwide spending units to the system despite ongoing conflict and problems in establishing and maintaining connectivity. It is still hoped that a FMIS will be implemented in Iraq. In 2008, a Memorandum of Understanding was signed between the United States and GoI to restart the program, and U.S.AID hired BearingPoint to re-launch the IFMIS project.

Improving cash management by moving towards a Treasury Single Account (TSA) has been part of the reform agenda since at least 2005. In that year, a joint World Bank/IMF mission recommended, as a medium-term reform (that is, by the end of 2006) that progress towards TSA should be made, subject to improvements in the payments and banking systems.[10] Progress has been limited and the Bank's PEIA concluded that the GoI did not yet operate a TSA which was a necessary reform. In a 2008 report, the IMF highlighted a number of weaknesses that reflected the absence of a systematic cash management function.[11] These included:

- A cash release system to fund expenditures that had led to the accumulation of extremely large idle balances in the bank accounts of the SUs, estimated at ID 9.5 trillion at end-2007 (12 percent of GDP);

- The existence of a substantial stock of advances, estimated at approximately ID 12.3 trillion (16 percent of GDP) as at end of 2005;

- The dearth of information about future cash requirements of Spending Units on which to base decisions about funds release as a result of the lack of a commitment control system;

- An unnecessarily high level of unremunerated central government deposits are lying idle in the CBI and the State banks (ID 5.5 trillion, or 7 percent of GDP); and

- The lack of cash forecasting capacity, which hinders reform efforts for both cash management and budget execution and control systems.

The PEIA identified significant challenges in the area of public internal and external financial control and public accountability. Weaknesses were found to exist in payroll and other internal controls, including internal audit. The Inspector General system, imported from the United States, constitutes a major departure from former Iraqi practice and its effectiveness has yet to be demonstrated, apart from in isolated cases. In practice, there remains a lack of clarity of the respective roles and responsibilities of Inspectors General, internal audit departments that were in place under the former regime, and the Board of Supreme Audit (Iraq's Supreme Audit Institution).[12] Coordination between the various organizations needs to be improved and all of them lack capacity. The financial management regulatory framework needs to be clarified and in this regard it is encouraging to note that work has been taking place on re-drafting the Financial Management Law.

The final link in the public accountability chain is also weak because external audit reports are not being submitted to the Council of Representatives (COR) in a timely manner. Consequently, there is no opportunity for the COR to hold the Executive responsible for its actions by means of requiring follow-up action on audit recommendations. In addition, legislative scrutiny of the annual budget law requires strengthening, although the CoR has

[10] In fact the Financial Management Law (CPA Order 93 of 2004) requires that all receipts shall be credited to a Treasury Consolidated Account and paid into the Treasury Single Account, and all payments shall be debited to the Treasury Consolidated Account and withdrawn from the Treasury Single Account.
[11] IMF, *Reform Priorities in Public Financial Management*, 2008.
[12] Iraq's BSA is a member of ARABOSAI and as a reform initiative has offered to work with regional colleagues in terms of mutual peer review of operations. This arrangement has not yet started due to concerns of other SAIs about travelling to Baghdad. The BSA is also actively engaged in working with SAIs from other parts of the world and has recently sought the support of the World Bank for institutional strengthening project that might involve a forma twinning arrangement.

recently been able to secure important changes to the 2008 draft budget law. In general, there is scope for a much greater role for those "demand-side" stakeholders with an interest in improved PFM, including parliament, the media, and civil society. Overall, there is a need for greater transparency in the whole way in which public financial and other resources are acquired and used.

Although government revenues in Iraq are dominated by oil exports, and taxation provides relatively little public finance (around 5 percent of revenues in 2007), it can be expected that taxation will assume increasing importance in the coming years. It is therefore encouraging to note that there have been improvements in the area of tax administration. In terms of transparency of taxpayer obligations and liabilities, Iraq's taxation system allows a relatively informed taxpayer to understand his level of tax liability, with some confidence that a fair system is in place. Controls in taxpayer registration exist and the system of penalties for non-compliance is sufficient. Tax audit and fraud investigation arrangements are, however, seriously deficient. Collection of tax arrears does not pose an immediate problem, although better systems are needed in preparation for a stronger taxation effort. Basically, sufficient arrangements for the appropriate transfer of collected tax revenue to the government from the revenue authorities are in place. However, the reconciliation systems needed to verify tax assessments, collections, arrears and transfers need urgent attention.

The IMF reported on tax reform issues in July 2007.[13] It concluded that, although substantial progress had been made in the development of a tax reform program in Iraq, the reform process was clearly constrained by security considerations and administrative weaknesses. The report suggested the following priorities:

- The need to ensure that appropriate tax provisions governing petroleum operations by private and state owned companies are in place as soon as possible, preferably in a separate petroleum tax law;

- A review of the legislation on income tax on individuals and companies with a particular focus on the exemptions, with a view to reducing the current wide range;

- The development of a plan for the design and implementation of this Value Added Tax (VAT); and

- For tax administration the establishment of a large taxpayer's office, and the development of a tax administration modernization strategy.

Implementation and sustainability of reforms in the past six years or so have been undermined by the very difficult security environment and the acute capacity shortages in the PFM system. The latter challenge has not been helped by the creation of new institutions like the Inspectors General and the Commission of Integrity (COI) that have been grafted onto the existing system. Even long-established organizations like the BSA are in need of modernization and greater contact with the international community. In these circumstances, it is difficult—and perhaps unrealistic—to point to any single outstanding example of a successful PFM reform. Instead, a range of initiatives have been undertaken, all of which have made some progress, though typically less than was hoped for. On the downside, the FMIS reform has probably been one of the most disappointing, while recognizing that the introduction of a nationwide system during a period of conflict was a tall order.

[13] IMF, *Issues in Tax Reform*, 2007.

It may well be the case that reform has been tackled on too many fronts at once given the conditions on the ground in Iraq. Until recently, there was no government-owned PFM reform strategy and action plan, so initiatives have tended to be piecemeal and lacking coherence. An overriding need in Iraq is to restore and enhance the capacity of the Iraqi PFM system. The events of the past six years have witnessed devastating losses to institutions, organizations, and human capital. Many experienced staff have been lost to the public service at the same time as new institutional arrangements and organizations have been created or replaced. Physical infrastructure has been destroyed and the effective functioning of the PFM system has been severely undermined by the difficult security environment. It will take a sustained and comprehensive capacity development program fully supported by the international development community to help Iraq to overcome these problems.

An integrated PFM reform program is clearly necessary**.** This needs to be led by the GoI and supported over the medium term by Iraq's international development partners. Careful consideration should be given to ensuring a sustainable pace of reform that does not exceed the absorptive capacity of the Iraqi PFM system. International experience demonstrates the importance of properly sequenced and resourced PFM reform programs backed by political and administrative champions. It also shows the value of adopting a "building blocks" or "platform approach" to PFM reform. This minimizes the risk of embarking on the reform of PFM components before the time is right. Essentially, the underlying philosophy is one of getting the basics right before tackling more sophisticated and challenging issues.

Implementation Strategies for Reform

At a strategic level, the importance of PFM reform has been recognized and acknowledged. PFM issues occupy a prominent place in the International Compact for Iraq (ICI), which is a framework for cooperation with the international community. Benchmarks and milestones have been set in the accompanying monitoring matrix, though in practice delays have typically occurred in the implementation of reforms. But the management of the PFM reform process in Iraq has suffered from the absence of any overall vision, strategy or prioritized and logically sequenced action plan. Reforms have been tackled in an opportunistic manner, often prompted by the advice or requirements of Iraq's international partners.

The PFM reform process is led by the Ministry of Finance, and in particular by Dr. Azez Jaffer in his role of Adviser to the Minister. Other key stakeholders are the Ministry of Planning (in relation to the capital investment budget); the Office of the Prime Minister (OPM); the office of the Deputy Prime Minister (ODPM); the BSA (in relation to the external audit of the public sector and accounting standards); the Inspectors General (internal audit and investigations in government departments); and the COI (investigations into allegations of fraud and corruption). The Council of Representatives (the Iraqi Parliament) is also seeking to strengthen its contribution to effective PFM through enhanced budget scrutiny, facilitated by a proposed budget office. Iraq's constitutional commitment to a federal state has led in the last two or three annual budgets to far greater decentralization of public spending to sub-national government in the form of the governorates and the Kurdistan Regional Government (KRG). Outstanding issues in the KRG concern the completion of merging two administrations, including the Ministry of Finance and Board of Supreme Audit.

Problems have arisen during the implementation of individual reform programs as a result of limited authority and resources being delegated to program managers. Too often, decisions have to be referred up the hierarchy in a way that stifles initiative and provides little incentive to the managers and undermines ownership of and commitment to the reform process.

Incentives in general appear to be a problematic area in the Iraqi civil service. Prior to the overthrow of the Saddam regime in 2003, a staff incentives scheme existed, but this was suspended by the Coalition Provisional Authority (CPA). In addition, staff motivation is undermined by the absence of a performance evaluation system based on objective criteria that would recognize and reward good performance. Politicization of ministries is commonplace, with political and tribal allegiance and loyalty being the primary basis for recruitment and promotion.

Political Economy of Reform

From a general political standpoint, the period under review has been one of great instability characterized by volatile governance arrangements. Iraq has seen a governing authority established by an occupying power, a transitional national government and a more permanent government that came to power through a newly established democratic process that was boycotted by many disillusioned voters. Similar skepticism prevailed during the first provincial elections, but the recent second set of provincial elections attracted much wider participation and greater acceptance. At the national level, boycotts of both government and parliament by sectarian political parties have occurred on a fairly regular basis. Parliament lacked a speaker for a protracted period of time. Thus the environment for public sector reform has been extremely challenging, especially as various ministries have been "captured" and ministerial posts have been shared out among the leading political groups.

The post-2003 period has witnessed attempts to promote considerable change that often represents a major departure from traditional norms and practice. New organizations have been created and significant amendments have been made to the legal and regulatory framework, often without much regard to the pre-existing laws and often failing to secure the required full understanding and acceptance of those public officials responsible for managing public finances. A great deal of uncertainty has arisen regarding the roles and responsibilities of new and existing organizations, a good example being provided by the three so-called "anti-corruption pillars" that operate in the area of accountability (the Board of Supreme Audit, the Inspectors General and the Commission of Integrity), where overlapping mandates exist and skills and experience remain limited. At the same time, capacity has been seriously depleted by a combination of factors associated with the five years of conflict that have followed the invasion of Iraq and the dismantling of the former regime.

The Bank's PEFA assessment highlighted the lack of credibility of the government budget. In recent years there have been persistently large variances (42 percent overspent in 2004, 27 percent under-spent in 2005 and 32 percent under-spent in 2006) between aggregate expenditure out-turns and budget. The biggest problem has been the inability of the GoI to implement large parts of its capital investment budget. This outcome reflects a variety of technical weaknesses at all stages of the budget management process from preparation (over-optimistic estimates of what can be achieved) through to implementation (where many issues conspire to make execution of the capital investment budget highly problematic). But it also has importance governance dimensions. The Executive's repeated optimism as to what can realistically be implemented in the current conditions in Iraq has risked its political credibility because of its failure to deliver much-needed public services. A great deal of political capital is being expended through the failure of Government to utilize efficiently and effectively for the benefit of the Iraqi people the huge revenues it receives from oil exports. Moreover, there are concerns that some regions are not receiving their fair share of government spending, as demonstrated by recent growing demands by the Council of Representatives to be provided with much more transparent information on the geographical allocation of budgetary resources. There have also been wide divergences in budget execution rates between ministries and between governorates.

One of the most significant challenges facing the GoI is to improve the integration of the capital and recurrent budgeting processes. Bank analysis of the Iraqi PFM system found that governance and institutional arrangements are important in relation to this issue, with responsibilities for different aspects of budgeting being divided between the Ministry of Finance (MOF) and the Ministry of Planning (MOP). Reforming these arrangements will be challenging, owing to the traditional rivalry between the two ministries, the political allegiances of the respective Ministers and the need to ensure no loss of face on the part of either Ministry that relinquishes any of its responsibilities. Other issues relevant to capital investment budgeting include the following poor co-ordination between implementing ministries and inadequate delegated authority and the reluctance of officials to take decisions and authorize resource allocations for fear of allegations of corruption.

Superficially, there appears to be a significant degree of ownership of PFM reform in Iraq. As stated earlier, the subject occupies a prominent place in the International Compact for Iraq, and this kind of strategic ownership is valuable. Essentially, Iraq has committed itself to improving the efficiency and effectiveness of public resource management. A number of important stakeholders can be identified both within and outside the Executive. These include the Adviser to the Minister of Finance, Dr. Azez Jaffer, and some senior officials within the MOF. Experience gained through working with these officials in several forums suggests that the need for PFM reform is well recognized and accepted by the MOF. Similarly, there is a willingness to tackle reform in parts of the federal Ministry of Planning and various line ministries, including the Ministry of Education. There is also considerable interest in the Kurdistan Regional Government. Outside the Executive, there are encouraging signs from the National Assembly, and its affiliated SAI, the BSA, of a genuine commitment to reform. This “demand-side” pressure could be very valuable.

But it is less clear how far government stakeholders are prepared to take difficult decisions in the face of political opposition and/or officials’ resistance. The reality has been masked in recent years by booming oil prices which have meant that many hard choices have not had to be made. This situation has changed, and the willingness of the GoI to adopt hard budgetary constraints, impose tighter financial controls, pursue value for money more vigorously, and ration more limited resources will be tested. In addition, much of the pressure for PFM reform has been coming from the donors, especially the United States. As the political and military situation evolves and donor support declines, commitment to reform may diminish.

Key Conclusions

At the outset, it is necessary to acknowledge that, in the post-2003 period, all attempts to reform and modernize the Iraqi PFM system have faced massive obstacles. Naturally, the very difficult security environment has not been conducive to the success of reform initiatives and undermined staff motivation. Moreover, the economic fabric of the country has been in disarray. For example, the lack of a properly functioning banking system has fostered an extensive reliance on cash transactions, which in turn has considerably raised the system’s exposure to the risk of fraud and corruption.

Under conditions like these, it is even more important than usual to concentrate reform on “getting the basics right.” Generally, this has been the case, as there has been a great deal of focus on budget execution and no real distractions in terms of attempting more sophisticated reforms like MTEFs, performance budgeting and accruals accounting. The FMIS experience provides a salutary lesson of what can go wrong in the absence of sound preliminary analysis of user requirements and effective change management. Even the initial limited objective of supporting budget execution on a nationwide basis proved elusive and over-ambitious in the prevailing context.

Attempts to restore and develop institutional, organizational and individual PFM capacity have doubtless made some progress, but this has been sub-optimal in the absence of a coherent capacity development strategy. Too often initiatives have been conducted in a piecemeal, uncoordinated manner. For example, participants in the many workshops that have been run in and outside Iraq have acquired new knowledge and skills, but it is unclear what impact this has had on their daily work.

There are some hopeful signs that the situation may be improving. The MOF has adopted a PFM reform strategy and action plan to provide a framework for future reform programs. The security situation has been improving—though it remains fragile and gains can quickly be reversed—and more donors appear willing to increase their in-country presence and support reform more proactively.

Table 1: Iraq PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	D
	Composition of expenditure out-turn compared to original approved budget	C
	Aggregate revenue out-turn compared to original approved budget	A
	Stock and monitoring of expenditure payment arrears	D
Comprehensiveness and Transparency	Classification of the budget	C
	Comprehensiveness of information included in budget documentation	D
	Extent of unreported government operations	D+
	Transparency of Inter-Governmental Fiscal Relations	D
	Oversight of aggregate fiscal risk from other public sector entities	D
	Public Access to key fiscal information	D
Policy-Based Budgeting	Orderliness and participation in the annual budget process	C
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	B
	Effectiveness of measures for taxpayer registration and tax assessment	C
	Effectiveness in collection of tax payments	D+
	Predictability in the availability of funds for commitment of expenditures	C+
	Recording and management of cash balances, debt and guarantees	C
	Effectiveness of payroll controls	D+
	Competition, value for money and controls in procurement	D+
	Effectiveness of internal controls for non-salary expenditure	D+
	Effectiveness of internal audit	D+
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	C+
	Availability of information on resources received by service delivery units	D
	Quality and timeliness of in-year budget reports	D+
	Quality and timeliness of annual financial statements	D+
External Scrutiny & Audit	Scope, nature and follow-up of external audit	Not Rated
	Legislative scrutiny of the annual budget law	D
	Legislative scrutiny of external audit reports	D
Donor Practices	Predictability of Direct Budget Support	D
	Financial information provided by donors for budgeting and reporting on project and program aid	D
	Proportion of aid that is managed by use of national procedures	D

JORDAN

by
David Biggs

General Overview

The Hashemite Kingdom of Jordan is a constitutional monarchy divided into 12 administrative divisions, or governorates. Legislation is rooted in its 1952 Constitution as amended. The executive branch of government is led by a Head of State, King Abdallah II (since February 1999) and Head of Government, Prime Minister Samir al-Rifai (since December 2009). The legislative branch has a bicameral National Assembly or *Majlis al-'Umma*. It consists of the Senate, also called the House of Notables or *Majlis al-Ayan* in Arabic (which has 55 seats with its members appointed by the monarch for four-year terms); and the House of Representatives, also called the House of Deputies or *Majlis al-Nuwaab* (which has 110 seats, with its members elected by popular vote on the basis of proportional representation to serve four-year terms). Jordanian law is based on civil law and Islamic legal principles. The court system is divided into religious, civil, and special courts. At the apex of the judicial hierarchy is the Court of Cassation, or the Supreme Court of Appeal.

On most aspects of governance, Jordan continues to be a high performer in both the region and among countries at a similar level of development. According to a number of global governance indicators, Jordan performs well on control of corruption, government effectiveness, regulatory quality, and rule of law, with the control of corruption being its highest score. The country's 2007 score on internal bank rankings was above the MENA average and close to the scores of the Gulf States. Jordan and the Gulf states also top Transparency International's chart for the region. The Global Integrity Index for 2008 gave Jordan a rank of "moderate"—the highest ranking of any MENA country, with particularly high marks for access to justice, anticorruption agency and law enforcement, government effectiveness, rule of law and regulatory quality.

Despite Jordan's generally impressive performance, challenges remain. While Jordan may have quite solid performance in terms of international comparators, popular expectations are rising and the public appears more critical of the Government's performance. According to the WGI, the level of political stability in Jordan, while not as critical as in conflict ravaged Iraq or West Bank and Gaza, is below MENA average and below the mean for lower-middle income countries. This problem is linked in turn to frequent government changes and cabinet reshuffles that impede the Government's ability to undertake meaningful structural reforms.

Jordan's PFM reform efforts have attracted significant donor support from both multilateral and bilateral sources. The IMF is involved in supporting a macro-fiscal unit, as well as on treasury and cash management issues. The World Bank has been supporting a variety of public sector reform initiatives, ranging from a joint expenditure review with the government to assistance developing capacities for macro-fiscal modeling in the MoF. More recently, Bank assistance has focused on support for the introduction of a Medium Term Expenditure Framework (MTEF) and policy driven budget process.

Among bilateral donors, the United States Agency for International Development (U.S.AID) is the most heavily involved in PFM reform through a US$40 million project that has PFM as is its main component. The main areas of U.S.AID focus are budget reforms—including results oriented budgeting—and implementing a Government Financial Management Information System (GFMIS). GTZ has had a long term involvement in the PFM reform area in Jordan focusing particularly on budget issues, although in future they intend to focus on internal control issues in cooperation with the European Union (EU). The EU provides budget support for PFM reform to support sustainable economic growth and fiscal consolidation, as well as various sectoral reforms.

Substantive Reform Agenda

There are two relatively recent assessments of Jordan's PFM performance. A PEFA assessment, sponsored by the European Union, took place during the spring of 2007. It concluded that "Jordan has made big progress in public finance management during the last years in terms of planning, controlling, monitoring and securing greater transparency of its fiscal policies, budget implementation and debt management."[14] In August 2009, a joint IMF/World Bank review titled, *Jordan: Advancing the PFM Reform Agenda*, concluded that, "the authorities have made considerable progress in advancing PFM reforms, actively supported by donors."[15] The reviews confirm that PFM has been high on the reform agenda of both the Government of Jordan and its international development partners, and that positive results have been achieved.

A summary of the performance PEFA indicator scores is at Annex 1 to this study. Using a four-point rating scale, the assessment produces the results shown in Table 2.

Table 2: Jordan Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A (best)	6
B	13
C	7
D (worst)	5 (note 1)
Total	31 (note 2)

Note 1 – includes 2 of the 3 donor indicators that form part of the PEFA framework.
Note 2 – comprises 28 system indicators and 3 donor indicators

The table reveals a good set of results, with 19 out of 28 (68 percent) of the performance indicators being scored as B or better. In the PEFA framework, the 28 indicators are divided into six dimensions of PFM, which are discussed below. A full presentation of the PEFA indicators for Jordan is provided in the annex to this chapter.

Budget Credibility. The PEFA assessment showed mixed results for the four indicators that refer to budget credibility. While the rating for aggregate expenditure and revenue budget variances were modest, there were problems with expenditure composition and payment arrears. The PEFA assessment attributed these to two factors, one specific (namely increases in oil price subsidies and in aid to Iraqi refugees), and the other generic (the lack of an accounting system based on commitments resulting in the absence of a system to monitor arrears). The assessment asserted that the waiving of oil price subsidies and the introduction in 2007 of a new system of accounting and monitoring taking into consideration commitments would allow Jordan in the future to improve substantially the two low scores (D). However, the more recent Fund/Bank review noted the continuing need to develop some basic PFM systems, such as commitment controls, to address the challenge of fiscal consolidation and the risk of accumulation of expenditure arrears in particular. This was seen as one of the factors that had prevented Jordan's public finances from benefitting

[14] European Commission, *Jordan Public Expenditure Financial Assessment*, 2007.
[15] World Bank/IMF, *Jordan: Advancing the PFM Reform Agenda*, 2009.

fully from the introduction of more advanced budgeting approaches in terms of budget credibility and aggregate fiscal discipline. In essence, one of the basics of a well performing PFM system was not fully in place.

Comprehensiveness and Transparency. Jordan scored very well in terms of the six PEFA performance indicators related to comprehensiveness and transparency. Budget formulation and execution are based on administrative, economic and sub-functional classifications, using GFS/COFOG standards. Recent budget documentation was found to fulfill seven of the nine information benchmarks required by transparent practice, with one omission being a list of financial assets and the other the medium-term budget framework which is now provided. Prominent among the successes identified by the Fund/Bank review was the adoption of a new GFSM 2001-compliant budget classification and Chart of Accounts.

Policy-Based Budgeting. The PEFA made a positive assessment of policy-based budgeting. The budget process was considered to be regular and orderly with a clear calendar—although it would be improved if the budget was approved by the Parliament before the end of the fiscal year. Among the important reforms in this area have been initial steps on establishing a Medium Term Expenditure Framework (MTEF) and introducing a results focus to the budget.

During the last three years, steady progress had been made in reforming the process of budget preparation as part of the MTEF reform (see Box 4.1). However, the Fund/Bank report indicated that the Minister of Finance was concerned that the reform had not yet resulted in significant improvements in public resource utilization. The analysis of the report indicated that the design of the reform was basically sound but pointed to two underlying problems: (1) the limited attention given to expenditure analysis within the government, and particularly within the General Budget Directorate (GBD); and (2) the tendency to treat current expenditure as "non-discretionary" and exempt from serious scrutiny.

The review emphasized the importance of focusing more on improved implementation rather than further consideration of the design of the reform. It also advised the implementation of a number of measures in the context of the 2011 budget cycle, including:

- GBD to introduce a revised calendar for the 2011 Budget that: (i) sets out the key stages and deadlines; (ii) provides more time for expenditure review and strategy analysis; and (iii) makes specific requirements for consultation with Cabinet at key stages during budget preparation.

- MoF/GBD to prepare a budget policy and priorities paper for discussion in Cabinet at the outset of budget preparation.

- MoF/GBD to prepare a budget framework paper for discussion and approval by Cabinet prior to issuing the Budget Circular and resource ceilings.

- Changes to the forward estimates (FEs) exercise should be introduced with the 2011 Budget to broaden its focus from prioritizing new capital spending projects towards wider program level reform initiatives.

- A "planning reserve" should be introduced into the forward estimates to provide space in the outer years of the MTEF to accommodate new spending initiatives that have not yet been identified or appraised.

While the focus on improved implementation of the reform is undoubtedly important, a separate World Bank review of the MTEF process in 2009 had some interesting insights on the reasons for weak implementation.[16] The review noted that the MTEF in Jordan had been initiated at a time when the MOF and GBD had been heavily involved in the implementation of other public finance management initiatives, such as the GFMIS and the new chart of accounts. These other reforms have significantly limited the time and capacities available to focus on the MTEF.

Box 2: Definition and Scope of the MTEF

The term MTEF is defined to be a comprehensive budget planning process. Specifically, it includes the following stages: (1) the development of the macro-fiscal framework that determines the overall availability of resources; (2) overall budget policy and strategy analysis; (3) review of sectoral/ministry strategies and expenditure programs; (4) setting and approval of budget resource ceilings; (5) preparation of the detailed budget for the coming year and Forward Estimates (FEs) for the following two years; and (6) review and approval of the draft Budget by Cabinet and the Parliament.

The focus of the MTEF reforms is on stages (1) to (4), which together constitute the strategic phase to budget development. The MTEF reforms in Jordan have emphasized a results-oriented budgeting (ROB) approach involving the introduction of performance indicators and the feedback of performance monitoring information into the subsequent rolling forward of the MTEF. The ROB approach cuts across a number of the stages in MTEF development.[17]

The second major reform aimed at improving the policy focus of the budget is the introduction of a performance focus through “results oriented budgeting” (ROB). This has been on the reform agenda in Jordan for more than a decade, although during most of this period progress was limited. A performance budgeting initiative was first assisted by GTZ Germany from 1999 to 2004, but it had little impact and was regarded as being too ambitious. From 2004, an ROB approach continued to be discussed and pilots were initiated in various ministries, but there appeared to be little ownership of this initiative by the GBD. The recent Fund/Bank report commented on the latest phase of this reform that started in 2008 with support from U.S.AID. The report commented that impressive progress had been made in a short time, although much remained to be done. The report’s recommendations covered various aspects of the new ROB approach, including the more limited and selective use of performance indicators as well as the elimination of almost all programs based on support services rather than services to external clients.

Predictability and Control in Budget Execution. The PEFA assessment scored Jordan quite well in terms of predictability and control in budget execution, with only two out of nine scores recorded as less than B. However, the more recent Fund/Bank review was more cautious in its assessment on the quality of expenditure controls. On the revenue side, tax management was found to have progressed with the creation of a single department to manage the two main taxes (income tax and sales tax). But it was noted that there were a large number of taxes and fees and that the tax base has been eroded by exemptions related to investments. As for budget execution, substantial

[16] World Bank, *Progress Assessment in Introducing a Medium Term Expenditure Framework*, 2009.

[17] The budget of 2008 has for the first time included the concept of “Results Oriented Budget”, where the budget has included the vision of each ministry and government department as well as their mission, strategic objectives and programs to achieve these objectives, while being consistent with the national priorities that were included in the National Agenda and the Forum "We are all Jordan". Moreover indicators for measuring objectives and performance were developed to facilitate operations of expenditure monitoring and the verification of the efficiency of resource allocation. (Source: MOF website)

effort had been devoted to achieving better coordination between the various concerned directorates (such as the Budget Department, Accounting, Cash and Debt Management Departments) so that the predictability of fund availability was well known by spending units.

Nevertheless, the more recent Fund/Bank review identified areas for improvement in treasury management, which has been an area in which the Fund has provided technical support since 2004. While acknowledging the increased coverage of the Treasury Single Account (TSA) system, it noted that: (1) government deposits with commercial banks had recently increased; (2) there were numerous special bank accounts for project specific external loans and grants outside the TSA; (3) cash management was still mainly through cash-rationing, albeit the cash flow forecasting had significantly improved; and (4) there was no functioning commitment control system. The review team therefore found it necessary to recommend to the authorities a set of detailed steps to be taken. In view of the long history of Fund support in this area, the on-going weaknesses raise questions about the implementation of the reform.

The PEFA assessment commented on the continuing need for improvement in payroll controls, non salary expenditures and procurement, although progress had been made. The internal control functions needed to be upgraded and modernized. Internal audit was seen as being primarily concerned with pre-audit of transactions and 100 percent check rather than sampling and systems review. This was later confirmed by the Fund/Bank 2009 mission. Given the fact that some spending units were not computerized and there was no centralized database system, the MOF was judged to have made excellent progress in the field of account reconciliation. The two low scores awarded were due to the complete absence of information on resources received and spent by service delivery units (D) and to the absence of expenditure commitments captured in the in-year budget reports, as the accounting system was still based on cash payments (C).

While separate to the direct expenditure reforms, a related component of the GoJ's reform strategy is its pursuit of a more decentralized approach in providing services to citizens in all governorates of the Kingdom. As part of this approach, the Ministry of Finance has linked electronically the financial directorates and centers throughout Jordan. The electronic connection has allowed the financial directorates to provide services for citizens near their places of residence, thus saving time, effort and cost. It also contributes to performance improvements, procedural simplification and a reduction of demands upon the central Ministry. Among the most significant services that were provided by the electronic connection are the completion of certain pension transactions provided by the Retirement and Compensations Directorate in the financial directorates of the governorates and providing services to citizens related to payments due to citizens. This was formerly provided only by the Central Ministry/ Legal and Public Funds Affairs Directorate. The governorate directorates are able to answer citizen inquiries in all governorates concerning owed public funds, as well as undertaking the task of receiving the due amounts, forwarding them to the relevant units and implementing legal procedures related to their collection.

Accounting, Recording and Reporting. Jordan scored well in the PEFA in terms of the timeliness and regularity of accounts reconciliation. Bank reconciliation for all central government accounts takes place on a monthly basis. Reconciliation with the TSA at the Central Bank is done on a daily basis. The Cash Management Directorate reconciles the accounts of the Treasury with the Bank of Jordan and the commercial banks. The Accounting Directorate reconciles the accounts of the various government departments and spending units of the central government on a monthly basis.

Less impressive was the availability of information on resources received by service delivery units. Although there is some availability, the collection process is ad hoc and not sufficiently widespread. However, there is also an increasing awareness that this needs to be improved. Plans for improved collection and analysis of financial and non-financial data are recognized in various strategic planning documents.

The Jordanian budget accounting system is decentralized and the MOF consolidates the accounts of spending units on a monthly basis. As discussed above, the budget accounting system is not yet based on commitments (with the exception of debt servicing and accruals), but on a cash basis. Jordan scored moderately in terms of the quality and timeliness of annual financial statements. A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant. Final annual accounts are transmitted to the Audit Bureau within two months of the end of the fiscal year. The Audit Bureau audits them and submits its annual report to Parliament for review.

Financial assets and liabilities are not yet covered by the annual financial accounts, and this explains the relatively low scoring (C). It is however possible to have access to the main elements of these assets and liabilities in different documents of the MOF accessible to the public. National standards of accounting are close to the International Public Sector Accounting Standards (IPSAs), and transition to a new system in full compliance with IPSAS has begun with foreign technical assistance.

External Scrutiny and Audit. The PEFA assessment pointed out that the Audit Bureau will have to change its nature from an *ex ante* basis that duplicates the work of the internal controllers of the MOF to an *ex post* audit placing reliance on internal control systems and their efficiency. The subsequent Fund/Bank report found that this reform was underway. While the PEFA found that the legislative scrutiny of the annual budget law by both houses of Parliament is quite good inside the two Finance committees of the Houses, the legislative scrutiny of the Audit Bureau reports was felt to be weak.

Implementation Strategies for Reform

The Jordan case provides an interesting example of the use of reform strategies as a mechanism to drive the process. There have also been some interesting general insights on the reasons for success or failure from the various Fund/Bank reviews.

The GoJ has endeavored to apply a strategic approach to its PFM reform planning and prioritization. Over the past decade or so, it has initiated numerous PFM reform initiatives based on a number of strategic documents, including some framed within the broader context of the National Agenda. In 1999, Jordan launched a Public Sector Reform Initiative with support from the World Bank and bilateral donors, which included a PFM reform component covering MTEF, the introduction of a GFS 2001 compliant chart of accounts and the introduction of a GFMIS. Later strategic documents included: the MoF's *Financial Management Reform Strategy 2004-2007*, the MoF's subsequent *Strategy for 2005-2009*, the GBD's *Strategy for 2007-2009*, and the *Policy Statement for Public Sector Reform for 2004-2009* issued by the Office of the Prime Minister (see Box 4.2).

The MOF strategy for 2008-2010 is a follow-up version of the previous one. The GBD as well as the Income and Sales Tax Department (ISTD) are not covered by this strategy and developed their own. The 2008-2010 strategy of the GBD follows and complements the 2007-2009 strategy. It is more sophisticated than the MOF strategy, since it provides a link between Jordan's national objectives and the strategic objectives of the GBD. Also, external technical assistance support is identified for each objective with a time horizon assigned. These strategies are then broken down into activities/measures for each unit within GBD and indicators are defined (but not quantitatively). The GBD and MOF strategies are overlapping substantially, and both are claiming responsibility for MTFF/MTEF, CoA and Budget classification reforms.

The 2009 Fund/Bank review contained a set of recommendations focused on strengthened management of the reform process. It emphasized coordination, prioritization and enhanced capacity, having noted the considerable additional demands that the ambitious reform agenda had placed on the limited capacities and financial management expertise of the MOF and the GBD, as well as on line ministries. These included:

- Establishment of a reform strategy to bring together the various reform streams with adequate prioritization and sequencing;
- Creation of a platform for donor coordination of the PFM technical assistance activities; and
- Periodic external evaluation of the PFM reform agenda.

Box 3: MOF Strategy as at 2009

The MoF had embarked on an important PFM-denominated reform program, the *Financial Management Reform Strategy 2004-2007* and had been implementing this program with external technical assistance. The MoF *Strategy for 2005-2009* included the same main objectives as those included in the initial strategy, although in a more aggregated form. This reform plan was widely supported by the donor community. The *Public Financial Management Reform Strategy 2004-2007* adopted by the MoF addressed the following four main objectives that continued in the 2005-2009 strategy:

1) ***Improving the macro-fiscal conditions of the Treasury.*** This objective included measures related to improvements in public debt management, in domestic revenue management, in rationalizing the tax system to minimize tax evasion and in reviewing public expenditures to allocate funds according to national priorities. It also included the use of an econometric model to estimate future revenues, strengthening the capacity to improve the MTEF, and establishing detailed spending ceilings by spending units.

2) ***Raising efficiency in planning, preparation, and execution of the general budget.*** This objective included a rationalization of budget preparation so as to arrive at Results-Oriented Budgeting within clear sector priorities; it also aimed to upgrade the quality of government services to citizens through more accountability in ministries and spending units. In this regard, the MoF had been trying to start a multi-year program to implement an ambitious and comprehensive computerization system (GMFIS) since 2005 and was planning to introduce a new Chart of Accounts in full conformity with *GFSM2001*. The reform program also calls for full implementation of a TSA in coordination with the Central Bank of Jordan, as recommended by various missions of FAD and METAC.

3) ***Institutional capacity building and human resource development.*** This objective required a review of the administrative and organizational structure of MoF and the definition of job descriptions. It also emphasized the need to reinforce the MoF Studies and Economic Policies Directorate and to decrease the cost of tax administration.

4) ***Improving the standard of services provided to citizen and investors****.* This objective was to be achieved through implementing a GFMIS to computerize and connect in one system the different financial activities in all ministries and. In addition to these financial management reforms, the government committed to improve accountability and governance by reducing the opportunity for corruption through the creation of the Anti-Corruption Commission (ACC) in mid-2006.

Source MOF, EC, IMF/WorldBank

The joint Fund/ Bank reviews undertaken in 2004 and 2009 have provided valuable insights into the implementation of PFM reforms in Jordan. In 2004, the review team suggested that the main constraints on the effective design and implementation of an ambitious budget reform program were weak leadership, institutional fragmentation and weak reform management capacity.[18] At that time, budget reform had never enjoyed broad support within the cabinet, nor had it been owned by the main line ministries. It had not been one of the highest priorities of the MOF. Various public sector reform initiatives had never fully integrated, either intellectually or operationally, the budget reform agenda. There also appeared to have been differences of views between different members of the government in their interpretation of key components of budget reform. For example, "results-based budgeting" was sometimes given a broad interpretation; other times, it was linked to narrower approaches such as improved analytical tools for conducting cost-benefit analysis and evaluating the impact of public investment projects. The institutional fragmentation of the budget process between MOF, GBD, MOP and the prime minister's office had been an obstacle to the formation of a unified view of budget reform and had compounded the problems of identifying a champion of the reform process and ensuring effective leadership from the MOF. The 2009 review pointed to the continuing fragmentation of the reform process in some of the institutional and technical aspects of budget preparation and management as a major impediment to effective reform.

The Fund/Bank reviews have concluded that the most successful reform initiatives in the public finance field had been those that had been focused, well-designed, carefully planned, well-managed, and effectively led by the MOF—backed, as required, by technical assistance from external donors. Initiatives that had been less successful (e.g., pilot studies of performance budgeting) had been poorly designed, weakly managed and the support of the donor agencies had often been less than completely effective. Some technical studies had been good but had been overwhelming in the quantity of recommendations provided, and there had been insufficient guidance on the prioritization and sequencing of reform and on managing institutional and capacity constraints.

The critical conditions for success of the reforms were directly related to removing some of the obstacles associated with previous reform efforts, and included: (1) strong leadership by the Cabinet, Minister of Finance and project managers in the MOF; (2) a clear link between budget reform and the government's main policy priorities: (3) effective coordination between the central ministries, line ministries, and de-concentrated levels of government; (4) strong integration of budget reform and the overall public sector reform effort, in particular to enhance capacity for reform management; and (5) careful sequencing of the reform effort to ensure its full realism given the capacity constraints.

The reviews have also emphasized the importance of firmly anchoring budget reform efforts in the line management of the MOF and the GBD, which has been more effective than the establishment of special project teams and groups with separate staff to implement reforms. The latter approach has a tendency to distance these units from the day-to-day operations of the organizations concerned, as well as to make it difficult to fully integrate the new practices. It has been suggested that attempts to implement reforms through projects might also give wrong signals about the time and resource inputs required to achieve real change.

The 2004 review commented that the inter-agency task forces established by the MOF to implement the TSA and the MTFF appeared to be working well and might be replicated in the budget area. These task forces could serve as counterparts to advisors and consultants provided by international organizations and bilateral TA providers. Finally, it made the point that fundamental reforms in budget preparation must have strong leadership within the government, and that most of

[18] World Bank/IMF, *Work Program for Consolidating Budget Management Reforms,* 2004.

the work in developing the new mechanisms must be carried out within the ministries and departments themselves. It was not possible to establish any well-functioning system such as a GFMIS or an MTEF mainly through the use of foreign consultants and advisors. Consultants and advisors could be very effective when used selectively, in areas that are clearly defined by the authorities themselves. But they should always play a supporting rather than leading role.

Political Economy of Reform

There are a number of political and institutional factors that have hampered PFM reform in Jordan. In particular, Jordan has a history of frequent changes of ministers. This has added a degree of high-level volatility and uncertainty to government reform initiatives that has impacted adversely on the PFM reform process. Further, as mentioned above, the institutional fragmentation of various PFM functions between the MOF, MOP and GBD has been sub-optimal and made it more difficult to establish a cohesive reform agenda. Finally, as recognized by the recent Fund/Bank review, it is not clear that there has been wide ownership of the reform process beyond the central ministries and agencies.

The 2009 Fund/Bank review also identifies fiscal stress as a factor that could impinge on progress in the short term. In particular, the drive towards PFM reform in Jordan faces the risk of receiving less attention from senior management within the MOF because of the fiscal impact of the financial and economic crisis. The MOF is currently embarking on a series of ambitious and costly reform projects which necessitate strong support and commitment from the highest levels of the ministry in order to stay on track. GFMIS, for instance, is drawing intensively on the ministry's resources and is a high return/high risk type of project that can only succeed with strong political and managerial support. At the same time, the MOF is facing the challenge of fiscal consolidation. There is some risk that the short term pressures on Jordan's fiscal balance might force medium-term structural reforms on the back burner.

Looking over the past decade, it is possible to discern other political economy issues impacting on the PFM reform process. One example concerns a major reform of the income tax regime attempted in mid-2006 with significant TA input from U.S.AID, which resulted in the submission of a package of reforms to parliament. A number of deficiencies and distortions in the income tax regime involving both policy and administrative issues were to be addressed with the changes. Unfortunately, during parliamentary consideration, further retrograde changes were proposed with the opposite effect, and accordingly the package is stalled.

Key Conclusions

According to the PEFA assessment in 2007, Jordan's PFM system was performing well overall and its systems are clearly among the strongest in the region. The recent review by the Fund and Bank confirms that PFM reform has achieved notable successes. , However, progress to date has been uneven despite considerable effort from the GoJ and extensive amounts of donor assistance. To some extent this may have been due to an underestimation by certain senior PFM officials of the challenges that confronted the effective implementation of a program of significant change. However, an important lesson from the Jordan case has been the institutional fragmentation of the budget process between MOF, GBD, MOP, and the PM's office which has been an obstacle in ensuring effective leadership of the reform process.

Table 3: Jordan PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	A
	Composition of expenditure out-turn compared to original approved budget	D
	Aggregate revenue out-turn compared to original approved budget	A
	Stock and monitoring of expenditure payment arrears	D
Comprehensiveness and Transparency	Classification of the budget	A
	Comprehensiveness of information included in budget documentation	A
	Extent of unreported government operations	B
	Transparency of Inter-Governmental Fiscal Relations	B+
	Oversight of aggregate fiscal risk from other public sector entities	B+
	Public Access to key fiscal information	B
Policy-Based Budgeting	Orderliness and participation in the annual budget process	B+
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	B+
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	B
	Effectiveness of measures for taxpayer registration and tax assessment	C+
	Effectiveness in collection of tax payments	B
	Predictability in the availability of funds for commitment of expenditures	A
	Recording and management of cash balances, debt and guarantees	B+
	Effectiveness of payroll controls	B
	Competition, value for money and controls in procurement	B
	Effectiveness of internal controls for non-salary expenditure	B
	Effectiveness of internal audit	C
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	B+
	Availability of information on resources received by service delivery units	D
	Quality and timeliness of in-year budget reports	C
	Quality and timeliness of annual financial statements	C
External Scrutiny & Audit	Scope, nature and follow-up of external audit	C
	Legislative scrutiny of the annual budget law	A
	Legislative scrutiny of external audit reports	C
Donor Practices	Predictability of Direct Budget Support	C
	Financial information provided by donors for budgeting and reporting on project and program aid	D
	Proportion of aid that is managed by use of national procedures	D

LEBANON

by
Robert Bou Jaoude and Elena Morachiello

General Overview

Despite the fragile structure of the country, Lebanon made significant progress in creating an open, service-oriented economy during the 1990s. It is now a major banking center and provides educational and health services to the entire region. It also embarked on a massive reconstruction effort to rebuild the country's heavily damaged infrastructure following the end of the lengthy civil war. At the same time, strains were appearing. Growth decelerated, and there was a threatening buildup of public debt which has presently reached alarming levels. Lebanon's debt to GDP ratio is among the highest in the world, and results from continuing high deficits in the public finances, the lack of tangible reforms in PFM and other sectors, and chronic political infighting rooted in the country's confessional political system.

Lebanon's PFM system, like four others in the region, is based on the francophone model, with an emphasis on pre-audit and a court of accounts system of auditing. Particularly for Lebanon, the prospect for reforms in PFM systems is intrinsically linked to the political context of the country. Reform programs have been repeatedly interrupted by the political unrest. Upon taking office in July 2005, the GoL committed before Parliament to an ambitious PFM reform agenda for the two coming years. Given the outbreak of hostilities with Israel, the agenda had to be adapted a year later to make space for post-conflict needs and restoring foundations for growth. While necessary, this reorientation came at the expense of efforts in public debt reduction and the improvement of PFM systems. In early 2007, the GoL presented a new reform program at the International Donor conference held in Paris (Paris III). The program was well received by the donor community, which pledged US$7.6 billion in support over the medium-term. However, these proposed reforms are still not fully implemented due to the conflict between the various political and religious factions in the country.

The World Bank and the IMF have been continuously providing technical assistance to the GoL to support PFM reform. The most recent comprehensive technical assistance on PFM was delivered through the 2005 CFAA and the Fiscal ROSC, respectively. More recently, in 2007 and 2008, the IMF has been advising the Government on how to improve cash management, budget coverage and revenue forecasting.

The World Bank is currently providing two grants to the Ministry of Finance (MOF), and both are designed to implement and support the government planned reforms in PFM. The first is the Emergency Fiscal Management Reform Implementation Support project (EFMIS), whose objective is to: (1) increase the capacity of the macro fiscal policy unit; (2) enhance capacity in all areas of expenditure programming and budget preparation; (3) implement reforms in budget execution, treasury management, and the public audit function, thus enhancing the overall control environment; (4) provide essential advisory services to strengthen the debt management function and improve coordination with the Central Bank (BdL); and (5) build on the MoF's efforts to improve aid coordination and manage donor relationships, in addition to capacity building activities directed to the public sector. The output of the reforms is expected to be felt starting FY10.

The second is an IDF grant with the objective of building capacity and training in PFM, especially in the key areas of budget preparation, government accounting, internal control, audit and information technology.

Before 2005, efforts had been made to improve expenditure management and policies. However, the quantum leap in reform dates back to the mid-nineties, which saw the computerization of the budget directorate and treasury operations, as well as of payroll and pension management. At the same time, with IMF assistance, a new budget classification was introduced in accordance with GFS 1986. This system enhanced the budget presentation and introduced limited transparency through instituting the administrative, economic and functional classification of expenditures. However, this wave of reform did not generate sustainable PFM improvement, mainly due to the political environment that rules the country and subsequent international conflicts.

Substantive Reform Agenda

In the past decade, the most successful PFM reforms have related to tax administration—in particular, the introduction of the value added tax. Progress on the expenditure side has been more limited, although some reforms were introduced in the 2005-2007 period despite the adverse impact of the protracted political stalemate, which also paralyzed legislative activity. These include the hiring freeze to contain the wage bill and the establishment of a Cash Management Unit (CMU). In the key areas of budget coverage, credibility, preparation, and debt management, reforms were at the center of proposals, draft laws, or pilot projects, but were never approved or fully implemented. The crucial need to reinforce internal and external audits functions was not adequately addressed. As a result, at end-2007, the state of PFM systems was akin to the one described in the 2005 Fiscal ROSC and CFAA.

The most recent reform period corresponds to the program the GoL presented at Paris III, which is both a summary of the 2005-2007 achievements and an agenda for future action. From 2007 onwards, only minor improvements in budget execution and transparency, as well as the effective introduction of the CMU, have been completed.

Credibility of the Budget. Today, the government still relies on the annual budget law for instructions on the content and structure of budget submissions. Macro-economic assumptions are not used to guide budget formulation, and the MoF does not contain a formal unit dedicated to the development of a macroeconomic framework. (Presently, this task is performed by consultants financed through the UNDP.) As a result, the budget preparation process does not set envelopes for line ministries based on macro-economic perspectives or sectoral objectives. Budgets are constructed from the bottom up, with no consideration of multi-year planning and sustainability. This approach introduces a high degree of uncertainty into the budget process and is fundamentally at odds with much needed fiscal efficiency and discipline. Moreover, for the past three years, Parliament has not approved the budget law. As a result, the government has operated on the 1/12 formula for expenditures incurred during this period. Lebanon has long been characterized by high budget deficits and one of the highest debt to GDP ratios in the world, which though reduced by twenty percentage points from its peak in 2006, still stood at 160 percent in 2008.

In the program presented to the donor community in Paris, the GoL recognizes the impending need to improve budgetary processes in order to restore credibility and fiscal discipline. Nonetheless, for now, concrete measures to set hard budget ceilings for line ministries only amount to the reported introduction of the MTEF in the 2008 budget circular. In effect, as will be described further below, the MTEF is not functional but only operational as a pilot project in the Ministry of Education, and even there it only sets ceilings in terms of overall expenditure.

Comprehensiveness and Transparency. Insufficient budget coverage and transparency are another fundamental weakness in Lebanon's PFM practices. First, the budget excludes foreign financed projects. Secondly, a number of activities are included as an annex to the budget document, but fall outside the reported budget and are not fully disclosed to Parliament when disbursed.

Recently, the MoF—which is the main initiator of PFM reforms—has started to expand the coverage of the budget to include foreign financed investment. In 2007, it drafted a budget law allowing for the integration of the largest extra-budgetary entities, such as the Council for Development and Reconstruction (CDR) and the Higher Relief Commission (HCR). However, the law has yet to pass. It fails to include the extra-budgetary expenditure of other large entities, such as the National Social Security Fund (NSSF), which provides health services, family allowances and pensions, or the Independent Municipal Fund, which provides most of the financing to the country's 927 municipalities.

In addition, the draft law does not address the issue of incomplete reporting to Parliament on state-owned enterprises (SOEs), of which there are 55 in total. These are part of the public sector and their financial situation has major implications for the country's fiscal position.[19] In 2005, both the CFAA and the ROSC identified the electricity utility *Electricité du Liban* (EdL) as a particularly problematic case. The April 2008 Cash Management report by the IMF found that debt servicing and guarantees provided by the GoL to EdL were still high. This being said, the 2009 budget proposal annex does include the estimated transfers needed to subsidize EdL's losses. Finally, a large number of treasury advances are being processed outside the regular budget framework.

Budgetary information includes economic, administrative and functional classifications, in conformity with IMF GFS 1986 standards. However, as mentioned below, there is no performance or program budgeting.

Policy-Based Budgeting. Given a flawed budgetary preparation process, the consequent lack of credibility, and the absence of a link between sector allocations and macroeconomic sustainability, the budget is hardly the realistic representation of policy priorities. The MTEF usually provides the link between the budget and government policy by translating the cost of sectoral strategies into budget allocations with respect of overall expenditure ceilings, revenue forecasts and fiscal targets. A full MTEF is still lacking, and what the GoL refers to as an MTEF is only an aggregate fiscal framework communicated in the budget circular. The overall expenditure level is communicated as a hard ceiling for the current year and as a general guideline for the two following years.

Whereas a sectoral MTEF is being piloted in the Ministry of Education with World Bank technical assistance, a general MTEF is not in place as no sectoral ceilings are provided, no costed sectoral strategies are integrated, and no estimation is made in the budget preparation process of the recurrent expenditure implications of investment budgets. As part of the MTEF pilot exercise in the Ministry of Education, the GoL is beginning to introduce notions of performance and results-oriented budgeting, which it would like to adopt across the board, in combination with the transition to a new budget classification using the IMF GFS 2001 Manual. The Bank's technical assistance under the two grants made available to the MOF will provide training to the MoF staff in performance budgeting concepts and tools.

Today, a weak flow of information between the MoF and the various implementing entities makes the budget preparation process a segregated exercise. This factor, coupled with an inadequate level of consistency of budgetary data, undermines the effective implementation of an MTEF and, more generally, efforts to make the budget a useful and credible tool for policy implementation. Flaws in

[19] Public enterprises are considered part of the public sector by the IMF GFS 2001 Manual. Government oversight of aggregate fiscal risk from public sector entities is also included as a performance indicator by the PEFA under budget comprehensiveness and transparency.

the area of information availability were still detected in 2008 by the IMF technical assistance mission on cash management.

The investment budget is financed, mainly, through grants and borrowing. Such financing is not reflected in the budget law, and the law (which integrates such financing into the budget in the form of an annex) has not been approved by parliament to date.

Predictability and Control in Budget Execution. The abovementioned weaknesses in budget credibility and preparation create uncertainty in the budget execution process. Spending by extra-budgetary entities further undermines predictability and control over budget execution. As they operate outside the regular budget process, their spending escapes MoF oversight. As ultimately all spending has to be financed by the same revenue stream, any overspending by these entities will adversely affect execution directly and indirectly by crowding out resources budgeted for approved expenditure and programs. The same applies to losses or arrears accumulated by SOEs. The abovementioned practice of off-budget treasury advances compounds the high degree of unpredictability, leading to significant deviations of actual expenditures from budgeted amounts. In addition, the MoF continues to rely heavily on budget carryovers, which violate the principle of annual budgeting and undermines budget execution.

The MoF has started taking steps to address these problems. The 2007 budget law mentioned above included two of the largest extra-budgetary entities (CDR and HRC) in the budget; it would also forbid carryovers for expenditures for which no third liability already exists. However, the law still stands as a draft.

Cash management is also jeopardized by the heavy reliance on treasury advances, carry-forwards, extra-budgetary expenditure, and low government oversight of SOEs. Treasury advances and carry-forwards weaken the reliability of cash forecasts. Extra-budgetary entities pose a problem to cash management, given that in Lebanon, they carry their banking operations outside the Treasury Single Account (TSA). As a result, their transactions escape the system of treasury management and oversight.

IMF technical assistance has recently focused on cash management issues. A Cash Management Unit (CMU) has been established within the MOF, and it has recently started working on improving treasury and revenue forecasting. A law to restore the TSA as it operated before the civil war has been drafted.[20] It specifies that all public agencies and institutions, with the exception of municipalities, migrate their cash balances to the TSA. Going forward, the GoL has also committed to link debt to cash management, a recommendation that has been repeatedly made by the World Bank and the IMF.

Accounting, Recording and Reporting. The reporting on the budget has been enhanced. The Government provides annual and quarterly financial data, monthly statistical reports, and annual economic and fiscal reports. The revenue agencies also post relevant tax and customs information on policies, practices and statistics on their websites and through other dissemination means. Subsequent to the Paris II agreement in 2002, the annual budget report includes a section on the aggregate debt levels. However, budget execution reports are not timely as they are submitted to Parliament two years after the completion of the fiscal year on which they are based. This falls short of international best practice, which is six to nine months from year-end. Also, the Court of Accounts (COA), the government external auditor, has failed to issue an opinion on the

[20] According to the 1963 Public Accounting Law, all public funds have to be deposited at the Treasury Single Account (TSA) at the Banque du Liban (BDL). During the civil war, the law was modified to allow public agencies and municipalities to open separate accounts, although still at the BDL.

Government's accounts since 1999. For this reason, the IMF and the Bank have asked the government to amend the PAL to require that the final budget execution report, the financial statements and the auditor's report on the statements all be tabled in Parliament within nine months of the fiscal year-end.

In addition, budgetary reporting does not cover important aspects of government financial operations. Information on extra-budgetary funds is limited; no detail is provided on the expenditures of public enterprises, or on the operations of municipalities beyond budgetary transfers. This being said, greater transparency has been observed in MoF operations over the past year, with more information provided on budget execution and related expenditure. Contingent liabilities arising from loan guarantees are reported, but not those associated with future pension entitlements, the limited privatization activities, or outstanding legal actions. Reporting on arrears is incomplete. Arrears are caused by the violation of the annuality principle in the regular budget, by the existence of extra-budgetary entities, and by the poor monitoring of SOEs, so that both are able to accumulate an unknown amount of arrears and losses. Treasury advances cause cash constraints, thus indirectly contributing to their buildup. Reconciliations of banking and fiscal data are undertaken on a monthly basis. Nonetheless, not all discrepancies can always be accounted for, due to the multiple extra-budget funds and separate bank accounts still in place. Because of the limitations of its reporting system, Lebanon does not yet subscribe to the IMF's Special Data Dissemination Standard (SDDS), but the country participates in the less rigorous General Data Dissemination Standard (GDDS) program.

Though an IFMIS is in place, parallel legacy systems are being used alongside it. The 2005 CFAA deemed the system unable to meet future needs and inadequate in terms of the links between the various modules (budgeting, payroll, revenue, treasury and debt management). It recommended replacing it with a new one. A Chart of Accounts that complies with the GFSM 2001 requirements has still not been developed. Government accounts are prepared on a modified cash-basis, though the government has agreed to the long-term adoption of full accruals. For now, accounts are not complete and do not adhere to IPSAS. With the transition to accruals, full IPSAS compliance will be required. The Bank's technical assistance under the IDF grant will provide training to MoF staff on the accounting practices required for IPSAS compliance.

In its current reform agenda, the GoL pledges to improve reporting of revenues and expenditures, by developing a unified system of data collection, monitoring and reporting, which will also be linked to the MoF's budgetary and accounting systems. This data system will be comprehensive, accessible to the public and auditable. With the support of a Bank grant, the system has been developed and is presently being tested through transferring from CDR and the MOF budgets live data into the system.

Internal Controls and Effectiveness of Internal Audit. Internal control functions are based on the 1963 Law on Public Accounting. The legislative framework is outdated and does not reflect the evolution in international standards. The system of internal controls is characterized by, on the one hand, duplications in ex-ante controls and, on the other, a low internal audit capacity. Duplications in ex-ante controls occur because both internal and external audit are performing ex-ante controls on expenditure, alongside MoF inspectors. The modern concept of audit as primarily an ex-post activity is in fact not fully applied in the Lebanon PFM system. Internal audits are mostly undertaken by the Central Inspection Board (CIB), an entity administratively linked to the Council of Ministers. The CIB undertakes financial inspections in order to ensure the proper use of public funds, but mostly limits its activities to legal compliance. Moreover, not all public entities are covered, as the CIB is not authorized to inspect certain bodies, such as the CDR or the Central Bank (BdL).

The need to upgrade internal controls and audit functions is mentioned only marginally by the government's current reform agenda in the context of the modernization of tax administration, and it is not seen as an overall reform. However the EFMIS grant will be supporting the enhancement of the control environment within the PFM system through introducing a modern internal audit function at the MOF on a pilot basis.

External Scrutiny and Audit. The external audit function is provided by the Court of Audit (COA). The COA has not expressed an opinion on government accounts since 1999. Nor does it regularly audit the final report on budget execution. As with other PFM systems, its functioning has been jeopardized by Lebanon's broader political instability. In the past, the civil war limited the opportunity to update the underlying legal framework to reflect developments in international standards. More recently, due to ongoing political cleavages, the Government has been unable to appoint a head for the Court of Accounts and the position has remained vacant for the past three years.

Due to the abovementioned confusion with regard to the appropriate domain for internal control (ex-ante) and audit (ex-post), the COA is still exercising pre-audit activities. This lessens its capacity to perform proper external audit activities, such as expressing an opinion on the audit of the consolidated government accounts. It also hampers its independence. According to the 2005 CFAA, the relationship between the COA and the Executive failed to meet INTOSAI independence requirements. Finally, the COA is not conducting performance audits.

The reform agenda presented at Paris III was drafted by the MoF, which has been the main initiator of PFM reforms. The fact that the COA is a separate body may account for the failure to mention either achievements or intended measures in this area in the Paris III document. Under the IDF grant, the Bank will provide training on modern audit techniques for the COA. Nonetheless, present weaknesses in external control are such that improvements are both critical and demanding in terms of government commitment.

Lebanon has serious shortcomings in governance and anti-corruption.[21] The Global Integrity Index rates overall integrity (measured in terms of corruption, governance and the legal framework) as very weak in 2007, the last available year. It is cause for concern that the audit and procurement domains do not receive extensive attention in the current reform agenda.

Implementation Strategies for Reform

The World Bank and the IMF have been continuously providing technical assistance to the GoL in support of PFM reform. The most recent comprehensive technical assistance on PFM issues was delivered through the 2005 CFAA and the Fiscal ROSC, respectively. More recently, as above-mentioned, in 2007 and 2008 the IMF has been advising the Government on how to improve cash management, budget coverage and revenue forecasting. Grants were also made available to the GoL to support defined elements of the PFM reforms.

The Paris III donor's conference was presented with a comprehensive reform plan which included reform to elements of the PFM system, mainly targeted towards the consolidation of the budget. Though the reforms presented at the Paris conference were endorsed by the government, most have not been implemented to date due to the difficult political environment. That said, some reform actions were introduced, especially in the payroll area. Presently, payments are being done through

[21] Lebanon remains one of the few countries in MENA that have neither signed nor ratified the UN Convention against Corruption (UNCAC).

electronic transfers to employees bank accounts. Moreover, the payment of taxes can be done at commercial banks counters as well as at MOF revenue collections units.

The MOF is in charge of implementing PFM reforms. A unit financed by the EC is in place with the mandate to assist the MOF in this role. However, no monitoring system is in place to report on progress or delays.

The reforms in the budget process and tax administration and the introduction of the value added tax were implemented following different approaches. The reforms to the budget process were performed through the introduction of a parallel administration mainly comprising consultants financed through donors. This approach did generate the sought after reforms. However, these reforms were not sustainable, as the MOF employees were not the owners of the change. In contrast, the reform of tax administration was based on having an external firm support the MOF tax department in developing new tax declarations and introducing new tax procedures, including the automation of the process. This approach had a better impact, as MOF staff did take ownership of the process after the departure of the consulting firm. For the introduction of the value added tax, the government provided salaries and benefits which were higher than those usually granted to public sector staff. This approach did attract competent staff and contributed to the VAT's successful implementation—a success that neighboring countries are now replicating.

As mentioned previously, the EFMIS grant will be another tool that the ministry will be using to push reforms forward. As reforms will possibly have an impact only by end 2010, it is still early to comment on achievements and successes. In general, reforms to date have been limited in scope and impact. Given the current political environment, reform will continue to be challenging in the near future.

Political Economy of Reform

In Lebanon, many ethno-confessional minorities with strong identities and high geographical concentration developed divergent political projects inspired from their own history. Each time these minorities found themselves facing each other without a foreign broker to manage their relations, they had to go through the difficult task of building fragile and unstable consensus. The main groups in Lebanon are the Maronites (Christians 22 percent), the Sunnis (Muslims 26 percent), the Shiites (Muslims 26 percent), the Druzes (5 percent) and the Greeks (Christians, Orthodox and Catholic, about 10 percent). Tensions between religious communities are a constant factor in Lebanese political life. Such conflicts, which often revolve around struggles to secure "gains for the sect" at the expense of gains for the nation, do not facilitate PFM reform.

The country is governed by a president, a parliament and an executive, all three of which operate within the framework established by the 1991 Taif Agreement or document of national accord. The Taif framework has numerous loopholes and is not fully applied by the hierarchy governing the country. As a consequence of the fragmented sectarian nature of Lebanon's political system, bargaining, negotiating, cliental behavior and political rent seeking have hampered the effective functioning of government institutions and made it difficult to secure decisions on reform. This was observed after the Paris donors meetings, when political and sectoral conflicts were the main reason for not moving forward with the implementation of reforms that were agreed to by the Government. The future is not particularly promising, as Lebanon's electoral law plays a major role in perpetuating the existing political, social and economic position of various sectarian groups rather than a national commitment to reform.

In fact, any reform that could destabilize the country's sectoral equilibrium is condemned to failure, whatever the soundness of its technical content or its potentially beneficial impact. No reform will succeed if it reduces the political rents available to one confessional community if others are allowed to keep their traditional sources of rent. A key example is the Public Accounting Law (PAL). The PAL establishes the budget framework. It sets the rules for the preparation of the annual budget request, specifies the budget preparation calendar, defines the roles of the Minister of Finance and the technical ministers, defines expenditures and revenues, and gives detailed prescriptions for revenue collection and management, sale of assets and collection of state loans. It then defines the four stages of expenditure creation—commitment, liquidation, authorization and payment—and the responsibilities of various parties at each stage of the process. The law sets out the procurement processes and procedures to be used for the acquisition of goods and services, and it describes the rules and operation of the Public Treasury.

When the government has presented minor modifications to the law, Parliament delayed and stalled the approval of the amendments. One reason was their fear that spending controls would be weakened if the Court of Accounts (COA) were to lose its ex-ante approval function at the same time as the MOF commitment controller functions were delegated to the spending ministries. However, the main reason for the failure to pass the amendments was political. The COA is headed by a president selected on a sectarian political basis, and the loss of COA's ex-ante control function would alter the current equilibrium between the various confessional groups.

One way out of this bind is to find a "compensation mechanism." Another is to promote a comprehensive package that would bring the whole system to a new equilibrium. Unfortunately, based on the current political environment in the country, the opportunity for a comprehensive approach to reform is not readily foreseeable in the near future.

Key Conclusions

PFM reform in Lebanon has been a challenging endeavor. Some progress has been made in tax administration reform, but this is an exception. The approach to tax reform successfully blended international expertise with local ownership. The reforms—which targeted the critical issue of enhancing Government revenues—were sustainable, particularly with regard to the implementation of the value added tax. On the expenditure side, different implementation strategies have been followed and these have been less successful in generating ownership. However, the main factor behind the repeated failure to reform various elements of the PFM system was the political agenda of the various players. Finding a strategy that addresses these political factors will be critical if Lebanon's PFM reforms are to be successful in the future.

MOROCCO

by
David Shand and Daniel Tommasi

General Overview

Morocco is a lower middle income country with a population estimated at 31.3 million in 2008. Its 2007 GDP per capita is estimated at US$4,093 in PPP terms and US$2,422 in nominal terms. It gained full independence from France in 1956. It is a constitutional monarchy, although the King retains significant executive power. He appoints the Prime Minister and Cabinet based on election results. Opposition parties were allowed to take power after the 1998 elections. The new King, Mohammed VI, has moved the country towards greater democracy and freedom of expression.

The 2007 elections were generally regarded as free and fair. There is an active and well established civil society.

The government is pursuing liberalization of the economy to improve the investment climate and attract foreign investment. Reform of the public sector is associated with this policy. Structural reforms have contributed to strong economic growth over the past decade. The country is divided into 16 regions and some 61 provinces and prefectures, which have their own elected assemblies and budget. There are also around 1,500 communes.

Morocco's PFM system follows the French system. It has a solid legal basis which is strictly observed and provides strong central oversight of public finances. According to the most recent IMF ROSC, the PFM system is robust in terms of financial control and provides reliable information. Fiscal transparency is reasonable, but the scope of the budget needs expansion. Budget execution and accounting procedures are cumbersome and need streamlining.

Along with Tunisia, Morocco's scores are among the highest in the region on various dimensions of budgetary and financial management. The Bank's 2003 Country Financial Accountability Assessment (CFAAs) assessed Morocco's PFM fiduciary risk as low. Morocco has achieved success since 2003 in fiscal consolidation based on improved revenue management and stricter control of the civil service payroll, including the introduction of a voluntary retirement package in 2005. This consolidation has been achieved despite increases in international fuel and food prices, which have increased the burden of fuel and food subsidies in the budget. Morocco's fiscal targets for 2009—which include a budget deficit of no more than 3 percent of GDP, public debt of no more than 60 percent, and a civil service wage bill of less than 10 percent of GDP—have been achieved. The budget deficit was reduced from 5.2 percent of GDP in 2005 to 2 percent in 2006 and moved to surpluses of 0.2 percent in 2007 and 0.4 percent in 2008. Public debt similarly fell from 62 percent to 47 percent of GDP at end 2008. Fiscal sustainability analysis suggests that the fiscal framework is robust to shocks.

In most measures of governance, Morocco has consistently performed above the MENA region and lower middle income averages. It scores well on the quality of public administration and average on accountability and corruption. Its major weakness on comparative indicators is insufficient accountability. Public opinion surveys suggest that people perceive corruption to be a serious problem in Morocco. According to the *2009 Global Corruption Barometer* published by Transparency International, two thirds of Moroccans polled felt that their government was somewhat or very ineffective in fighting corruption. The *Global Integrity Index* gives the country and overall "very weak" rating and emphasizes problems with whistle-blowing protections, limited citizen access to information, no election oversight, poor regulations governing the budgetary process and ineffective rule of law. (Concerning the budgetary process, the index focuses on legislative and citizen oversight.)

The Ministry of Economy and Finance (MEF) is the key player in PFM reforms, along with the Ministry of Public Sector Modernization (MMSP). It should be noted that there is no separate Ministry of Planning or Investment. The Ministry of the Interior plays a role with MEF in overseeing the finances of sub-national governments.

In 2003, the Government launched a major public administration reform program (PARAP) managed by the MEF and the MMSP. This program covers PFM and civil service reform, including reducing the civil service wage bill. The Government requested Bank assistance, and this program has been supported by a series of three Bank Public Administrative Reform policy loans, the latest being a DPL approved in 2008. Each of these loans contained PFM reforms as one of its major components. An ongoing series of programmatic DPLs is envisaged to continue this work, and a fourth US$80 million Public Administration Reform DPL was approved by the World Bank's Board in April 2010 that also includes PFM reforms as one of its four main components.

The EC has also provided budget support grants and the AfDB has provided budget support loans including PFM issues. Both institutions are participating in the Bank's DPL and making use of a common policy matrix. The Bank has provided technical assistance for the introduction of performance budgeting and an MTEF. A working group to prepare a new Organic Budget Law (OBL) was set up in 2008 and the broad orientations of this new OBL have been agreed by the MEF. The European Commission is providing technical assistance in the development of the new OBL. The Bank has also been active in PFM ESW with a CFAA in 2003 and a draft PEFA assessment prepared in 2008. This assessment was a joint undertaking of the Bank and the EC, working in collaboration with a government counterpart team. The IMF also prepared a fiscal transparency ROSC in 2005.

Substantive Reform Agenda

The substantive reform agenda is assessed using the PEFA assessment as the framework within which the PFM reform process and results are reviewed. A summary of the PEFA indicator scores is included in Annex 1 of this study. Using a four-point rating scale, the assessment produces the results shown in Table 4.

Table 4: Morocco Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A (best)	8
B	10
C	8
D (worst)	4
Not Rated	1 (note)
Total	31 (note 3)

Note: the PEFA exercise comprises 28 system indicators and 3 donor indicators

Credibility of the Budget. This component is examined in some detail in the PEFA assessment. In the years 2005-07, all categories of budget revenue were significantly underestimated, with 2007 revenues being 20 percent higher than budgeted. While to some extent this may reflect better than expected revenue administration, there appears to be a conscious underestimation.

This underestimation of revenue is also accompanied by significant additional budget appropriations granted through decrees, increasing the approved budget during the year. In 2007, such increases amounted to 26 percent of the amounts provided in the Budget Law. However, aggregate expenditures in 2006 and 2007 were close to the Budget Law provisions, meaning that most of the additional appropriations were not spent.

The PEFA assessment only briefly analyzes the composition of expenditures. It notes that the variation in the composition of expenditures exceeded 10 percent only in one of the past three years, namely 2005. The 2007 CFAA suggests that there are considerable variations in both operating and investment expenditures, particularly the latter, compared to the original budget estimate due to additional revenues being available during the year through special additional funds and fund transfers. No details of these adjustments or transfers are made available. Nevertheless, the CFAA concluded that budget execution is generally in line with the budget as passed, and actual expenditures do not differ significantly from budgeted amounts except for items such as fuel and food subsidies.

Because of the system of commitment control, the amount of any expenditure arrears should be known and subject to monitoring. However, the PEFA assessment suggests that such reports are incomplete. The CFAA suggests they generally do not exceed 5 percent of total expenditures. The PEFA assessment notes that the stock of arrears has been considerably reduced during the past few years to less than 10 percent of budget expenditures, but it was unable to quantify the amounts more precisely.

Comprehensiveness and Transparency. The classification system is based on administrative, economic, functional and detailed sub-functional components and is broadly GFS/COFOG compliant. However, a program classification has not been implemented. The paragraphs of the investment budget are sometimes called "programs" by the MEF, but they cover investment projects.

However, budget comprehensiveness needs improvement. Outside of the budget are expenditures for various social funds (the social security agencies, pensions of government and private sector employees, and civil servant health insurance) and some 220 autonomous government agencies, including the Hassan II Fund for Economic and Social Development. This fund receives a substantial proportion (up to 50 percent) of privatization revenues to finance economic, infrastructure and social projects. Its revenues and expenditures, which are around 6 percent of the investment budget outlays, are not included in the annual budget law or in the overall balance of central government. There is, however, some disclosure of its operations. The budget documents include a separate report on public establishments and enterprises, as discussed later. The PEFA assessment notes that, despite the extent of extra-budgetary funds, the amount of expenditures not covered in different fiscal reports is very small—less than one percent. Extra-budgetary funds are included in the Treasury Single Account.

The budget itself is somewhat fragmented, although the total picture is presented in a consolidated budget document. Under the Organic Budget Law, the budget is broken down into four separate components—the general budget covering ministries and related bodies and comprising about 85 percent of budget expenditures; 160 autonomous agencies or SEGMA (mainly educational institutions and hospitals); nearly 100 special Treasury accounts, including various earmarked revenues such as for roads and certain housing expenditures (which are exceptions to the Organic Budget Law provision of no earmarking or offsetting of revenues); and a fourth component comprised of various annexes that are now being abolished. Military expenditure is fully reported in the same way as expenditures of other ministries. All these components of the budget are executed according to the same rules.

The PEFA assessment rates the comprehensiveness of the budget documents as reasonable, noting that they contain five to six of the nine desirable pieces of information. This includes macro-economic budget assumptions, budget balance and financing information, stock of debt and major revenue and expenditure measures. Not included are financial assets and a summary of the prior year's information in comparable form.

The budget documents presented to Parliament are extensive. Apart from the draft budget law covering some 50 chapters and 10 annex tables, there is an economic and financial report providing macro-fiscal information, detailed budget booklets for each ministry's operating expenditures and staffing expenditures, and details of the other parts of the budget (autonomous agencies, special

Treasury accounts and past and future financial operations of public establishments and state enterprises). While overall the budget information is extensive and available to the public, in practice, it is not user-friendly because of its fragmented nature. One particular deficiency is a lack of detailed information on budgeted and actual amounts for previous years.

The budget documents also contain an annex on the financial operations of state owned enterprises. The MEF exercises strong central oversight of these institutions through a separate MEF unit with several hundred staff. However, there does not appear to be any systematic management and reporting of contingent liabilities which arise from government guarantees of their financing. The scope of activity of state owned enterprises remains substantial, but their quasi-fiscal activities are limited. Social obligations carried out by these enterprises are generally covered by explicit payments to enterprises from the budget.

Contingent liabilities are not reported in the budget documents or elsewhere, with the exception of guarantees of external debt. On the other hand, there are no fewer than three separate reports published annually on the public debt. Since the 2007 budget, a report on tax expenditures has been included in the budget documents and published on the MEF Website.

External financial assistance from international donors is included within the budget, with the exception of a few project-grants. Morocco has achieved a high degree of integration of project aid in the national system by setting up a reimbursement procedure. Expenditures financed from external aid are budgeted and paid by the Treasury according to the same procedure than other expenditures and the Treasury is then reimbursed by the donors. Therefore, expenditures financed from external aid are not separated from other expenditures in the budget documents. According to the MEF, all expenditures financed from external aid follow this reimbursement procedure with some exceptions, notably for some TA grants which are not covered by the budget.

Sub-national governments (SNG) elect their own assemblies and develop their own budgets, which in the case of the provinces are executed by the governor who is appointed by the King and reports to the Ministry of Interior. The MEF and Ministry of the Interior must approve these budgets, and investment expenditures must reflect government priorities. Three revenue sources are shared with SNG, of which the 30 percent share of VAT revenues is the largest. The horizontal allocation of funds between SNG is largely determined by transparent mechanisms and rules. However, the level of transfers from central government is provided too late to SNG for them to fully take account of it in preparing their budget. While consolidated financial reports on SNG finances are prepared, they are generally too late to be useful—often over two years after the year end.

The 2005 IMF Fiscal ROSC concluded that parliamentary and public access to fiscal information is broadly satisfactory, although the information provided is complex and insufficiently standardized. The MEF has worked over the past four years to improve the provision of information to Parliament and the public. Budget execution is reported on a monthly basis (with a one month lag) in the official monthly Treasury statement. A six monthly budget execution report is provided to the Finance Committee of Parliament and is publicly available.

Thus overall, considerable fiscal information is publicly available including the budget documents, within year reports on budget execution, reports of the Court of Accounts and contract awards over a certain amount.

Policy-Based Budgeting. The budget cycle operates on a precise calendar established each year by a circular from the Prime Minister. Some delays have occurred, but the budget is invariably passed by Parliament before the commencement of the fiscal year.

The preparation of the budget is guided by broad policy orientations and priorities announced by the King and the Government. Apart from providing the macro-economic context and fiscal targets, it contains sectoral objectives for designated priority sectors. The budget guidelines circular sets spending ceilings for each ministry based on these priorities.

Previously, a five year economic and social development plan used to be prepared and adopted by Parliament, establishing broad guidelines as well as expenditure projections based on macro-economic projections. The last five year plan covered the period from 2000-04. This approach has now been discontinued.

The High Planning Commissariat has prepared a strategic note for 2007-15. This note provides broad policy orientations and identifies growth scenarios. The MEF has been preparing a three year rolling MTFF since 2007 to guide the expenditure ceilings. The focus now is on developing sector MTEFs as the basis for increased allocative efficiency. With the support of the Bank, an MTEF handbook was prepared in 2006. In 2008, nine sector/ministry MTEFs were prepared. The preparation of sector MTEFs is being extended to five additional ministries with the support of the Bank.

The MTEF handbook covers processes to ensure close integration between MTEF and budget preparation and framing the sector MTEFs within indicative expenditure ceilings for each sector. However, this integration with the budget has yet to be implemented, although this may occur in the 2009 budget, and the effectiveness of these sector MTEFs prepared in isolation from the budget is therefore unclear. All ministries have prepared 2008-12 action plans which are intended to guide the elaboration of sector MTEFs.

These MTEFs may improve allocative efficiency if their processes are integrated into the budget processes, as recommended in the methodological guide. Nevertheless, at the moment, preparation of the budget remains input based with little explicit discussion of policies and priorities.

Previously, the Bank was providing assistance to the government to develop a performance budgeting approach based on pilots in a number of ministries. However, while some performance budget documents were drafted, government support for this exercise was weak and the initiative has not been pursued after these initial drafts. (There have recently been some indications that this could be changing.) The budget documents include hundreds of input or output indicators, but little attention is paid to them. The government intends to improve these performance indicators, including reducing their number. The government has improved the presentation of the budget documents. The line-item classification has been streamlined, but further progress is required. Recurrent and investment expenditures of ministries are presented in separate volumes. Goods and service expenditures are detailed by ministry and directorate, but personnel expenditures are only detailed by ministry.

It is expected that these issues will be addressed under the implementation of the new Organic Budget Law. Performance budgeting will be a key item in the new Organic Budget Law, and the Government will implement a modern budget classification that has already been drafted.

A few performance contracts have been developed between the Ministry of Health and its de-concentrated regional divisions. In October 2009, 17 performance contracts have been signed with universities. It is premature to assess the impact of these contracts on budget management. There are also moves to provide the Inspectorate General of Finances with a performance auditing role, but the lack of technical capacity has limited progress.

Predictability and Control in Budget Execution. Tax administration continues to improve. The PEFA assessment ranks tax administration highly, noting the strict limits on discretionary powers of tax officials, easy taxpayer access to information to assist them in meeting their obligations and the existence of appeal mechanisms (although it is too early to assess the latter). The legal basis for taxes is clear and tax legislation is modern, albeit complex and frequently amended. A single taxpayer identification number is under development, as is a web based system for providing information to taxpayers and receiving declarations. Performance criteria for tax audits have been adopted and a government claims preparation code has been developed.

The budget execution system is well-structured and reliable to ensure the legal correctness of expenditures, but has been cumbersome and slow with an excessive level of ex-ante controls. It takes considerable time for funds to be made available to spending ministries, although Special Treasury accounts and autonomous agencies may carry forward funds within specified limits. It also takes considerable time to enter into to commitments and to authorize payments. The commitment stage is complex, time consuming and subject to delays leading to approval and payment bottlenecks towards the end of the year. It reflects the strong controls of the French system with separate processes for commitment of expenditure, verification of payment and payment authorization on the one hand, and making payments and accounting on the other.

A prior action for the 2008 DPL was the simplification of ex ante controls to reduce paperwork and improve budget execution. In 2007, cumbersome virement rules were revised to provide greater flexibility to ministries. This has already resulted in improvement in the timeliness of budget execution. Morocco has embarked on a reform of the organization its ex-ante control system. By a decree of February 2006, the TGR (Kingdom General Treasury), which controls payment orders, and the CGED (General Control of Expenditures Commitment), which controls commitments, have been merged. It is planned that ministerial treasuries, reporting to the MEF but located within ministries, will perform simplified modernized ex-ante control, which will be based on risk assessments and the size of the transactions. For the moment, only a very few "ministerial treasuries" have been implemented.

The PEFA assessment suggests other significant recent improvements. It comments that cash planning is well carried out and that spending ministries are able to plan and commit expenditures consistent with their budget allocation at least six months in advance. While there are significant within year budget adjustments as discussed above, these are clear and transparent.

There is a strong system of internal audit comprising the Inspectorate-General of Finance (IGF), which conducts ex post audits, and the audit and inspection division of the Treasury within the MOF. There are also general inspection offices in individual ministries, but they are weaker than the IGF. The PEFA assessment comments that IGF observes international internal auditing standards, and thus focuses on systems improvement issues and not just compliance.

Accounting, Recording and Reporting. Bank reconciliations in the central administration are carried out at least monthly. However, reconciliation of suspense accounts and advances is less satisfactory, being carried out only annually. In addition, a number of such accounts and advances remain un-reconciled.

Budget execution is reported on a monthly basis (with a one month lag) in the official monthly Treasury statement and enables direct comparison with the initial budget. The information is considered reliable. A six monthly budget execution report is provided to the Finance Committee of Parliament and is publicly available.

Authorizing officers, accounting officers and auditors have their own separate computer systems, which make it difficult to exchange data. However, a new integrated expenditure control system GID is being developed to overcome this and will be used by the new integrated ministerial treasuries.

The final accounts cover budgetary and Treasury transactions. While they contain reliable information on budget execution and financing, they are not required to be submitted until two years after the end of the fiscal year, which is too late for them to be used for accountability purposes. They have traditionally been withheld for such a long period of time to enable minor errors or reconciliations to be determined. The 2006 accounts were not received by the Court of Accounts until June 2008, 17 months after the end of the fiscal year. However, these delays are expected to be reduced by the implementation of the new GID computer system. Once prepared, the final accounts are audited in a timely and professional way by the Court of Accounts. Then, the draft financial settlement law (*loi de règlement*), which consists of the audited final account is submitted to parliament, but with significant delays. Once enacted, the settlement law is published in the official bulletin and on the MEF website.

The final accounts also do not contain details of approved adjustments to the original budget. While they are prepared on a modified cash basis, they are not prepared according to any recognized standards such as IPSAS. No information on assets or liabilities, financial or other, is reported in the statements.

External Scrutiny and Audit. The Court of Accounts reports both to the King and parliament. Regional courts to audit SNG were established in 2004. The Court meets the INTOSAI standards in terms of mandate, powers and independence. As well as judging financial statements, the Court reviews the reliability and relevance of internal control systems. The PEFA assessment indicates that its audits cover at least 50 percent of total expenditures each year.

The Court presents both an annual report on its operations (presented around eight months after the end of the year) and a report on the annual financial statements or draft financial settlement law (*loi de règlement*), which as discussed above is very late because of the time taken by Treasury to submit the statements to the Court for auditing. The Court issues a "Declaration of Conformity" rather than a formal audit opinion. The Court's annual report publishes government responses to its observations, but there is no formal system of government response.

Parliament approves the financial settlement law once the final accounts are audited by the Court of Accounts. However, previous long delays in issuing the accounts have meant that the information is very dated. There appears to be little parliamentary or public interest in this process, although the PEFA assessment suggests that parliament may occasionally hold hearings. The government is currently reducing delays in submitting the draft financial settlement law to parliament. In 2009, the settlement laws for the years 2003 to 2007 were tabled together in parliament.

Parliament receives a six monthly report on budget execution in a statement made by the Minister of Finance to its Finance Committee. In addition, presentations may be made to the Committee during the year on specific fiscal issues. While parliament receives extensive (but fragmented) budget documentation, there are strict limits on its powers to amend the budget. It may neither increase revenue levels nor increase expenditures without offsetting reductions. In practice, the government often simply refuses to accept amendments by issuing a "declaration of inadmissibility." It has some two months to consider the budget. The draft budget is examined by a number of specialist finance commissions, and the overall finance commission has a small professional analytical group.

Implementation Strategies for Reform

In summary, the Government has implemented several modest but effective PFM modernization measures. The format and the presentation of the individual ministry input based budgets has been improved; a tax expenditure report is presented with the budget; the ex-ante controls of the MOF (commitment and Treasury's controls) are in the process of being unified and based on risk assessment; and virement rules have been somewhat relaxed. These actions have been generally successful.

Furthermore, more reforms are currently underway. A new GID system is under development and a new OBL is being developed. The government has moved to strengthen the effectiveness of resource allocation through sector MTEFs. However, as mentioned above, the extent to which they will be integrated with the budget process is unclear. Hundreds of input and output indicators have been included in the budget document but, as noted, not in a satisfactory manner.

As mentioned above, in 2002 the Government launched a major public administration reform program (PARAP) managed by the MEF and the Ministry of Public Sector Modernization, covering PFM and civil service reform, including reducing the civil service wage bill. This basic strategy has continued, supported by four Bank operations. The monitoring and evaluation of these operations by the Bank itself through PSRs has also formed part of the management of the reforms.

The reforms have been coordinated by the budget directorate (DB) of the MEF. Managers from this directorate (as well as other MEF managers) are highly competent and know what PFM reforms they wish to achieve in the medium term. The DB has controlled the reform pace. For example, it coordinated the preparation of the MTEF handbook, but it has avoided implementing it fully because it fears being tied by the forward expenditure estimates. In the same way, it did not relax ex-ante control on certain goods and services expenditures. There is a PFM reform subdivision within the budget directorate of MEF under the supervision of the deputy director of the budget directorate, among his other responsibilities. Thus management of the reforms has been allocated to a high level official, and he appears to have a clear view of needed reforms. However, there does not appear to be any systematic monitoring of the reforms by the government.

The Bank has undertaken monitoring of the PRFM reform operations through PSRs. Although there is no overall reform master plan, the draft OBL in effect performs that role. No direct incentives to organizations to promote and accept the reforms were provided.

Reforms have been piloted in certain agencies or departments. The sector MTEFs have been based on pilots involving a large number of ministries (around 30 percent). They are now moving to cover all ministries, which should not be particularly challenging. As is true in many contexts, the key issue in the implementation of the MTEFs will be their actual influence over budget decisions rather than being merely a paper exercise.

The Planning Directorate of the Ministry of Health is monitoring, in addition to the MTEF, performance contracts with its de-concentrated regional divisions, but the results are not yet clear.

Political Economy of Reform

The broader political environment has assisted the reforms. Public sector reform is seen as part of overall structural reform, and it does not seem that the PFM reform was affected by political developments such as elections. Rather, improved governance is central to the Government's economic and social reforms. Improving public sector operations, and particularly improving service delivery, is widely seen as an important objective.

The reform program was first launched by a Prime Minister order in 2002. The current Government's reform program was approved by Parliament in 2007. The then Prime Minister gave significant support. There is no clear opposition to the PFM reforms, but rather different points of view on its end objectives. The Budget Directorate (DB) has adopted a cautious approach, but it has implemented effectively discrete and concrete reforms. Line ministries are expecting increased responsibilities and flexibility in budget management and want more rapid and effective progress, but the DB has been reluctant to move too quickly on these issues.

There has been extensive consultation with civil society, in which the Bank has participated. Since 2002 the PARAP has been the topic of numerous debates, seminars and conferences. This consultation has confirmed the direction of PARAP and added momentum to its implementation.

As mentioned earlier, managers of the MEF and DB have been clear on what they wished to achieve under the reforms and have controlled the pace of reform. Because they present the reform in an optimistic light, there is at times a mismatch between the way the reform measures are understood by the press and donors and the actual results on the ground. The DB has now agreed to prepare a new OBL, because of both the EC and the Bank pressures and discussion with its peers in France and other countries. If recent history is any guide, the approach is likely to remain cautious and incremental.

Morocco is not particularly dependent on foreign assistance, which represented 4.2 percent of the 2009 budget revenues (compared with 3.2 percent in 2005 and 3.8 percent in 2006 and 2007). These figures cover both budget support and project aid, but exclude some small amounts of grants which are outside the budget. Dialogue with the EC on PFM is seen as facilitating increased economic cooperation with the EC. Dialogue with the Bank may have an indirect effect on the dialogue with the EC.

France's and other OECD countries moves to reform their PFM have had some influence. Particularly, the approach developed in France to streamline the ex-ante expenditure controls, based on a risk management approach, has influenced the Morocco's ongoing reform of ex-ante financial control. It appears that, as compared with Algeria and Tunisia, Morocco is more open and inclined to following the French approach in such an area.

Key Conclusions

The pace of reform has been set by the country itself, and this has resulted in a number of modest but effective reforms. However, it is expected that with the OBL under preparation, the reform process will be deepened. It remains to be seen whether the pace of reform will accelerate and gain greater traction, or continue to move at a steady pace. In any case, the development of an effective performance oriented approach to budgeting needs time.

Table 5: Morocco PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	A
	Composition of expenditure out-turn compared to original approved budget	C
	Aggregate revenue out-turn compared to original approved budget	A
	Stock and monitoring of expenditure payment arrears	C+
Comprehensiveness and Transparency	Classification of the budget	A
	Comprehensiveness of information included in budget documentation	B
	Extent of unreported government operations	C+
	Transparency of Inter-Governmental Fiscal Relations	C
	Oversight of aggregate fiscal risk from other public sector entities	B
	Public Access to key fiscal information	A
Policy-Based Budgeting	Orderliness and participation in the annual budget process	A
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	A
	Effectiveness of measures for taxpayer registration and tax assessment	B+
	Effectiveness in collection of tax payments	B+
	Predictability in the availability of funds for commitment of expenditures	C+
	Recording and management of cash balances, debt and guarantees	A
	Effectiveness of payroll controls	B+
	Competition, value for money and controls in procurement	B
	Effectiveness of internal controls for non-salary expenditure	C+
	Effectiveness of internal audit	C+
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	A
	Availability of information on resources received by service delivery units	B
	Quality and timeliness of in-year budget reports	B+
	Quality and timeliness of annual financial statements	D+
External Scrutiny & Audit	Scope, nature and follow-up of external audit	D+
	Legislative scrutiny of the annual budget law	B+
	Legislative scrutiny of external audit reports	D+
Donor Practices	Predictability of Direct Budget Support	Not Rated
	Financial information provided by donors for budgeting and reporting on project and program aid	D+
	Proportion of aid that is managed by use of national procedures	B

SYRIA

by
Mark Ahern

General Overview

In the past decade, Syria has embarked on a transition from a centrally planned to a "social market" economy. The PFM system is starting to change in line with the change in economic approach, but many of the features of the system from the central planning period remain to date.

Within the government, PFM is led by the Ministry of Finance (MOF) and the State Planning Commission (SPC), although the SPC role has been diminished with the transfer of responsibility for the investment budget to MOF in 2008. The Central Organization for Financial Control (COFC) operates as Syria's supreme audit institution. The PFM system is dominated by the central government, but the offices of line ministries located in the governorates are financed through the Ministry of Local Administration. The Governors oversee the administration of these resources but do not have an active role in allocating resources to the offices in their governorate.

In recent years a number of reforms have been instigated with the support of the Deputy Prime Minister (who is a former UN official) and the Minister of Finance. As part of this process, a major review of the PFM system was carried out by a joint World Bank/IMF mission in early 2006. This review provides the most comprehensive assessment of the current PFM system. Although the report set out a possible strategy for reform of the system, the Government has not adopted a reform strategy. The World Bank conducted limited further work in the PFM area following this study, but in the past year the Bank has started a more active dialogue with the Syrian authorities as part of a wider governance agenda. Since 2006, the IMF has continued to play a minor role with TA in the area of budget preparation. The IMF has had a larger involvement with the MOF on revenue administration reform, which is a priority of the Minister of Finance.

The EU started a large project in the MOF in 2005 (known as the MOF Modernization project) with tax administration and customs components, along with a component in the PFM field. The PFM elements of the project focused on budget classification, accounting, and performance budgeting issues. The EU is about to launch a successor project in 2010. The UN agencies have been active in Syria covering most sectors, however they have not been working in the MOF nor had an active role on PFM issues.

Substantive Reform Agenda

An informal Public Expenditure Financial Accountability (PEFA) assessment was completed alongside the 2006 World Bank/IMF report but was not widely disseminated. A summary of the performance PEFA indicator scores can be found in Annex 1 to this study. Using a four-point rating scale, the assessment produces the results shown in Table 6.

Table 6: Syria Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A (best)	0
B	4
C	10
D (worst)	10
Not Rated	7 (note 1)
Total	31 (note 2)

Note 1: There are 3 donor and the 3 tax administration indicators that form part of the PEFA framework.

Note 2: PEFA comprises 28 system indicators and 3 donor indicators

The EU is proposing that a full PEFA assessment be undertaken at the start of the new project in 2010—with an aim that it clarify priorities for the new project. The following sections set out the reform agenda in each of the six sections of the PEFA framework.

Credibility of the Budget. In Syria, the budget is a compliance document rather than central element of fiscal management. When comparing the execution of the budget in Syria against the original presentation, the revenue projections have proven to be broadly accurate. However, the expenditure outturn frequently differs significantly from the original budget. The variance on the expenditure side in part reflects the secondary role played by the budget in fiscal management. Policy decisions are largely taken outside the budget cycle, and the budget process is a technical exercise that attempts to reconcile the policy decisions with determined fiscal constraints. In the process, there is limited connection between an agreed policy and the budget provision, which can result in significant changes to the budget during implementation. Although the World Bank/IMF report proposed major reforms to the budget preparation process, there have not been any reforms to increase the relevance of the budget in fiscal management to date.

Comprehensiveness and Transparency. The budget documents are prepared for the specific purpose of parliamentary discussion, and they are not generally available to the public. They focus on line item allocations but contain limited information on the overall fiscal position, or the government's expenditure priorities. The budget covers all expenditure of administrative entities and any transfers to economic entities, but the boundary between administrative and economic entities is not clear. Although the EU prepared a revised budget classification in 2008 (including an economic classification in line with the GFS 2001 classification), it is not clear that the existing IT system has sufficient flexibility in the chart of accounts to manage the new classification, and there has been no attempt to implement it.

Policy-based Budgeting. The five year plan is the main planning process and includes medium term fiscal projections prepared by the SPC. GTZ has in the past been involved in supporting capacity development of modeling at SPC for the five year plan. There has been no macro-fiscal analysis or forecasting for the annual budget. Following a recommendation of the IMF, the MOF intends to establish a small team in the Budget Department to prepare fiscal projections.

The responsibility for the investment budget was shifted from the SPC to the MOF in 2008, and the MOF had this responsibility during the preparation of the 2009 Budget. Despite responsibility for the investment budget moving to the MoF, the separation of the two budgets was maintained within the MOF. In the line ministries, there are separate planning and finance departments with responsibility for the investment and recurrent budgets, respectively.

The EU MOF Modernization project conducted a number of training workshops for the budget department on performance budgeting concepts, but no reforms were made on the back of this training. The IMF is providing support to the budget department with medium term forward estimates. The work is focusing on two pilot ministries and utilizes a program structure to integrate the recurrent and investment budgets. The work started in 2007, and it is intended that the presentation of the 2010 budget would include forward estimates for the two pilot ministries using the program structure.

Predictability and Control in Budget Execution. There is a heavy emphasis on transaction control in the Syrian system. The MOF financial controllers are involved in ex ante control of transactions and the COFC scrutinizes ex post. There is an internal audit operation for all government entities linked to the central inspection agency (CACI), but the function does not meet recognized professional standards. The heavy focus on control makes the budget execution process extremely rigid, but to date there is not a reform program in this area.

The authorities amended the legal environment for procurement with the Uniform System of Contracts Law No (51) of 2004, which was enacted in 2005. In commenting on the procurement system, the 2006 World Bank/IMF report noted that there are a number of features of the current procurement system that limit the level of competition for contracts. In particular, there are explicit preferences provided to state enterprises, single sourcing is commonly used, and there are no defined processes for addressing complaints. In 2008, the authorities asked the World Bank to complete an assessment of the procurement system using the Country Procurement Assessment Report (CPAR) methodology, and it is possible that a reform agenda will emerge from this assessment.

The responsibility for managing the government's funds is divided between the Treasury Department and the Public Debt Department in the MOF. The Treasury manages funds associated with budget expenditure, while the Public Debt Department manages a Fund that is financed from debt issuance and the proceeds of surpluses from state enterprises. This fund is used to make investments into state enterprises. The World Bank/IMF report recommended that the two departments be restructured so that they have clearly defined roles and responsibilities—with the Treasury being responsible for financing of the public sector's needs and the management of these funds. The government has not acted on this recommendation.

Accounting, Recording and Reporting. Budget execution is managed through a network of financial directorates, with a directorate in each governorate. All of the directorates now have an IT system to manage the execution process, with the final three directorates automated in October 2009. However, there is no network linking the IT systems of the financial directorates, and any reports to Damascus are provided in hard copy. In year reporting is confined to the investment budget, and while there are various reports on transactions, there is no comprehensive fiscal reporting.

The EU MOF Modernization project developed an IFMIS to support budget monitoring. The intention was that the system would operate only at the MOF and would receive information from the financial directorates, which would continue to execute the budget using existing systems. The system was developed over two years and was completed in 2008, but it is not being used by the MOF.

The Syrian accounting system operates on a single entry basis. The EU project was meant to support the introduction of double entry accounting. The strategy adopted was to incorporate updated accounting procedures in the IFMIS as it is being developed. As the IFMIS is not being used, the approach has had no impact.

External Scrutiny and Audit. The external audit agency (COFC) carries out audits of all public bodies as well as state enterprises. Its focus is on transaction level testing rather than risk assessments. The agency is a member of INTOSAI. The COFC reports are submitted to the People's Assembly, but appear to have little impact. There are no current plans to reform the activity of the agency.

Summary. The main success in reforming the PFM system has been the transfer of responsibility for the investment budget to the MOF from the SPC. This has integrated the budget management process in the MOF—although it has to date been a relocation exercise, and the opportunity to reform the budget process in light of this change has yet to be fully grasped.

Although the EU MOF Modernization project aimed to address a number of important weaknesses in the PFM system, the outcomes of this project were limited. Many activities were undertaken by the project team, but the work was not integrated into the operations of the relevant line departments in the MOF. Moreover, the strategy adopted attempted to overcome the capacity weaknesses in the civil service by incorporating the new approaches (such as double entry accounting) into a new IFMIS that the project was developing at the MOF. As the IFMIS is not being used by the MOF, these efforts have failed. The EU is looking to refocus the successor project to improve its effectiveness.

The PFM reform agenda has so far been limited. In general, the initiatives have been focused on the MOF but have been relatively discrete. Although many PFM reforms would have an impact well beyond the MOF, there has been little if any discussion of the possible reforms with other agencies, or with other ministers, to date.

Implementation Strategies for Reform

Although the 2006 World Bank/IMF report presented a possible action plan for reforms, this was never discussed by the government and has had limited visibility. The decision to transfer the investment budget to the MOF was driven by the minister in charge of the SPC (the current Deputy Prime Minister) and was not linked to a broader PFM reform strategy.

The EU MOF Modernization project determined its priorities based on an initial assessment of Syria's PFM systems. While these priorities were endorsed by the senior managers of the MOF in their role overseeing the project, it does not appear that the reforms were given a high priority by the MOF. The MOF manager charged with overseeing the EU MOF Modernization project was an advisor to the minister (and more recently has been appointed the Manager of International Relations). The project was managed outside the MOF, and the line managers within the MOF were not closely involved on a day to day basis. There was a formal process for monitoring the project with regular reports on activities. But given the limited achievements of the project, it does not appear that this process was effective.

The IMF has been working directly with the Budget Directorate, although the Deputy Minister of Finance follows developments. While there were few signs of progress in the early stages of the project, there is now a prospect of some reform being reflected in the 2010 budget process.

Although the IMF is following developments, there is no mechanism for monitoring progress within the MOF.

Both the EU and the IMF have offered staff workshops and study tours to increase their understanding of the proposed reforms they were promoting. These were welcomed by the staff concerned, but had no discernible impact on progress with the reform.

The revenue administration reforms being pursued by the government have involved establishing a new revenue agency that is not subject to the standard civil service regulations. This should allow more flexibility in remuneration, which is considered to be an important feature in motivating the staff of the new agency.

It is too early to comment on the success of piloting of reforms. The IMF project with the budget department aims to pilot the forward estimates techniques with two ministries in the 2010 budget, and this will be an opportunity to assess the approach.

Political Economy of Reform

Syrian politics has been dominated by the ruling Baath party for many decades. While this has created a stable environment, the lack of reforms over a long period has made the civil service extremely cautious when considering change.

The push for reform in Syria has come from the highest political level, with the main proponents in the PFM area being the Deputy Prime Minister and the Minister of Finance. Over the past five years, these two key reformers have retained their position, which has helped provide continuity to the reform effort. Senior civil servants in the MOF and the SPC have been responding to directions from Ministers and have not been active proponents. Broader geopolitical developments have exerted tremendous pressure on Syria and occasionally diverted the attention of the key political figures.

The capacity to manage reforms within the civil service is weak. There is enthusiasm from junior staff, but within a hierarchical civil service, this has limited effect. The lack of leadership from the senior civil service is a significant constraint on the ambitions of the Ministers. In view of this, the Minister of Finance has focused his efforts, giving priority to reforms in tax administration over those of expenditure management.

Because the Syrian PFM system has changed little over an extensive period, there is no real culture of reform within the civil service. This factor, coupled with a heavy control environment that has historically discouraged innovation, has created a very challenging environment for reform. However, in general the civil service has provided passive support rather than an active campaign of resistance against proposed changes. In addition, there are some in the ruling party who are suspicious of changes that they consider to be promoted from outside, such as the proposals to reform the PFM system. This may explain why a low key approach has been taken to such reforms in the past.

Syria has not been aid dependent, and as a consequence the donors have not been influential. The EU has been negotiating an Association Agreement as part of its neighborhood policy, but the Agreement has not been ratified. The UN agencies have been active providing technical assistance in a range of sectors, but they have not been involved in PFM reform. The World Bank has not been active in Syria for a number of years and is considered by some non-reformers to be a tool of those exerting pressure on the country.

Key Conclusions

To date, the attempts at PFM reform in Syria have not been successful. The capacity to manage PFM reform is limited, and any change requires a concerted political effort and focused support. The Minister of Finance has responded to the capacity constraints by focusing specifically on revenue reforms. The Minister's support, coupled with incentives for staff created by the establishment of a new revenue agency with more remuneration flexibility, has led to some progress in this area. However, progress has been slower than planned, with a delay in the planned introduction of a VAT.

The efforts on expenditure reforms were primarily led by donors, and there has been limited ownership by the authorities to date. The projects were implemented without the government discussing expenditure reform objectives and without an agreed reform strategy. Moreover, the EU MOF Modernization project was not closely linked to the work of the line managers in the MOF. The donor projects therefore developed little traction and did not have a direct impact on the PFM system, although they may have prepared important ground for future initiatives.

Table 7: Syria PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	C
	Composition of expenditure out-turn compared to original approved budget	D
	Aggregate revenue out-turn compared to original approved budget	B
	Stock and monitoring of expenditure payment arrears	Not Rated
Comprehensiveness and Transparency	Classification of the budget	D
	Comprehensiveness of information included in budget documentation	D
	Extent of unreported government operations	C
	Transparency of Inter-Governmental Fiscal Relations	C+
	Oversight of aggregate fiscal risk from other public sector entities	C
	Public Access to key fiscal information	D
Policy-Based Budgeting	Orderliness and participation in the annual budget process	B+
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	Not Rated
	Effectiveness of measures for taxpayer registration and tax assessment	Not Rated
	Effectiveness in collection of tax payments	Not Rated
	Predictability in the availability of funds for commitment of expenditures	D+
	Recording and management of cash balances, debt and guarantees	C+
	Effectiveness of payroll controls	D+
	Competition, value for money and controls in procurement	D
	Effectiveness of internal controls for non-salary expenditure	B+
	Effectiveness of internal audit	C+
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	B
	Availability of information on resources received by service delivery units	C
	Quality and timeliness of in-year budget reports	D+
	Quality and timeliness of annual financial statements	C
External Scrutiny & Audit	Scope, nature and follow-up of external audit	C+
	Legislative scrutiny of the annual budget law	C+
	Legislative scrutiny of external audit reports	D+
Donor Practices	Predictability of Direct Budget Support	Not Rated
	Financial information provided by donors for budgeting and reporting on project and program aid	Not Rated
	Proportion of aid that is managed by use of national procedures	Not Rated

TUNISIA

by
David Shand and Daniel Tommasi

General Overview

Tunisia was in French possession prior to gaining its independence in 1956, and its PFM system is based on the same principles as the French budgetary law. It has a population of around 10.3 million (2008 estimate) and is a lower middle income country with a GDP per capita in 2008 of US$8,530 (PPP) and US$4,032 (nominal).

Since President Bourguiba's tenure in office ended in 1987, Tunisia has been moving slowly to a more democratic and pluralist system of government. There remain strong limitations on freedom of expression, but it has experienced relative political stability. Greater liberalization of the economy is being pursued to improve the business climate and attract investment. Tunisia has also long had a "progressive" social tradition in the Arab world, with its secularism and commitment to equal rights for women.

Tunisia has a system of strong executive government, with the President appointing the Prime Minister and Cabinet and the 24 regional governors. Parliament is relatively weak, but has been strengthened by the set up of an upper chamber (*chambre des conseillers*) in 2002 and somewhat opened up to opposition parties, which were allocated 25 percent of the seats in last October's elections.

Although recent PFM diagnostics are lacking, the 2004 CFAA concluded that the legal and administrative framework for PFM is sound and offers a solid level of assurance regarding the reliability of information and a strong control environment. The 2008 Development Policy review (DPR) comments that overall the PFM system functions sufficiently well for any fiduciary risk for budget support to be regarded as low, and that in general the budget system is reliable, workable and cost effective. Other Bank internal reviews have rated Tunisia's PFM well above the regional average. However there is a need to modernize the PFM system by moving to a performance based budgeting framework; to develop an MTEF to assist in fiscal sustainability; and to modernize its accounting framework. Tunisia also needs to significantly improve public access to budget information.

A draft PEFA assessment covering the three years 2006-2008 has been undertaken in collaboration with the government by the Bank, the European Commission and AfDB. However, the assessment remains to be finalized. When the assessment is completed in 2010 it will provide a comprehensive and up-to-date analysis of Tunisia's PFM institutions and practices.

Tunisia shows solid performance on WBI governance rankings and is well ahead of the rest of the region in terms of government effectiveness, control of corruption, rule of law and regulatory quality.[22] However, it scores poorly on voice and accountability. While it scores relatively well on ICRG's corruption index and Transparency International's CPI, there are increasing concerns about the integrity and transparency of the investment climate.

A prudent fiscal policy has helped maintain fiscal discipline, and Tunisia has pursued fiscal consolidation over the past few years. The central government balance (excluding grants and privatization) was a deficit of 2.9 percent of GDP in 2006 (less than the 2006 Budget Law

[22] World Bank, *Tunisia Country Governance Brief*, 2008.

projected); 3.0 percent in 2007; and 2.6 percent in 2008, representing a substantial improvement from the 1990s. According to IMF estimates, the deficit will increase in 2009 to 3.8 percent, mainly due to a decline in revenues and the Government's fiscal stimulus in response to the severe economic crisis. However, it is expected that the deficit will gradually decline in the next few years to 1.8 percent in 2012. Public sector debt has declined from 56 percent of GDP in 1996 to 51 percent in 2008. Tunisia retains a large public sector, which comprises around 45 percent of GDP. The public service, which makes up some 12 percent of the labor force, is expensive—around two-thirds of recurrent expenditure. Reducing public service wage pressure is a key budgetary issue that has yet to be addressed.

Tunisia has also been pursuing a program of decentralization, and an increasing amount of public expenditures are undertaken through the 24 governorates. Most of their resources come from the central budget, of which they represent around 5 percent. However, to some extent, this program is cosmetic, in that there have been no major changes in expenditure assignments and municipalities remain tightly controlled by the governorates. In addition, the governors—who are the executive heads of the governorates—report to the Ministry of the Interior and are appointed by the President.

Devolution of public services is however much more advanced, although to a differing extent between the sectors. In the education, health and agricultural sectors a growing share of the budget is implemented in the different regions by legally autonomous entities (*Etablissements Publics Administratifs*), even though their operational autonomy can still be increased, notably in terms of personnel management, procurement and the ability to retain earnings.

Civil service capacity also appears to be good. The 2008 DPR comments on the "orderly organizational architecture and generally high level of skills in the public sector," and refers to Tunisia's public service as having "a well deserved reputation for competence, integrity and compliance with the rules."[23]

The 2004 Presidential electoral program proposed PFM reforms, such as performance based budgeting, which were then integrated in the XIth Development Plan (2007-2011). The 2009 presidential program added the accounting and public administration reforms (e-governance and public service quality). Thus the origin of Tunisia's PFM reforms was essentially homegrown, even if it was partly inspired by the French budget reform (rather than being a donor generated reform). A PFM reform program is being implemented gradually but steadily. Improving the use of resources is also a component of the Strategy for the Development of the Public Service 2007-11. The Bank has been assisting with initial analytical support to clarify the concept of the envisaged budget reform, as well as in drafting a budget reform master plan. This master plan has not yet been formally approved at the political level, but is nevertheless largely used in the reform implementation. As it was drafted in parallel and close coordination with the final negotiations of an EC budget support to the budget reform, a large part of it has been included in the program's specific conditions of disbursement and performance indicators. It is expected that a revised version of the reform master plan will be submitted to a special inter-ministerial committee chaired by the Prime Minister in 2010, once the new Government is appointed.

The Bank has also provided assistance in the development of program management and performance monitoring within pilot line ministries (termed the "management dialogue"). It is now proposing further ongoing technical assistance in performance based budgeting, subject to Cabinet agreement to the PFM reform master plan which includes the necessary changes to the organic

[23] S. Schiavo Campo, *Tunisia Development Policy Review*, 2008.

budget law. (However, it is not clear when the new law may be passed.) Bank support has been closely coordinated with the EC's financial and technical assistance, which is supporting the government in developing MTEFs and performance monitoring within pilot line ministries. The EC is also assisting the government in strengthening tax administration.

The Higher Education Reform Support World Bank project is supporting the implementation of performance contracts for the universities, and it is expected that by the end of 2009 most universities will have agreed four year performance contracts with the Ministry of Higher Education. Performance contracting is also being pursued in secondary education (*projets de regions*) as well as in the health sector.

Tunisia is not heavily aid dependent. Donor financial assistance amounted to only 1.6 percent of budget revenues in 2008. However this is increasing. The EC is providing €29 million general budget support, with policy conditions targeted to the budget reform, along with a €2 million grant for technical assistance. A joint budget support program has been approved by the World Bank (including a DPL of US$250 million), the AfDB (US$250 million over two years) and the EC (€70 million) for Integration and Competitiveness. This budget support accounts for less than 2.5 percent of the annual central government budget of around US$12.9 billion.

In the 2009 Budget, project-loans amounted to only US$0.66 million, or 3.8 percent of total budget expenditures, and project grants between 1 and 2 percent of the total budget. External financing is significant only for a few ministries, such as the agriculture ministry. The overall role of donors and TA in the reform process should not be over-estimated. The government needs TA on specific issues, but success will basically depend on the degree of political and administrative guidance and support. In addition, there are adequate skills in both the government and the Tunisian private sector for the management of the reform program.

The PFM reform is coordinated at the technical level by a special unit within the MOF, which reports to the Minister of Finance. A technical committee comprised of the senior management of the MOF, the Ministry of Development and International Cooperation (or MDCI, which prepares the macro-economic framework and the five-year development plan), and the expenditure control institutions such as the Directorate General for Financial Control (DGDP), the Public Services Audit Office (or CGSP) and the Court of Accounts. Policy decisions on the PFM reform program are taken by a dedicated inter-ministerial committee chaired by the Prime Minister.

Substantive Reform Agenda

Credibility of the Budget. Budget execution stays close to the initial provision. Despite the various exogenous shocks of the last three years, actual expenditures exceeded budget by less than 10 percent, the variation in expenditure composition exceeded the overall deviation in primary expenditure by 10 percent in only one year, and that actual revenues consistently exceeded budget revenues with the largest variation being over 13 percent in 2008. The variation in investment expenditures was generally higher than that for recurrent expenditures, but not significantly so. This is due to the authorities' practice to keep a reserve of unallocated investment spending of around 10 percent in order to compensate the limited flexibility of their five-year development plan. Important changes to the initially approved budget are done in a transparent manner through a modified appropriation act, as was the case twice during the last three years.

Aggregate budget execution data and the initial budget are set out in the Official Gazette, which is published on the MOF website annually about three months after year end thus enabling comparison at the aggregate level. Quarterly budget execution data is also available on the IMF SDSS. The final accounts (*Loi de Règlement*) and the 2006 initial budget are also on the website, but comparison of actual versus budget in terms of expenditure composition may be difficult because of differing formats.

Table 8: Budget Execution Rates

	2006			2007			2008		
	Est.	Act.	%	Est.	Act.	%	Est.	Act.	%
Operating expenditures	7076	7112	100.5	7606	7904	104	8528	9341	109.5
Investment expenditures from general revenue	2068	2109	101.9	2295	2566	111.7	2558	2721	106.4
TOTAL	**9144**	**9221**	**100.8**	**9901**	**10471**	**105.7**	**11086**	**12062**	**108.8**

Expenditure arrears do not seem to be an issue, given the constant treasury surplus, the robust budget control systems in place and the regulation providing compensation for late payments to suppliers.

Comprehensiveness and Transparency. The budget classification system is not fully compliant with GFS 2001, particularly because of the absence of a functional classification. The classification system in some cases mixes administrative with input (economic) categories, as noted by the DPR.

Budget coverage is generally comprehensive. The CFAA notes that off-budget funds do exist and that the budget also excludes the operations of the social security funds. However, all donor project loans are included in the budget although donor project grants are not. As mentioned below, the revenues and expenditures of many funds/agencies that are off budget are shown as information in the budget documents. In the agriculture sector, professional offices (*offices des céréales*) managed by professional organizations are off-budget. But this may be explained by their governance arrangements.

The MOF coordinates the preparation of both the recurrent and investment components of the budget (title I and title II). Generally, a new investment project may be included in the budget only if it is included in the five year development plan, which is prepared by the MDCI. However there are a few exceptions for Presidential decisions. The development plan therefore represents a pre-selection of investment projects, but not all planned projects are budgeted. To ensure that the new investment budgeted projects are in conformity with the planned policies the Ministry of Development and International Cooperation (MDCI) participates as policy advisor in budget discussions held between the MOF and line ministries. Other central institutions involved in PFM, such as the Ministry of Civil Service and the Directorate General of Financial Control, may also participate.

The main limitation on the comprehensiveness and the quality of budget documents, as underlined in the CFAA, is that they do not give a complete picture of public spending. They cover only central government ministry revenue and expenditure, with separate booklets giving details on spending by public enterprises or entities receiving transfers from the budget. Local government budgets and the social security funds are not covered by government fiscal data. The former represent around 5 percent of the central budget. However the budget documents show expenditures financed by own source revenues of several public agencies, including transfers from the social security institutions to the public hospitals. The government financial table produced by the MOF has the same coverage than the budget documents. Some data covering the whole general government is published on the SDDS, but the data is not timely and is of questionable quality.

Some revenues and expenditures are managed through Special Treasury Funds, defined by the Organic Budget Law. These represented 3.7 percent of the 2009 initial budget. They constitute an exception to the principle of non-earmarking of revenue and to the principle of annual expiration, as their balances are automatically carried over from one year to the next. In addition, their management is more flexible than other budget appropriations, since their expenditure ceiling may be raised during the year if revenue is higher than budgeted. However, their operations are transparent in that their receipts, expenditure and balances are recorded in the annual budget laws and are detailed in the budget documents.

Capital expenditures are partly de-concentrated to the governorate level. The 2004 CFAA comments that the transparency of budgetary relations between central and local government could be improved and suggests an annual summary of revenue sharing should be included as an annex to the budget.

In terms of oversight of fiscal risk, the CFAA noted that government guarantees for borrowing by public entities are not systematically managed and disclosed, but their amounts are minimal compared to the size of the budget. However, the aggregate amount of government guarantees is now disclosed in the debt annual report published on the MOF web site six months after the end of the year. Furthermore, the Prime Minister's Office and the Court of Accounts ensure that all autonomous agencies and public enterprises prepare audited annual financial statements, which are centrally reviewed in terms of fiscal risks, including by the MOF.

According to the CFAA, the documents that make up the budget law and its annexes are well prepared, easy to understand, and contain much relevant information**.** Most of the information requirements for budget documentation in the PEFA methodology seem to be met, but this will be addressed by the forthcoming PEFA assessment. The overview that introduces the budget law and the report on budget data provide good information. The economic and financial overview prepared by MCDI (termed the economic budget) is well written and illustrated with numerous macroeconomic tables in support of the assumptions on which the budget is based. However, the projections are for only one year forward. The same is true of the budget summary, which includes revenue tables based on the latest available budget outturns for the previous year, the latest budget execution figures for the current year, and the budget proposed for the forthcoming year. However, in the budget, this data is aggregated at ministry and agency level and covers only the forthcoming year. No historical data is provided.

Policy-Based Budgeting. There is a clear budget calendar which is observed. The budget is formulated in conjunction with spending ministries, which are involved at an early stage of the budget cycle. However, the annual budget circular does not provide the line ministries with budget ceilings.

As mentioned above, some link between policy priorities and the annual budget is provided through the Five-Year Development Plan, which is presented in parallel with the budget. The Plan sets overall macroeconomic objectives for the country, along with the list of public investment projects to be carried out over the period. The capital expenditure section of the annual budget law reflects the components of the Plan. However, current expenditures do not appear to be prioritized through the National Plan.

A move to performance or results based budgeting is underway, although progress is slow. Four pilot ministries have identified programs and appointed program managers, with a view to restructuring their budget in program form. They have started defining program objectives and performance indicators. The pilot ministries are the Ministries of Health, Higher Education, Agriculture and Education. (Until mid-2009, only the Vocational Training Division of the Ministry of Education was considered as being pilot.)

In conformity with the draft PFM reform plan and the agreement with the EC on budget support funding mentioned earlier, the program budgets of the pilot ministries will be presented in 2010 to Parliament as an annex to the 2011 draft budget for information purposes. A second group of pilot ministries is also planned before the finalization of the new budget legislative and regulatory framework and its full scale implementation.

Some elements of multi-year budgeting are in place. The Five-year plan ensures medium term planning of investment activities. More detailed investment programming occurs during budget preparation. Commitment authorizations for multi-year capital expenditure are included in the budget. With the support of the EC, MTEFs were prepared in the education and professional training sectors in 2005-2007. However, these sector MTEFs were prepared in isolation from the budgeting processes and did not play a role in budget policy formulation.

The MOF has prepared a three-year aggregate MTFF. It is expected that it will now prepare three year indicative ministry ceilings to frame the MTEFs of the pilot line ministries. Pilot ministries have drafted MTEFs covering the years 2010-2012, together with the 2010 draft budget. These draft MTEFs are structured on a program basis. Their first year is consistent with the 2010 draft budget. They include only ongoing capital expenditure projects and a selection of new projects already included in the five year development plan. However, as of mid-October 2009, these draft MTEFs were not finalized. Because the MOF has not yet communicated the indicative multi-year ceilings, line ministries have generally avoided including new projects in the third year (2012) of their draft MTEFs.

Predictability and Control in Budget Execution. The budget is generally executed in a straight forward way without any significant deviations. However, some execution procedures are quite cumbersome. The organic budget law provides for fixed ceilings to ensure fiscal discipline. Only a few categories of appropriations (e.g. public debt payments, externally-financed investments) may exceed the limit set by the budget law. Virement rules provide only limited flexibility in budget execution and are enshrined in the organic budget law.

Line-ministries are fully responsible for managing their appropriations, including payroll. The actual release of funds requires a Presidential decree and then Ministry of Finance orders. For the current expenditures, funds are released by orders from the Ministry of Finance at the beginning of the fiscal year. By contrast, the release of funds for new investments projects is granted only once the whole project is ready for launch and has had all the required approvals. The release of funds for ongoing projects is partly regulated according to work progress. The release of funds to devolved entities requires a further decision by the line minister.

Tax administration is being modernized with technical assistance from the EC, based on recommendations made by IMF and World Bank in 2005 and 2006, and is expected to be completed in 2009. The tax collection system has been weak, with Tunisia previously ranked at 148 in the world in the “Doing Business” international survey on payment of taxes. This reflects complex laws with multiple exemptions and special regimes, which have been partly addressed through modernizing the tax laws, procedural simplification and a culture of assisting taxpayers to meet their obligations. The previous bonus system for tax assessors has also been changed. As a result, individual and business income tax collections have increased from 7 percent to 12 percent of GDP over the past decade. However, the simplification of the tax system, as well as the evaluation and consolidation of numerous and important tax exemptions, remains an issue.

Accounting, Recording and Reporting. Fiscal reporting is generally reliable. Reconciliations of banking and fiscal records are done satisfactorily on a monthly basis, facilitated by efficient computerization, even though some delays may occur. Each accounting officer prepares a report on all transactions for the month and forwards it to the Treasurer General for the preparation of aggregate data. In-year budget execution reports are prepared on a monthly basis and provide reliable information for managing the commitment and payment stages. However, the CFAA indicates that transactions related to projects financed by donor funds are reported with some significant delays of several months.

Financial control is ensured by effective and reliable control systems—both internal and external, as well as exante and expost. Financial controllers, who are part of the Directorate-General of Financial Control (DGDP), carry out the ex ante control of expenditure commitments and report to the Prime Minister's Office. In addition, the law provides for strict separation of function between those responsible for commitments and payment authorization operations (the authorizing officers) and those in charge of revenue collection, payment of expenses and management of funds (government accounting officers). Centralization of accounts rests with the General Directorate for Public Accounting (*Direction Générale de la Comptabilité Publique*, or DGCP), which is also responsible for the final statements on which the financial settlement law (*Loi de Règlement*) is based.

There are two major internal audit bodies, both of which appear to be well staffed professionally. The Public Services Audit Office (CGSP) under the Prime Minister and the Financial Audit Office (GCF) under the Minister of Finance have similar roles, except that CGF's work extends further into value for money issues whereas CGSP focuses more on financial management systems. A further internal audit body is in charge of the public property.

A feature of the Tunisian public finance system is that revenues and expenditures are managed through separate accounting systems.

The level of computerization and the fact that expenditures are registered at each stage of the expenditure cycle (from commitment to payment) limits any problems arising from such an old fashioned bookkeeping system. The DPR also reviews this issue but discounts its importance. The reform of the accounting system is included in the Presidential program published in October 2009. Its implementation will probably be dependent on the development of an IFMIS that will cover revenue, expenditure and financing transactions.

However in some public agencies such as hospitals, some form of accrual based accounting and double entry bookkeeping is already being implemented. In addition, public hospitals are currently considering implementing cost accounting systems with the view to establishing a fee-for-service system.

Expenditures financed by donor project-loans are included in the budget. They are accounted for through a dedicated IT system and reported as other expenditures. They may be managed by a PIU under special arrangements. Project-grants are not included in the budget. However, generally data on project-grants are included in line ministries requests for the budget and are reviewed by the MOF. In general, they are monitored by line ministries but outside the budget. While these arrangements do not reflect full use of the country systems, they do not constitute a significant weakness given the relatively small amounts of donor project loans and grants.

Tunisia has a dual system of annual financial reports. The accounts of Treasury (which are the accounts of the public accountants), termed *comptes de gestion,* are prepared within six months of year end and the "general accounts of the financial administration." The latter accounts include the consolidated financial statements of the public accountants, budget execution reports and various other financial statements. They are prepared within 12 month of the end of the year. The accounts are then audited in detail by the Court of Accounts, which issues a declaration of conformity of the Treasury accounts with the "general accounts of the finance administration."

Thus it takes more than two years to table the draft financial settlement law (*Loi de Règlement)* in Parliament. The draft law presents the audited budget execution report as well as the budget execution reports of the special accounts and public agencies included in the annexes to the budget. The Court of Accounts report on the annual accounts is transmitted to Parliament with the draft financial settlement law. However, the information contained in the government accounts is limited. For example, they do not provide any information on assets and liabilities and do not meet the requirements of any international accounting standards.

The public has limited access to budget information. The annual budget law is published in the Official Journal. However, most of the relevant information prior to the adoption of the budget such as the draft budget law is not disclosed to the citizens. Little information is publicly available on budget execution, although aggregate budget execution data is available on the MOF website as discussed earlier. Generally, given the lack of freedom of press and the weakness of civil society, government budget proposals and outcomes are not questioned.

External Scrutiny and Audit. Good quality external audit is carried out by the Court of Accounts and the INTOSAI standards on autonomy, scope and quality are met. The Court is a member of ARABOSAI and INTOSAI. The Court's staff is highly qualified and its audit methods have evolved towards greater emphasis on results and performance. There is a separate chamber for the audit of public enterprises.

The declaration of conformity referred to above is accompanied by a comprehensive and high-quality annual report by the Court that analyzes public financial management. The Court also plays a key role in the review of the draft financial settlement law (*Loi de Règlement*). It also produces reports on the financial statements and the quality of financial management of public sector entities. These reports are submitted to the President and Parliament and published in summary form in the Official Gazette and on the Court's website.

Audit reports and other financial control reports are followed up by the High Commission for Administrative and Financial Audit (HCCAF), a small body unique to Tunisia, which is directly linked to the Presidency.

Under the Constitution, Parliament has a clear role in approving the budget. The CFAA comments that recent changes have increased its role in budget approval. Parliament's oversight of budget execution is formally exercised through its vote on the financial settlement act (*Loi de Règlement*). However the value of this review is limited by the fact that the public accounts may be some two years old by the time the settlement law is considered by the Parliament, as well as by the lack of any formal Parliamentary hearing on the report by the Court of Accounts.

Implementation Strategies for Reform

Tunisia has generally adopted an evolutionary approach to reform. It avoids comprehensive or "big bang" initiatives. Its competent civil servants work with parties such as the Bank to develop ideas which are analyzed and debated. Any agreed changes are introduced in a gradual manner so as to minimize risk through being able to correct for mistakes and to build on experience.

However, this does not mean that all careful, incremental reforms have been successful. Results are uneven. Some "one agency" reforms, including the implementation of performance contracts in the health sector in the late 1990s and early 2000s, were not successful. The de-concentration in the agriculture sector has been more successful, although this could be explained by the implicit political role of agriculture regional commissioners.

The most effective approach to reform in Tunisia would probably consist of realistic and not overly-ambitious reforms covering the whole government, such as replacement of the outdated but functional IFMIS. That Tunisia has been adapting its planning system to the new context of globalization and an increased role for the private sector without major disruption also illustrates the validity of this approach.

A draft Master Plan for budget reform was developed in February 2008 with assistance from the World Bank. It was discussed by the reform technical committee in April 2008. It was reviewed in detail and completed by high level MOF officials at the request of the Minister of Finance in the second quarter of 2009. It is expected that it will be further reviewed in the Inter-ministerial Committee chaired by the Prime Minister. Although it has not been formally approved by the government, it has been largely used in the reform implementation as well as included in the EC budget support to the reform, with which it was closely coordinated.

This draft master plan gives broad objectives and directions for the reform. It also details some measures to be implemented in a pilot period that will involve a few ministries, focusing for the moment on the implementation of sector MTEFs (which will be, in principle, framed by an aggregate MTFF and an MTBF that will frame the inter-sectoral resource allocation) and performance monitoring. It covers a range of PFM issues and includes a proposed training program, the implementation of a new budget classification, the finalization of the chart of accounts and the preparation of a new organic budget law. The master plan suggests studies of possible streamlining of budget execution procedures but remains non-committal. While such a reform may be supported by the MOF and line ministries officials, as it would make line ministries more responsible and accountable, it may face resistance from the financial comptrollers who report to the Prime Minister. The roll-out of the reform beyond pilot ministries would start around 2015 with the enactment of a new organic budget law and the implementation of a new budget classification.

The key player in PFM reform is the MOF, which contains a small general directorate dedicated to the reforms—the GBO (budget management by objectives) MOF unit. Similar GBO units have been established in the pilot ministries. The MOF GBO unit does not produce regular progress reports, but since 2007-2008 it has prepared reports as requested by the Finance Minister or the Prime Minister.

It is too early to discuss successes or failures of the current reform program. Until mid-2007 almost no progress had been achieved in PFM reform. Since then, progress has been made, although at a slow pace. The draft reform master plan provides a vision of the reform scope and defines the first steps in the reform process. However, the government prefers to await the results of the pilots and the various studies proposed by the draft master plan before deciding on a number of key issues, such as the reform of the budget execution system.

Initially, three ministries and a division of the Ministry of Education have been selected as pilots for the MTEF and performance budgeting initiative. The 2008 agreement with the EC provides for three additional pilot ministries in 2010. The whole Ministry of Education has been made pilot in late 2009, at the request of its minister and staff. The Bank and the EC will provide technical assistance in these pilots.

Achieving progress in these pilots will need constant input and attention. While program managers should play a major role in the development of a performance pilot budgeting approach, for the moment their status is unclear and no financial or other incentives have been provided to them. In the same way, for the moment, the GBO units established within line ministries are ill-equipped, insufficiently staffed and have not been provided with any particular incentives.

The MTEF and performance budgeting pilots could be either self reinforcing or self defeating, depending on which extent they will feed into the budgeting process and whether they will provide other benefits to line ministries, such as increased flexibility in budget management.

Political Economy of Reform

The broader political environment has helped the reform. The support of the President and the Prime Minister is clear. PFM reform was a key measure in the 2004 Presidential program, which was the origin of the reforms, and most politicians support PFM reform. The slow pace of reform could raise some doubts on the political commitment, despite the 2004 Presidential program, its integration in the XIth Development Plan and the recent developments noted above. The new Presidential program issued in October 2009 focuses more on the accounting reform as well as on other public administration reforms (such as e-governance and public service quality) rather than budget reforms. This does not mean that budget reform will stop, but it appears to not be enjoying the same degree of high-level attention it enjoyed earlier.

In addition, a large part of Tunisian society expects movement in the direction of European standards for public management, reflecting Tunisia's desire to converge more towards the EU. The Government's commitment to improve economic competitiveness and attract foreign investment recognizes the importance of a well functioning public sector, as set out in the *Strategy for the Development of the Public Service 2007-11*.

Most senior officials in the MOF appear now to be committed to PFM reform. Prior to 2007, while many senior officials supported the reform, some senior and well-positioned officials seemed reluctant to facilitate progress. In a workshop on the reform experience held in June 2006, for example, the then Minister of Finance called for extreme caution in implementing the reform. The situation changed in 2007. The new manager of the MOF GBO is clearly committed to reform implementation, and the Minister of Finance has played an active role in finalizing the draft reform master plan.

Within the pilot ministries, enthusiasm for PFM reform was uneven until 2008. It has increased significantly in 2009. Although some officials believe that cooperation between MOF and line ministries would benefit from improvement, progress has been made recently and solid cooperation has been achieved between the MOF and GBO units in line ministries. Budget execution reforms may face resistance from the financial comptrollers, who report to the Prime Minister's Office, since they may fear losing their power if ex-ante financial controls are relaxed. However, they may agree with such reforms if a gradual approach is adopted or if their duties evolve with the reform.

Within line ministries, the reform may face opposition from those who fear losing their powers because of the introduction of management by program. It is still premature to assess which groups within line ministries will be affected. However, some general directors who will not be appointed as program managers, as well as the financial and planning departments in some line ministries, may fear losing their status and influence with the implementation of a program approach. Governors may also fear some loss of power under if sectoral MTEFs and performance budgeting are implemented. PFM reforms will need to be carefully designed and managed to limit this potential resistance. It does not appear that the powerful agriculture regional commissioners will lose power, and they appear to favor reform.

Taking into account previous experience, such as the hospital performance contracts, some are skeptical that a performance based approach will achieve necessary changes. However, performance contracts have been implemented recently in the Higher Education sector, and the Ministries of Education and Health are considering moving in this direction. It is premature to assess whether the lessons from the failed previous experiences in implementing performance contracts will be duly taken into account. However, performance contracting and performance budgeting need to be implemented hand in hand.

Current dissatisfaction and future resistance may be analyzed in parallel. For example, managers within line ministries complain about intrusive activities of financial comptroller controls or about regional commissioners who do not implement sub-sector polices. However, the level of dissatisfaction is comparatively low, while reform credibility is gaining ground in light of the recent progress.

Key Conclusions

Within Tunisia, the key issue is political commitment. The fact that PFM reform is included in the XIth Development Plan but not in the new Presidential political program does not mean that the reforms will be halted. Nevertheless, it will not facilitate its implementation, especially because the reform was included in the previous presidential program, and it may inadvertently signal that these reforms have slipped as a priority at the highest political level. However, there have been several positive developments as well. Pilot ministries have been increasingly involved and are now committed to undertaking new PFM approaches. The MOF GBO (reform) unit is active and the draft reform master plan has been widely reviewed and followed within the MOF. Furthermore, parallel reforms (such as accounting reform and performance contracting) might reinforce the main budget reform, which offers an opportunity to modernize the current PFM system, irrespective of how strong the link between performance and the budget might be.

However, incentives for the reform may be tempered by the fact that dissatisfaction with the current system is weak and it is unclear if there will be quick wins. Resistance from the financial controllers and other technicians may exist, but they are not the key challenges. MTEF and performance reports will probably be produced by the pilot ministries and the reform program agreed with EC will generally be implemented. However, without strong political support and the delegation of greater responsibility for PFM reform to program heads and managers, there is a risk that such activities may be largely technocratic and bureaucratic in nature. The key issue remains as to whether a broad consensus can be built on these reforms and to what extent they will actually improve government decision making processes.

WEST BANK & GAZA

by
Mark Ahern

General Overview

The Palestinian Authority (PA) was established in 1994 following the 1993 Oslo Agreement, with responsibility for areas of the West Bank and Gaza (WBG) under Palestinian control.[24] The PA adopted a PFM system which broadly follows the Anglo model, but in the ten years following the Oslo Agreement the PFM system evolved. Authority became increasingly concentrated in the executive, and the role of the parliament was reduced. Within the executive, the president dominated, collective decision-making was limited, and institutional arrangements were weak.

With the start of the second *intifada* in 2000, the PA's finances deteriorated significantly. The government was pressured by donors to initiate a range of reforms—including reform of the PFM system. These reforms started in 2002, with Salam Fayyad as the new Minister of Finance, and the first stage continued through 2005. The broad aim of these reforms was to improve expenditure control and oversight of PA resources. They ended up being among the most far-reaching of those implemented in MENA during the last decade.

Following the election of a Hamas government in 2006 and the re-imposition of budgetary restrictions by Israel and donors, a further fiscal crisis ensued and a number of the PFM procedures and practices stopped operating. A second stage of reforms (initially aimed at reestablishing the systems in place in 2005) commenced with the formation of a Caretaker Government led by Salam Fayyad in mid-2007. Because the Caretaker Government did not have effective control of Gaza, these reforms also involved establishing institutions in the West Bank to replace those previously operating in Gaza.

Important agencies in the reform process are the Ministry of Finance (MOF), the Ministry of Planning (MOP), and the Palestine Investment Fund (or PIF, which is responsible for the oversight of state enterprises). In 2005, the State Audit and Administrative Control Bureau (SAACB) was established with an external audit function—although this entity had a minimal role before 2008.

A large number of donors have been active in WBG, either in delivering budget support, conducting projects, or providing technical assistance for PFM reform. Among the donors supporting the PFM reform agenda, the World Bank prepared a number of analytical reports, including a Public Expenditure Review (PER) that was released in 2007; a Country Financial Accountability Assessment (CFAA); and a Country Procurement Assessment Report (CPAR) in 2004. The IMF provided strategic advice on both budget execution and budget preparation reforms following the formation of the Caretaker Government in 2007. DFID has conducted projects supporting the preparation of a development plan (the PRDP) and improving budget preparation. The EU has taken a specific interest in the areas of internal and external audit, and U.S. AID has supported projects aimed at general capacity building.

Substantive Reform Agenda

An informal Public Expenditure Financial Accountability (PEFA) assessment was completed alongside the 2007 PER. The following sections set out the reform agenda in each of the six sections of the PEFA. A summary of the PEFA indicator scores is at Annex 1 to this study. Using a

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[1] The agreement limited PA's role in a number of important dimensions where control remained with Israel. This included management of the borders and the associated fiscal revenues.

four-point rating scale, the assessment produces the results shown in Table 9.

Table 9: West Bank and Gaza Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A (best)	0
B	4
C	11
D (worst)	12
Not Rated	4 (note 1)
Total	31 (note 2)

Note 1: Includes the 3 tax administration indicators that form part of the PEFA framework
Note 2: PEFA comprises 28 system indicators and 3 donor indicators

Credibility of the Budget. When considered on a commitment basis, the aggregate recurrent budget is a realistic indication of likely expenditures. Because reallocations during budget execution remain a common practice, there can be significant variances within the expenditure categories. In addition, while considerable effort has been made to clear past arrears, liquidity constraints created by inconsistent donor flows mean that it is common to find a buildup of expenditure arrears, as there is not a commitment control system in place.

One of the major reforms that improved the realism of the recurrent budget is the introduction of controls on the wage bill. This has addressed an earlier problem where civil and security recruitment was not in line with the provisions in the budget.

The development budget is almost entirely financed through donor projects. The timing of these projects is beyond the direct control of the PA, and the budget is regularly substantially under executed.

Comprehensiveness and Transparency. A range of reforms have been introduced to improve the transparency of the PFM system. Following reforms in 2002, the PA's banking arrangements are managed through a central treasury account at a commercial bank.[25] Prior to the reform, line ministries had separate bank accounts from which they received revenue and made expenditures. The reform consolidated PA revenue flows and cash balances, although donor funds are generally separate. Changes are now being introduced to consolidate the small cash balances held for budget execution by line ministries.

A range of improvements have been made to the transparency of the budget with the publication of a budget book. This includes information on macroeconomic assumptions, the deficit, and how it will be financed, among other information.

In order to improve the transparency with which state assets are managed, the PIF began operating as an independent investment company from 2003 onwards. Its chief objective is to safeguard and consolidate the Palestinian people's investments and property, both in West Bank and Gaza and abroad. Management of the Petroleum Commission, the PA's petroleum monopoly, was taken over directly by MOF. A number of monopoly arrangements were reformed and the companies were

[25] The PA does not have a Central Bank. In view of problems experienced with the freezing of bank balances at the central treasury account during the period of the Hamas government, the PA now operates its central account from two commercial banks.

sold by the PIF. The Cement Company is the only remaining monopoly within the PIF portfolio. Prior to the PIF there was limited transparency in the functioning and financing of state enterprises.

A system of monthly reporting through the MOF website was introduced in 2002. While the procedure stopped operating during the period of the Hamas government (in part because the expenditure process was fragmented and necessary information was not available to the MOF), it was reintroduced by the Caretaker Government in 2008.

One area where reform continues to be necessary is budget classification. A different classification is used for budgeting than for accounting, and neither classification is aligned with the GFSM 2001. There is a proposal to unify the classifications using a revised budget classification for the 2011 Budget.

Policy-Based Budgeting. As indicated earlier, the reforms introduced by the Minister of Finance Salam Fayyad from 2002 initially focused on expenditure control and oversight. Relatively less attention was given to enhancing the policy focus of the budget. This is reflected in the PEFA, which identified a number of significant weaknesses in the procedures for budget preparation. However, a range of reforms initiated since 2007 (and supported by a DFID project) have substantially improved the situation. The MOF and the MOP had tended to work independently when preparing the recurrent and development budgets, but for the 2009 budget sectoral teams of MOF and MOP staff worked together—although the MOP staff generally had the lead. Budget submissions from line ministries were required to be based on a strategy for each ministry and to have a medium term focus. An effort was made to identify the recurrent expenditures associated with possible investment projects at the time they are being considered. For 2009, the information had a minimal impact on budget decision allocations, but it is expected to become more relevant over time.

For the 2009 budget, the line ministries were also asked to present a combined recurrent and development budget based on a program structure. The aim of the budget reforms is to eventually introduce program budgeting. The reform was mainly led by the MOP and the definition of programs was largely left to each ministry to decide. This has resulted in a range of different approaches being adopted. In time, the programs will need to be revised and standardized. In order for expenditure against the programs to be monitored in budget execution, some of the programs will also need to be simplified. The accounting system will not be able to manage the complex cost allocations that were adopted by some ministries.

The IMF recently provided advice on priority reforms for budget preparation. While commending the reforms to date, they cautioned against trying to move too quickly on the program budgeting reforms. The mission also recommended measures to improve the transparency and accountability of the development budget. The development budget continues to be mainly financed by donors and much of the aggregated expenditure presented in the budget is outside the control of the MOF.

Predictability and Control in Budget Execution. A number of reforms are taking place to improve controls during budget execution. A cash plan to assist in managing budget execution was prepared for the first time for the 2009 budget. While this addresses one of the weaknesses identified in the PEFA assessment, cash management continues to be complicated by the unpredictability of donor flows that finance about half of the recurrent budget. As a result, an important use of the cash plan will be to communicate the PA’s cash needs to donors. A Debt Management Department was established by the MOF in Ramallah in 2008 to replace the department that earlier operated in Gaza. One of the first tasks of the unit is to recreate the external debt records that were lost during the Gaza conflict in early 2009.

Payroll controls have improved substantially in 2007 and 2008. They now provide more assurance on the integrity of an item that in the original 2009 budget constitutes more than 50 percent of recurrent expenditure. In particular, the payroll system is now connected with the accounting system of the MOF; security forces are now integrated with the civilian payroll; a separation of duties has been implemented between the payroll and IT department; and a separate financial controllers department reviews the payroll on a monthly basis.

A draft procurement law has been developed with the support of the World Bank. The law aims to improve on the earlier law that was both incomplete and insufficiently robust to provide for a clear, rules-based environment for conducting public procurement. The reforms associated with the new law include: (1) establishing an independent public procurement agency under the new procurement law; (2) preparing standard bidding documents based on the new law; and (3) preparing a user's manual and guidelines.

A new Internal Audit Department was established in 2004. Support for the unit has been provided through an EU project. While the PEFA assessment recognized that good initial progress was made by the department, it was understood that it would take time for it to be fully functional.

Controls over expenditure were strengthened by creating a separate Department of Financial Control in 2004. MOF financial controllers were out-posted to spending ministries, and they report to the Director-General of the Financial Control. This system replaced the previous system, in which each ministry had a financial controller reporting to its minister. Recently, the management of the financial controllers has been brought under the Accountant General.

The lack of commitment controls is a weakness identified in the PEFA. With the introduction of the new accounting system, commitment controls were intended to be introduced during 2009 but are not yet in place.

Accounting, Recording and Reporting. From mid-2007 on, the accounting system based in Gaza was not available to the PA in Ramallah. A new computerized accounting system was developed by customizing a system operating earlier in the Ministry of Education. This system was able to start processing payments in the MOF from January 2008—only four months after the project started—but because it is a bespoke system it has continued to be further refined and developed. A particular focus has been on addressing the findings of a review by Ernst and Young, which identified a number of weaknesses, especially in the security of the system.[26] During 2009, the system has been progressively rolled out to line ministries.

With the operation of the new accounting system, the release of monthly budget reports was reintroduced by the 15th of the following month in early 2008. These reports are posted on the MOF website. In addition, the MOF has been able to prepare financial statements for 2008 and these are to be audited by the SAACB. This would be the first audit of financial statements since the 2003 accounts. The earlier audit was heavily qualified. Because the SAACB is being supported by the Office of the Auditor General of Norway it has some credibility, and the MOF has been committed to improving the quality of the accounts it presents.

DFID is supporting the MOF in preparing the financial statements for audit and the World Bank has provided strategic advice. Through this support, a range of improvements to accounting

[26] Ernst and Young/Ministry of Finance, Palestine, *Systems Functionality Review Report*, 2008. This review was commissioned by the Ministry of Finance to provide them with assurance on the integrity of the new system.

procedures have been identified. These will be the focus of the substantive reform agenda during 2009 and 2010. The work will include specifying accounting standards that, to date, have not been disclosed.

External Scrutiny and Audit. The SAACB was established in 2005 but had few staff until a major recruitment took place in early 2008. The SAACB's mandate includes the audit of almost 10,000 institutions at the levels of central government, local government and NGOs, but to date it has not had the capacity for this task. A range of donors have recently started working with the SAACB. An EU project is designed to build capacity in the SAACB, and a needs assessment was carried out in late 2008. The project is expected to start in 2010.

In 2009, the SAACB is expected to complete an audit of the financial statements of the PA. As mentioned earlier, to support this activity the Office of the Auditor General of Norway is providing technical guidance and has already conducted a series of training seminars.

The SAACB is a member of Arab Organization of Supreme Audit Institutions (ARABOSAI) and Asian Organization of Supreme Audit Institutions (ASOSAI), and is working towards becoming a member of INTOSAI. Furthermore, it has been working on developing close bilateral relationships and has signed two bilateral agreements with Jordan and Kuwait that provide for assistance with training staff.

The Parliament (PLC) has not been sitting since a number of members were arrested in 2006. The PEFA indicates that the Budget Committee of the Parliament was active but lacked the information and resources to adequately fulfill its mandate.

Summary of the Substantive Reform Agenda. Since 2007, there has been an extremely large reform agenda touching on almost all aspects of the PFM system. Some of these efforts are independent, such as reforms in the SAACB. But there are two large components of work—one on budget preparation and the other on budget execution—where a number of different reforms are connected. Many of the reforms are still work in progress, and for this reason it is too early to judge the final outcome. But the indications are generally positive—although the budget reforms are moving more slowly than the MOP and the MOF had hoped. It does not appear that the size of the reform agenda alone is a problem in West Bank and Gaza.

While many of the reforms carried out since 2002 have made a significant contribution to improved PFM, a number stand out as particularly impressive successes:

- The creation of the central treasury account has improved the control of cash balances by the PA—and after a period of fragmentation during the Hamas government—was quickly reestablished by the Caretaker Government in 2007.

- The establishment of the PIF has substantially improved the oversight of the state assets and successfully reduced the potential for abuse. The PIF is considered to be a transparent and well run organization, and the legislative arrangements for the Fund should ensure it is enduring.

- The introduction of monthly reporting on budget execution has improved fiscal transparency. The system stopped operating during the Hamas government but was quickly reintroduced by the Caretaker Government.

- The quick implementation of a new accounting system in 2007 and early 2008 was particularly impressive. Because of the crisis faced by the PA, the process followed in developing the system was not ideal. But the fact that it was able to process payments within four months of the concept being discussed was exceptional. The system has required further development since that time, and the ongoing costs of managing a bespoke system may be problematic.

In contrast, a major failure was an IT project that the EU carried out for revenue administration. The project was abandoned by the PA after □5 million was spent.

Implementation Strategies for Reform

There has been no grand strategy to guide the PFM reform process, although a number of recent donor reports have strongly advised that a reform action plan be developed. In the initial 2002-05 period, Minister of Finance Salam Fayyad deliberately took an "opportunistic" approach to pushing reform priorities guided by a few basic principles. The approach, which has continued since mid-2007, was outlined as follows in a recent study of the PFM reforms in WBG.[27]

Focusing on the Structural. Minister Fayyad wanted to tackle the structural aspects of the PFM system instead of focusing on corruption directly. He explains, "When you get into a situation like this, people are usually looking at the 'sexier' aspects of managing the public finance question, corruption, who took what, when and how—but not this structural aspect. I was really preoccupied with that. It's not that there is no corruption or anything like that—but I felt it necessary, and we took the approach that was based on, 'Let's stop the leakage. Let's stop the leak and make sure the system functions well here on out.' Then we go back to the extent that there were infractions and all that—we can deal with that—but to look back doesn't have much effect."[28]

Knowing the Priorities. Fayyad began by focusing on the major structural problems related to revenue and expenditure management and the budget. He observes, "There are elements without which you cannot have a well functioning public finance system. Conceptually, unless you have central treasury operation, unless you have consolidation of your revenues, and unless you are executing expenditures within a budgetary framework, you do not have much of a public finance system to speak of. You can be talking about catching somebody stealing some money here and there, but that doesn't do it. Whatever it is you do, that has to be the key objective of policy early on."

Being Opportunistic. At the same time, Minister Fayyad adopted a flexible view, recognizing that he could not determine a priori the sequencing of reforms or expect to have control over the entire process. He explains, "The context in which you are operating has to be kept in mind all the time. It's not easy. You are working within a system of deeply entrenched habits—not good ones—so you basically have one of two choices. Either to come in and say, "This is what I want to do. Either it's done, or I'm out"—which is what everyone was expecting, or maybe even banking on. Or, you could be opportunistic: do what you can, as soon as you can do it, wherever you can do it. I chose the latter way…But, at all times have clarity as to what is important and what is not too important."[29] He describes his approach as "patient, deliberate, methodical, and opportunistic, looking for an opening here and there."

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[27] Nagarajan, *Reforms to Public Financial Management in Palestine*, 2008.
[28] Fayyad, *Transcript*, 2008.
[29] Ibid.

Generating Credibility from the Start. Minister Fayyad wanted to generate confidence in the reform agenda by taking specific, quick steps that made an impression. He explains, "I have learned about the need to move fast, and make an impression. It gets more difficult with time, not easier. You need to use your success as a stepping stone. Success breeds success. If you say 'give me time, I will assess,' that is wrong approach. You need to immediately begin to make an impression."

In the period from mid-2007 the approach continued to be flexible and the focus shifted in response to emerging problems. For example, payments systems and banking arrangements were the priority in 2007. With the preparation of financial statements, the weaknesses in accounting procedures have become more important.

Other Implementation Issues. The management of the reforms varies significantly from initiative to initiative. The reforms in MOF have not followed project management systems. For example, the main driver of the reforms that started in mid-2007 was the Accountant General, and he managed the reform process with limited interaction with others in the MOF. This avoided bureaucratic delays and established a strong sense of ownership by the Accountant General, but it created tension within the MOF as other managers and staff felt excluded from the process. It also meant that linkages between the reforms and other work of the MOF were not always made, and that some important areas were given low priority. However, with the donor supported projects, such as the reforms in budget preparation project in the MOP, there have been formal reporting arrangements and a structured approach to project management.

While many issues are decided by the Minister of Finance, senior civil service managers are prepared to take decisions. There are solid technical decision makers in the MOF, but the human resource capacity is thin. The lack of depth in the MOF has placed a heavy burden on key managers and the success of the reforms can be directly attributed to the skills of these managers.

Specific financial incentives were not provided to support the reforms. Study tours were used occasionally as opportunities to broaden the understanding of staff, but these were only for a small number. More importantly, some civil servants were motivated through non-financial rewards. For example in re-launching the monthly reporting process in 2008, the PM made a strong endorsement of the importance of the documents and gave a personal commitment that the reports would be posted by the 15th of the following month. This was a strong motivation for the staff preparing the reports—who subsequently worked weekends and public holidays to ensure that the reports were posted in time. There is also a strong sense of nationalism driving many of the reformers, who were working in an environment where the lack of effective institutions is an argument used by some against establishing a Palestinian state.

While there are examples of the use of pilots during the reform process, this has not been the norm. Instead, many of the changes were introduced across the board—recognizing that the initial performance would be deficient, but that it would improve over time. Examples include reforms to the budget preparation system, and the changes to financial regulations which were applied to all agencies.

The self-reinforcing nature of some of the reforms has been an important attribute. Good examples are the reforms to the payment processes, payroll procedures, and monthly reporting. Once introduced, these procedures have continued. Even when there was a break in monthly reporting during the Hamas period, it was reinitiated without too much difficulty. In contrast, sectoral analysis is in the early stages of development as part of the budget reforms, but it is already clear that this will be a more difficult reform to sustain through time.

Donors have monitored the progress of some reforms through frequent missions by technical teams. In addition, the World Bank has an advisor working closely with the MOF on a day to day basis, and DFID has a team embedded within the MOP. A donor coordination system helps to keep donor representatives informed of progress. The Fiscal Sector Working Group is one of the committees established through this system, and it has been used to ensure that the donor community is informed of progress with reforms. However, until recently, PFM issues have been given lower priority to fiscal discussions at these meetings.

Political Economy of Reform

In the past eight years there has been little political stability and this, coupled with the associated fiscal crises, has created a challenging reform environment. Externally, there have been distractions created by the difficult relationship with Israel and the inconsistent budget support flows from the international community. Internally, the differences between the President and Prime Minister in 2003, along with the political break between Hamas and Fatah and the bifurcation of PA administrative structures between the West Bank and Gaza, have been particularly disruptive. The MOF has been unable to operate in Gaza from mid-2007 on and has needed to replicate many functions and systems again in the West Bank. Although the separation of Gaza created a new set of challenges, the period since mid-2007 has generally been a stable period for reform under the technocratic Caretaker Government.

A positive aspect of the political challenges is that it created opportunities for reform. In some areas, there was a complete failure of earlier systems. The crisis provided an opportunity to make improvements when developing new replacements. Moreover, the disruptions meant that there was a tolerance for problems and hence a willingness to introduce new approaches, while knowing that initial implementation would not be perfect. A related issue is that the PA is a relatively new institution, and the old procedures had not become entrenched.

Another strong positive of the political environment is that Salam Fayyad has had extended terms as Minister of Finance since 2002 (excluding the period of elections and Hamas control), and this has provided continuity in leadership of the MOF. There has also been continuity in many of the key positions within the MOF. Reforms have progressed furthest when there has been a combination of strategic support from the Minister of Finance and technical support within the MOF. The staff in the MOF have not changed significantly and they have also been supportive of reforms. In particular, the Accountant General has been a key driver of the accounting reforms that have taken place since mid-2007.

In the initial 2002-05 period, the reform process was highly politicized. Reforms were identified with one faction in the internal political debate. There was also a general concern that the reforms were removing some of the earlier discretion of expenditure that supported the patronage based system. For example, the development of the PIF created more transparency in the operation of state companies.

There have also been problems where the management of a reform spanned two agencies. Both the MOP and the MOF have a stake in the budget preparation reforms, but MOF lost capacity with the closure of the Gaza office. As donor support was primarily linked to MOP, it had a stronger role. MOF also has a stronger focus on compliance and payment issues than the policy and planning elements of budgeting. This in part reflects the interest of the Minister. The lack of an agreed vision for the budget reform has created problems and these continue.

A further major drive has come from the donor community. With the PA needing substantial support for the recurrent budget, the donors have been pushing for PFM reforms that would give them comfort in disbursing budget support to the PA. Donor support has also been a driver for the PRDP and program budgeting initiatives, as donors are looking for more information on how the budget support is being used. WBG does not have an IMF program, but donor engagement has been established through a trust fund operated by the World Bank. The policy benchmarks set out in the trust fund have in general been viewed positively by the reformers as a way to strengthen their hand in internal debates, and not as a mechanism to impose reforms on the country. For this reason, the Minister of Finance pushed for a new World Bank trust fund during 2008 even though the commitments of unconditional budget support suggested that this was not necessary. This approach has its limitations, however, as was demonstrated in late 2005 when the PA failed to follow the conditions on controlling the wage bill.

On technical issues, perhaps the most important donor contribution has been in providing strategic advice on the PFM system, which has helped to shape the reform agenda. This has been particularly important for the MOF, where the Minister of Finance has not been enthusiastic about having international experts based in the ministry. His view is that this can result in the expert doing the work and not building the capacity in the MOF staff. The MOF has therefore relied on the recommendations from short missions. This approach has been successful, but is being revised as more complicated reforms are addressed. For example, in preparing the 2008 accounts more intensive guidance (involving an international expert) was needed and this is likely to also be necessary as the accounting procedures are updated. A priority in this work is to ensure that the international expert also develops the capacity of MOF staff. With the MOP and the proposed support for the SAACB, donors will work through resident experts and consultants.

Key Conclusions

The case of WBG is an example that substantial reform agendas are possible provided there is the support at both the political and technical levels. In this case, the Minister of Finance and the MOF have had a common vision for the changes and have been committed to reform, especially in payment processing and bank consolidation areas. The more limited success of budget reforms can be attributed to the split management between MOP and MOF, and the fact that the Minister of Finance gave priority to reforms aimed at expenditure control and put less emphasis on the links between planning and budgeting.

Both the Minister of Finance and the key MOF staff have preferred informal management systems and a reform plan was not developed. This reduced bureaucratic delays, but it meant that the need for some important reforms, such as those required in the accounting area, were not being realized and initiated as early as they should have been.

The role of donors has been especially useful in providing strategic guidance and in strengthening the hand of the reformers in internal debates by linking support to the reform agenda. Although the internal and external political environment has been extremely challenging, this has also had a positive element by encouraging a willingness on the part of the PA reformers to adopt change. The willingness to change existing systems can also be attributed to the PA being a young institution without deeply established systems that are resistant to reform.

Some of the features of WBG—such as the political challenges—are unique. But the lessons in the role of leadership and management of the reform process are applicable to other countries.

Table 10: West Bank and Gaza PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	B
	Composition of expenditure out-turn compared to original approved budget	C
	Aggregate revenue out-turn compared to original approved budget	B
	Stock and monitoring of expenditure payment arrears	D+
Comprehensiveness and Transparency	Classification of the budget	D
	Comprehensiveness of information included in budget documentation	B
	Extent of unreported government operations	C+
	Transparency of Inter-Governmental Fiscal Relations	D+
	Oversight of aggregate fiscal risk from other public sector entities	D+
	Public Access to key fiscal information	C
Policy-Based Budgeting	Orderliness and participation in the annual budget process	C+
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	Not Rated
	Effectiveness of measures for taxpayer registration and tax assessment	Not Rated
	Effectiveness in collection of tax payments	Not Rated
	Predictability in the availability of funds for commitment of expenditures	D+
	Recording and management of cash balances, debt and guarantees	C
	Effectiveness of payroll controls	C+
	Competition, value for money and controls in procurement	Not Rated
	Effectiveness of internal controls for non-salary expenditure	D+
	Effectiveness of internal audit	C
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	C
	Availability of information on resources received by service delivery units	D
	Quality and timeliness of in-year budget reports	B
	Quality and timeliness of annual financial statements	D+
External Scrutiny & Audit	Scope, nature and follow-up of external audit	D
	Legislative scrutiny of the annual budget law	C+
	Legislative scrutiny of external audit reports	D
Donor Practices	Predictability of Direct Budget Support	D
	Financial information provided by donors for budgeting and reporting on project and program aid	C
	Proportion of aid that is managed by use of national procedures	C

YEMEN

by
Arun Arya

General Overview

Yemen is the poorest country in the MENA region and faces daunting challenges in an uncertain global and regional environment. Significant progress has been made over the last few years, but living conditions for most of the 22 million Yemenis remain difficult. Yemen's governance structures are complex and it remains a country afflicted by security issues. Yemen is unlikely to reach most Millennium Development Goals (MDGs) by 2015, and the situation is particularly dire for women. The Government is implementing a program of economic and governance reforms, but time is of the essence as oil resources are rapidly depleting while the population continues to grow at a rapid pace. Yemen is also now beginning to be affected by the global economic crisis in spite of the financial sector's relative insulation.

Yemen is a democratic state based on a multiparty parliamentary system. The executive branch is comprised of the President and the Council of Ministers, with executive authority established in the Office of the President and the Prime Minister being responsible for the day to day running of government affairs. The Minister of Finance is responsible for the management of public finances and appoints Accounting Officers to each ministry and department with responsibility for safeguarding of public funds; ensuring the application of funds as intended by parliament and in accordance with approved policy; maintaining financial records in accordance with the financial regulations; maintaining an efficient system of internal controls; and submitting the financial, accounting and stores records to the Central Organization of Control and Audit (COCA).

The parliament votes on the budget but has no authority to directly amend budget lines. The Ministry of Planning is responsible for the preparation of the investment budget. COCA is responsible for conducting external audit and special investigations for the Cabinet, the Minister of Finance, and the Public Accounts Committee. The Supreme Tender Committee is responsible for the endorsement of tenders over given thresholds. Line ministries are responsible for preparing and implementing their respective budgets. The Accounting Officers posted under each line ministry serve as the custodian of public funds for those ministries and the finance officers, accounts officers, cashiers, and procurement officers report administratively to the Accounting Officer of the line ministry in which they serve.

There are two main tiers of sub-national government in Yemen. The first is at the Governorate level (22), whose executive is headed by a Governor. There is a local council whose members are elected by districts. The second tier are made up of the district councils (303) headed by a council chairman. Both tiers have the right to raise revenues.

The country is heavily aid-dependent, and a major part of the Public Investment Program is financed by donors. The government expects donors to finance around US$1.6 billion in 2009 and 2010 respectively, which is about 50 percent of its total Public Investment Program of US$3.3 billion during those years. Among Yemen's various development partners, the core group supporting PFM reform is comprised of DFID, the Netherlands, UNDP and the World Bank. Other donors working on PFM Reforms outside this core group include U.S.AID and GTZ.

Substantive Reform Agenda

A PEFA Assessment was carried out by the World Bank in 2007, with a particular focus on the period from FY 2004-06. The Ministry of Finance was deeply involved in this assessment. It constituted a PEFA Task Force to review the draft PEFA report and give its recommendations to the PEFA Secretariat, and the report was finalized in June 2008. A summary of the PEFA indicator scores is at Annex 1 to this study. Using a four-point rating scale, the assessment produces the results shown in Table 11. The government accepts the PEFA Assessment and has placed it on its official website for public use. It is also using the assessment as an input into the next phase of its PFM reforms.

Table 11: Yemen Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A (best)	5
B	7
C	6
D (worst)	9
Not Rated	4 (note 1)
Total	31 (note 2)

Note 1: Includes the 3 donor indicators that form part of the PEFA framework.
Note 2: PEFA comprises 28 system indicators and 3 donor indicators.

Credibility of the Budget. Approximately 75 percent of Government revenues derive from oil production.[30] Given this dependence and the price volatility of oil, the Government has adopted a conservative approach to revenue estimates to shield the budget from sharp revenue swings. As a result, the actual revenue out-turns tend to surpass budget projections. In principle, robust revenue achievements provide a sound starting point for achieving a credible budget. This policy posture on the revenue projections, however, has not been coupled with a fiscal policy that specifies how any excess revenues will be managed. In practice, much of the surplus has been directed to primary recurrent expenditure, thus undermining budget credibility on the expenditure side. In addition, the current policy of subsidizing domestic petroleum consumption means that, with increasing oil prices and the subsequent increase in government revenues, subsidy payments automatically increase. However, an analysis of the increased expenditures shows that even when domestic petroleum subsidies are excluded, the increase of expenditure over original budget estimates is still substantial and to a degree that undermines the credibility of the budget.

In addition to weaknesses in budget preparation, the poor matching of aggregate expenditure out-turn figures to the budget estimates reflect a range of weaknesses in the process of budget execution. There is a lack of predictability in budget releases; weak cash management; uneven commitment controls; less than fully effective salary expenditure controls; and a practice of ex-post approval of the supplementary budget by parliament.

The budget process occurs within a pre-announced resource envelope based upon fiscal forecasts and taking into account policy considerations. However, this top down framework is not linked to the detailed budget preparation of line ministries. Yemen is taking the first steps towards implementing a multi-year framework for budget estimates but this process still needs, as a pre-requisite, to develop stronger links between the fiscal framework and the sector development plans.

[30] This is in spite of substantial tax reforms since 2001, including a shift to a self assessment basis and improved customs systems, which have translated into healthier tax revenue streams.

The PFM systems are capable of delivering predictable and well controlled virement procedures. However, there are considerable adjustments made above the level of line ministries to budget appropriations, and this practice tends to undermine the credibility of the budget.

No monitoring of arrears is undertaken, so the arrears cannot be quantified. There is also no reliable data maintained on the level of arrears from the past two years. While the first four PEFA indicators (PI-1 to PI-4) focus upon the recurrent expenditure, the issue of the credibility of the budget must take into account the whole budget, including that portion which is financed by international loans and grants (see indicators PI-7 and D-2). The lack of reliable information on donor funded budget estimates has resulted in the Ministry of Planning largely guessing what such investment is likely to be. As a result, the Ministry of Planning has tended to adopt an extremely conservative posture, which has sometimes led to projects being left out of the budget estimates. These practices tend to undermine the credibility of the budget.

Comprehensiveness and Transparency. In Yemen the extent of budget documentation is voluminous, with 38 separate volumes presented to parliament. This includes a macro-fiscal policy statement, as well as details on expenditure and revenues for special funds and local authorities in addition to the line ministries. The budget at the time of PEFA Assessment adopted an economic and administrative classification, although it has since been revised to also include a functional structure based upon the UN's COFOG standard. Fiscal forecasts are realistic although not always adequately integrated into the budget process. There are effective debt management controls, with the Minister of Planning and International Cooperation being the sole authority for entering into loan agreements. All loans also require the Minister of Finance's endorsement and the parliament's ratification.

The Central Bank of Yemen (CBY) operates a Treasury Single Account with regular reconciliation of all transactions. To achieve full effectiveness, the Treasury Single Account would require closer management by the Ministry of Finance. There are some extra-budgetary operations financed out of internally generated funds held in special accounts by some of the line ministries, though these are not a significant ratio of total expenditure. All revenues collected directly by line ministries and revenue agencies, including the Oil Ministry, are transferred to the Consolidated Fund. All expenditure is made through a centralized payments system. While the majority of donor funds are deposited in the CBY, there are a number of major donors who do not adhere to this arrangement, so the tracking of project implementation is less regular or timely.

The recurrent expenditure allocations to local authorities are managed in the same way as the allocations to line ministries. There has been significant reform in recent years with respect to the local authorities. The Local Authorities Law (2001) provides for a rule based horizontal allocation of central government disbursements. However, without effective monitoring and evaluation mechanisms, the rule based allocation of resources has only been partially put into effect.

The transparency of budget management has improved in recent years. In particular, there have been significant improvements with respect to the amount of budgetary and fiscal information that is being placed on Government websites. However, public access to budget and other fiscal documentation at Government bookshops, libraries and other physical outlets is lacking.

Policy-Based Budgeting. The first steps towards implementing a multi-year budgetary framework have been taken. The GoY has issued a medium term national development framework (DPPR) that clearly states the medium term policy objectives. It was developed within a macro-fiscal framework (though not fully costed) and includes recurrent cost implications. A macro-fiscal analysis is performed each year (but without sectoral work being undertaken) before budget preparation begins. However the analysis is not linked to the process of budget preparation. Debt sustainability analysis is regularly undertaken and the debt stock is monitored and reconciled on a regular basis. Forecasts of fiscal aggregates on the basis of economic classifications are prepared for three years on a rolling basis. Statements of sector strategies exist for just a few sectors. These are not all fully costed, and where costings are prepared they are not in line with the aggregate fiscal forecasts.

The budget cycle is well defined and the call circular issues clear guidelines that provide a sound context for the budget process. The budget process encompasses policy input both at the beginning through cabinet approved sector ceilings, as well as at the end by way of parliamentary debate. The executive completes its budget submissions prior to the start of the fiscal year after allowing for two and half months of budget preparation by the line ministries and a full negotiation process. The Parliament approves the appropriations before the start of the fiscal year after subjecting the budget proposals to debate over a two month period. The budget documents are detailed and address many of the requirements for both meaningful budgetary oversight and to properly guide implementation. However, the parliamentary recommendations are not incorporated into the budget in a transparent manner. While a written parliamentary recommendation is included in the appropriations law, along with an undertaking to implement such recommendations signed by the Minister of Finance, there would be greater transparency if an approved budget reflecting the parliamentary recommendations was also included in the budget documents.

Predictability and Control in Budget Execution. There are three main sources for domestic revenue in Yemen: (1) oil revenues arising through royalties, income tax and government shares of production; (2) income taxes, both company and individual; and (3) customs revenues. The oil revenues are governed by Production Share Agreements (PSAs) entered into with 12 oil producing companies. While daily payment of tax receipts into the Consolidated Revenue Fund along with regular reconciliations are carried out by the Tax Agencies, reconciliations by the Oil Ministry are not performed regularly. There are significant tax arrears, dominated by a large uncollectible component which the authorities are considering writing off. The collection ratio of tax arrears remains low.

The adoption of a six-month general warrant for the authority to incur recurrent expenditure, as well as the three-month general warrant for capital expenditure, should provide the basis for predictability in budget execution. Unfortunately, at present, the warrants are not based on a projection of cash flows. The absence of effective cash management leads to higher financing costs as the government is forced to make greater use of short term borrowings. The problem is further compounded by the practice of adjusting the general warrants during the period.

Virement control is strong. Virement control over transfers between budgetary chapters and sub-chapters are made at the level of the Ministry of Finance. The sub-account structure of the Treasury Single Account mirroring the chapter and sub-chapter ceilings facilitates effective virement control.

Since 2002, there has been a project to introduce an automated financial management system (AFMIS) in the MoF. The project has been significantly delayed, but AFMIS is currently being piloted in four ministries and will eventually be rolled out in others. It is hoped that its implementation will improve the level of budget execution control. However, while a commitment control module was expected to be built into AFMIS, this function is not yet integrated into the system. Manual commitment control systems are not uniformly implemented across all ministries.

The weak commitment controls, along with the updates of the General Warrant ceilings, contribute to the overall lack of budget credibility.

The CBY is currently performing the treasury function, which in most countries is done by the MOF. The MOF is looking to take over this function and this reform is included under the PFM reform agenda. However, more than 80 percent of CBY's staff are engaged in the treasury function, and the MOF does not have the capacity to implement the function as of now. Although CBY does not object to the function being shifted to the MOF, it privately expresses concern about the future of its employees.

Yemen, for the most part, uses a centralized payments system out of the Consolidated Fund held in the CBY and operated as a Treasury Single Account. The system facilitates daily bank balance consolidation that informs and controls payments. The lack of effective commitment controls however has led to liquidity shortages, which have delayed payments and contributed to what appears to be a high level of arrears—although, as noted above, there is no specific data on the size of arrears.

The MOLA recently championed some amendments to the Decentralization Act recently that paved the way for greater decentralization. It has also launched the Decentralization Strategy. If the decentralization strategy is be implemented in full, then the MOF will also have to decentralize its authority to the governorates. The MOF is concerned that the governorates do not have the capacity to take over this responsibility.

There has been substantial reform in the area of procurement by way of the passing of a new Tender Law in July 2007. This is an important first step towards improving the control of budget execution. The previous law did not establish an authority responsible for procurement policy and regulatory oversight, nor did it establish an independent procurement appeals mechanism. These have been addressed in the new law. U.S.AID is supporting public procurement reforms in Yemen and has provided training to government officials of pilot ministries on standard bidding documents. The National Procurement Manual is being prepared by the World Bank.

Despite the reform efforts, both COCA and the Chamber of Commerce paint a troubling picture of procurement practices in Yemen. The picture presented is one rife with collusion and lack of competition. It includes the abuse of contract variations with subsequent project overruns, non-transparent tender evaluations, an excessive resort to direct procurement methods, and the use of "slicing" to bypass procurement and authorization thresholds.

The management of the payroll is another area where control appears to be less than satisfactory. A Civil Service Modernization Project was started in 1998, which aimed to establish a clean personnel database by 2001. The project was restarted in 2005 with a clean up exercise (principally of double dippers and ghost workers) through a new database that includes biometric control data. The clean up exercise covers approximately 50 percent of Government employees. It does not include a significant portion of the Ministry of Defense. Progress to date on the biometric system has not been coupled with direct database links between the cleaned personnel database and the payroll. There are still less than adequate reconciliation controls for the addition, termination and modification of personnel records in the fragmented payroll files. Until effective links are established between the personnel database and the payroll files, the payroll will be vulnerable to ghost workers and double dippers creeping back over time.

There are two main components of internal audit in Yemen. The first, resident in all line ministries, limits its audit activities to operational audits. The Ministry of Finance also has an Internal Audit

Unit with jurisdiction over all line ministries, local authorities and public corporations. In addition to financial audits, this unit carries out limited systems and value for money audits. They prepare an annual work plans using a risk based approach to identify areas of focus and report regularly to the Minister of Finance and relevant line minister on their findings, with copies of reports submitted to COCA and the Cabinet. However, with a full time professional staff of only 16, their effectiveness is limited. There is also only limited follow up on the audit findings of the Internal Audit. The head of the public entity is accountable for the management of public funds. There is a Follow-Up Department within the MOF responsible for implementing corrective measures and audit recommendations. Finally, within the Finance Offices of each line ministry are Inspectors and Controllers. Their primary role is quality assurance of expenditure procedures through the application of pre-audit methods.

Accounting, Recording and Reporting. Government accounting standards are applied across all ministries consistently. While the appropriations accounts adopt a few of the mandatory standards of IPSAS (such as comparison between budget and actual, the inclusion of financial assets and liabilities, and the details of revenues and expenditure), not all of the mandatory standards are met. The CBY submits monthly budget Release Reports to the MOF based upon payments made—although these are highly aggregated. The line ministries submit Monthly Budget Execution Returns. However, these are submitted on average 12 weeks after the close of the period. They do not distinguish between commitments and expenditure. However, they do distinguish advances and payments and allow direct comparison of budget implementation to the original budget. The reporting format allows line ministries to report on accrued arrears, but this is often not followed. The line ministry reports are consolidated by the MOF, but with the delays their effectiveness as a management tool is undermined.

The Final Accounts Directorate of the MOF consolidates the accounts prepared by the line ministries and prepares annual statements with a table of financial assets and liabilities as well as revenue and expenditure information. The accounts are typically completed within nine months of the end of the fiscal year, but outside of the six month requirement of the Finance Law. One of the challenges in preparing the accounts is obtaining complete or timely financial expenditure data from donors on the project expenditures they execute directly.

There have been assessments on the level of expenditure carried out at the level of front-line facilities in the past three years, including a Public Expenditure Tracking Survey in the Ministry of Education which was supported by the World Bank, a Public Expenditure Review covering Health carried out by U.S.AID, and a Public Expenditure Tracking Survey in the Ministry of Health with support from DFID. These pointed to difficulties with salary payments and weak bottom up budget preparation procedures leading to a misalignment of resources.

External Scrutiny and Audit. Yemen is characterized by a well structured parliamentary oversight of the government's budget estimates. The approval process includes a debate on fiscal policy in addition to reviewing the details of the revenue and expenditure estimates. The Parliament was less involved in reviewing actual expenditures, but it has made a thorough review of the 2007 accounts, preparing a three volume 350 page review of the audit findings that included interviewing a number of Government officials responsible for the audit findings.

The submission of the audit reports and audited financial statements from COCA is timely, and COCA follows up on the audit findings. However, COCA is concerned that it does not receive the final accounts from the MOF in time, leaving it very little time to conduct its audit. A second major issue relates to the independence of COCA, which among other things includes a demand from COCA that it be granted a "single line budget" and authority to report directly to the Parliament. COCA also sees the present internal audit system as an encroachment on its authority, as it is external rather than internal to the line ministries.

COCA has sought to adopt many INTOSAI standards, but this is probably best characterized as a work in progress. A draft audit bill has been completed and is currently under consideration by the President. It will address, among other things, the independence of the President of COCA as well as the organization. GTZ is supporting COCA in its institutional restructuring and capacity building.

Implementation Strategies for Reform

The PFM reform program in Yemen has followed a very formal process. The program was developed based on a number of studies carried out by the World Bank and the IMF, including a *Country Financial and Accountability Assessment* (2004), and a *Country Procurement Assessment Report* (2003). In August 2005, Cabinet approved the Public Finance Management Reform Strategy and endorsed the components of General Budget Reform. A Public Finance Management Reform Action Plan was then formulated on the basis of above Strategy. It was divided into two phases, with the first phase to be implemented during 2006-08 (which was subsequently extended until June 2009). A Partnership Agreement was signed in May 2006 between Government and Donors to implement the PFM Reform Strategy. Following this, a Project Agreement titled *Implementation of Public Financial Management Reform Action Plan* was signed between UNDP and Government in September 2006 with an objective of supporting Ministry of Finance to implement PFM as per its action plan. The project cost of US$3.6 million was shared by DFID, the Netherlands and UNDP.

To implement the program, Yemen has adopted an elaborate committee structure for managing its PFM reforms. The institutional arrangements for the PFM reform program vest overall responsibility for implementation with the Ministerial PFM Reform Committee, which meets annually and is responsible for the implementing the strategy and achieving the desired reform outcomes. The Committee is made up of the Minister and Vice Minister of Finance, the Minister of Planning, the Minister for Civil Service, the Minister for Local Authorities and the Governor of the Central Bank. A PFM Reform Task Force headed by the Deputy Minister of Finance in Charge of Budget has been set up, which is responsible for overseeing the implementation of the reforms. There are a number of technical committees that have been given responsibility for specific agendas and tasks.[31]

Notably, the AFMIS project is not linked to the PFM Reform Task Force, with the subsequent risk that the computerization effort will not reflect the requirements of the reformed PFM. The technical committees are supposed to report to the Follow-Up Committee on a quarterly basis, but in practice this does not happen. There is a separate AFMIS Task Force, but there is no representation from COCA or the Internal Audit Unit of the Ministry of Finance on the Task Force. This raises questions about whether AFMIS transaction and reporting controls are fully compliant with the PFM requirements. It also suggests that there is little coordination between the AFMIS Project and these audit institutions with respect to the development of effective audit techniques for auditing public finance management implemented on the AFMIS platform.

[31] They include the Committee on Functional Classification, the Committee on the Accounting Manual, the Committee on the Treasury System, the Committee on Cash Management, the Committee on Internal Audit, and the Committee on Institutional Restructuring and Capacity Building.

Responsibility for the implementation of various reform pillars is delegated to the relevant Accounting Officer in each ministry. While components have been defined for the technical committees, each is currently developing a matrix of activities, outputs, inputs, indicators and milestones. The PFM reform program has not been integrated as a separate program within the MOF budget. A large part of the reason for the absence of these important elements appears to be the rather severe capacity constraints. Having said that, the past few years have witnessed some progress in addressing the first element of sound PFM practice—the achievement of aggregate fiscal discipline. However, it should be noted that most of the reforms have centered upon MOF and Ministry of Civil Service and Insurance activities rather than distributed actions rolled out to all the line ministries.

In the first phase, the Public Finance Management Reform Program was comprehensive and contained many elements of a sound PFM Reform program. However, it did not achieve its objectives. The program included a list of dated milestones, but it did not clearly distinguish activity start dates as well as end dates and whether pilot programs were to be employed or not. The project was managed by UNDP through a PFM Advisory Unit (PFMAU) located within the Finance Ministry. Problems arose from delays in setting up and staffing this PFMAU. A long-term international adviser was to head the PFMAU, but he arrived nine months after the project had been commissioned. There were also delays in the procurement of short-term consultants.

Such problems were compounded by the fact that roles and responsibilities at the government level were not clear. The project was to be implemented by the MOF, but some coordination was required with other agencies like COCA, the High Tender Board, the National Fiscal Training Institute (NFTI), the Civil Service Ministry, the Central Bank of Yemen; and the Ministry of Local Government. Coordination was expected at the level of PFM Reform Ministerial Committee chaired by Finance Minister, but such meetings rarely took place. If they did, they were more of a dialogue between MOF and donors rather than exchanges between various ministries. There was a PFM Task Force set up under the chair of Vice Minister Finance to help with more routine issues regarding implementation, but that task force rarely met.

According to the plan, quarterly progress reports accounting for physical and financial progress were to be prepared by the PFMAU for the benefit of donors and the Government. These were also to be presented in the PFM Donor Group meetings in a matrix form comparing the targets with achievements. While the PFMAU did furnish these progress reports occasionally, it was not able to do so on a regular basis.

Staff motivation has been a problem in Yemen. The multi-donor funded PFMAU is staffed with advisors, accountants, translators and secretaries with monthly salaries that could range as much as 10 times the average salary of US$250 for other civil servants. The PFMAU staff were contractual and committed to work on the reforms, but the major burden of implementation fell upon the shoulders of regular civil servants. They did not have the same motivation unless a particular reform was seen as an immediate priority by the Finance Minister.

The PFM Reforms were not planned to be piloted in certain agencies or departments. They were to strengthen PFM systems that were cross-cutting all ministries. It was the Finance Ministry that was the focus of all reform measures.

From the experience of PFM reform in Yemen, one can say reforms that are "self reinforcing"—like the reforms in budget classification or developing a link between the Public Investment Program and Investment Budget—are more successful than those requiring constant inputs and attention, like keeping the aggregate budget out-turn within close proximity to the original approved budget.

While the first phase of PFM reform had modest success, the government has prepared its vision and priorities for Phase 2 of the reform program on the basis of the PEFA assessment and the performance of Phase 1 of the program. The priorities include establishment of a commitment control system and an extension of the AFMIS system. The World Bank intends to support the government in implementing the PFM Reform Strategy. Under the new arrangement, a multi-donor trust fund will be set up, with financing from DFID, the Netherlands and the World Bank. In consultation with these donors, the World Bank is preparing a detailed PFM Reform Action Plan for Phase 2.

Political Economy of Reform

Politics in Yemen has been dominated by the ruling party, and this has provided some stability for PFM reform. The executive authority rests with President Ali Abdallah Salih, who has had more than 25 year's tenure. It was under his leadership that the National Reforms Agenda (NRA), including PFM reforms, was launched in 2005. The driving force behind the implementation of the NRA is the Deputy Prime Minister (DPM), who has been supportive of this agenda.

The last Parliamentary elections were held in 2003, and the initial term of this Parliament was until April 2009. However, this term has been extended for another two years until April 2011. This has given the government a long period to implement reforms. Elections were held at the governor level in May 2008, in which the Electoral College included only the council members at the district and governorates. Considering the clear majority of ruling General Party Congress (GPC) amongst the council members, the governors-elect were all their nominees. While there has been stability in the Presidency and parliament, there has been less stability at the level of the Minister of Finance and senior levels in the MOF. When the PFM Reform Strategy was approved in 2005, the newly appointed Finance Minister was Dr. Saif Al-Asali. The Minister was strongly supportive of the reform agenda. He drafted several laws, guidelines and strategies personally, which had the advantage of ownership. Unfortunately, the agenda also became very centralized, which led to a slow-down.

A new Finance Minister, Noaman Al-Sohaibi, was sworn in March 2007. He has also been supportive of PFM reforms and was heavily engaged in the PEFA assessment. Other major accomplishments during his tenure include containing expenditure within the original approved budget of 2007; the publishing of the 2009 budget for public access at the time of its submission to the parliament; linking the investment budget with Public Investment Program in 2008 and 2009; and the introduction of functional classification in the Budget in 2009.

Within the MOF, a new team of Deputy Ministers was appointed in early 2005 largely coming from academia. The complete change of Deputy Ministers at that time does not appear to have helped the reform process. The coordination of reforms within the MOF and with donors was led by the National PFM Coordinator. In March 2008, the position of National PFM Coordinator was upgraded and Mr. Jalal Yaqoub, the Deputy Minister for International Finance Relations in the MOF, was given this responsibility

Key Conclusions

Bringing together the substantive implementation and political analysis, a number of interesting conclusions emerge from the Yemen case. Yemen has made some progress on PFM reforms where the.MOF has put in special effort. This has tended to be where the Finance Minister or the National PFM Coordinator see that the reform can bring instant recognition (such as an improvement in a PEFA indicator) or resources to the government. One example is the enhanced transparency by placing the budget on a website at the time of transmission to parliament. Another is when the MOF introduced functional classification during preparation of the 2009 budget, which was motivated, at least in part, to get a higher PEFA Score.

However, longer term reforms have made less progress in spite of the extensive committee and program management structures that were established. One of the explanations provided is that the officers entrusted with the reforms also have regular duties to perform and are often overloaded with routine work or directed to other tasks by the Finance Minister. It confirms that—while management arrangements may look adequate on paper—they will only be effective if there is a willingness to make them work.

Table 12: Yemen PEFA Assessment

Overview of the Performance Indicator Set

	MENA Regional PEFA Study 2010	
Credibility of the Budget	Aggregate expenditure out-turn compared to original approved budget	D
	Composition of expenditure out-turn compared to original approved budget	C
	Aggregate revenue out-turn compared to original approved budget	A
	Stock and monitoring of expenditure payment arrears	Not Rated
Comprehensiveness and Transparency	Classification of the budget	C
	Comprehensiveness of information included in budget documentation	A
	Extent of unreported government operations	B+
	Transparency of Inter-Governmental Fiscal Relations	A
	Oversight of aggregate fiscal risk from other public sector entities	A
	Public Access to key fiscal information	C
Policy-Based Budgeting	Orderliness and participation in the annual budget process	A
	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+
Predictability and Control In Budget Execution	Transparency of taxpayer obligations and liabilities	B
	Effectiveness of measures for taxpayer registration and tax assessment	B
	Effectiveness in collection of tax payments	D+
	Predictability in the availability of funds for commitment of expenditures	D+
	Recording and management of cash balances, debt and guarantees	B+
	Effectiveness of payroll controls	D+
	Competition, value for money and controls in procurement	D+
	Effectiveness of internal controls for non-salary expenditure	D+
	Effectiveness of internal audit	D+
Accounting, Recording, & Reporting	Timeliness and regularity of accounts reconciliation	B
	Availability of information on resources received by service delivery units	B
	Quality and timeliness of in-year budget reports	D+
	Quality and timeliness of annual financial statements	C+
External Scrutiny & Audit	Scope, nature and follow-up of external audit	B+
	Legislative scrutiny of the annual budget law	C+
	Legislative scrutiny of external audit reports	D+
Donor Practices	Predictability of Direct Budget Support	Not Rated
	Financial information provided by donors for budgeting and reporting on project and program aid	Not Rated
	Proportion of aid that is managed by use of national procedures	Not Rated

ABOUT THE AUTHORS

Mark Ahern joined the Middle East and North Africa Region of the World Bank in July 2008 as a Governance Advisor. The main focus of his work is on public financial management (PFM) issues where he has been most involved with reforms in West Bank and Gaza, and Syria. Before joining the World Bank, he worked for the International Monetary Fund (IMF) for eight years, where he was a resident PFM advisor in various countries in Africa, the former Soviet Union, and the Middle East. He was also involved in a large number of technical assistance missions on PFM issues.

From 2004 to 2008, Mr. Ahern was based in the IMFs Middle East technical assistance center in Beirut (METAC), where he worked as the PFM advisor for ten countries in the Middle East region. He is originally from New Zealand and started his career by spending 15 years with the New Zealand Treasury working on sectoral policy issues, tax policy, and budget management. In his budget management role, he spent three years as Budget Director. Mr. Ahern has a Masters Degree in Economics from Canterbury University in New Zealand.

Robert P. Beschel Jr. is currently Lead Public Sector Specialist for the World Bank's Middle East and North Africa (MENA) Vice Presidency. In this capacity, he is responsible for coordinating the Bank's work on governance and public management throughout the MENA region and worked closely with senior officials to help realize their reform agendas. He sat on the World Bank's Public Sector Governance Board, which manages the Bank's global work on governance and public management, and is a core member of the Bank's Global Expert Team on Enhancing Public Sector Performance. He is also a member of the Bank's civil service, anticorruption and e-governance thematic groups. In August 2010, he will be going on external assignment to assume the position of Deputy Director for Policy in the Prime Minister's Office in Kuwait.

Previously, Mr. Beschel was Lead Public Sector Specialist in the World Bank's South Asia Vice Presidency. From 1996-1999, he served as Strategy and Policy Officer at the Asian Development Bank in Manila, where he was the principal author of the ADB's anticorruption policy (which was approved unanimously by the Board in July 1997) and Vice President of the ADB Staff Council. He has served as a long-term consultant to the World Bank Institute and as Executive Director of Project Liberty, a major initiative of Harvard's Kennedy School of Government to promote public sector reform in economies in transition. He has also served as Special Assistant for International Affairs to the president of the Carnegie Corporation of New York.

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Prior to joining the Bank, Mr. Arya worked for DANIDA as the Senior Sector Adviser for Water and Sanitation sector in Bangladesh, where he assisted the Government in preparing the Sector Development Program. He has also worked for the Indian Administrative Service (IAS) for 19 years, in which he developed wide ranging experience in governance, the administration of justice, economic development, social development, electoral administration, conflict management, media management and human rights. He completed a B.A. (Honors) in Economics from the St. Stephen's College, Delhi University, and has a post graduate degree in Management from the Indian Institute of Management in Ahmedabad, India.

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Mr. Biggs has a Bachelor's degree in Social Studies (Economic History) from Exeter University in the United Kingdom. He has been a Certified Public Finance Accountant (CPFA) since 1973, and was a senior employee of the awarding body, the UK's Chartered Institute of Public Finance and Accountancy (CIPFA), for 10 years. He has worked on public financial management issues for 40 years in the UK and a large number of overseas countries, including 3-4 year assignments in Kenya and Zimbabwe.

Robert Bou Jaoude is currently a Senior Financial Management Specialist at the World Bank. His experience covers Lebanon, Syria, Iran, Iraq, Jordan, Egypt and Kuwait. He has led a number of high-profile analytic and capacity building activities in public financial management and corporate financial reporting. He has also advised governments in different areas of financial management in medium income and post conflict countries, including support to Lebanon for the establishment of a reporting system on extra budgetary activities financing post war reconstruction. He is also a Member of the Quality and Result Committee providing advice to the FM sector board on Financial Management and Quality issues.

Prior to joining the Bank, as a member of the UNPD team, Mr. Bou Jaoude provided advice and support to the Lebanese Government in its reform program. He led the work on the trade facilitation and provided advice in the areas of budget reforms and the internal control environment at the Ministry of Finance.

During his career, Mr. Bou Jaoude gained professional experience in Lebanon, Canada and Jordan. He is a Certified Management Accountant and a graduate of McGill University in Canada. He also holds a Masters degree in money and banking and a Bachelors in Finance and Accounting from the American University of Beirut. He started his professional experience upon graduation in 1983 and has gained more than 22 years of diversified professional experience in the banking, private and public sectors, in addition to working with the UNDP. His experience covers accounting, auditing, financial controls, treasury operations, retail financial, banking operations, banking supervision and regulation.

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Between early 2004 and early 2008, she worked at the Audit Commission for the European Space Agency in Paris, especially on budgetary issues, including medium-term planning, budget transparency and classification, cost-accounting and activity based budgeting. She also assessed the transition to accrual accounting and to full alignment with the International Public Sector Accounting Standards (IPSAS). In Paris, she attended OECD public sector accruals symposiums and the meetings of the Working Party of Senior Budget Officials (SBO). Between 1999 and 2004, she was a World Bank Consultant for the Middle East and North Africa Economic Policy division (MNSED), focusing on Public Expenditure Reviews, including the assessment of contingent liabilities, extra-budgetary practices and quasi-fiscal activities.

Ms. Morachiello earned a Bachelor of Science (Economics) from the London School of Economics and Political Science in London; a Masters from the *Institut d'Etudes Politiques* in Paris; and a Masters in International Economics from the School of Advanced International Studies in Washington D.C. She has published articles on development issues for *Il Sole 24 Ore,* Italy's leading financial daily.

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In the MENA region he managed the 2004 West Bank and Gaza CFAA and was a major contributor to the West Bank and Gaza 2007 PER, which included a PEFA analysis. He also wrote the PFM chapter of the 2005 Egypt PER and has also contributed to training courses for Iraqi officials.

Before joining the Bank, Mr. Shand was a PFM consultant in the Fiscal Affairs Department of IMF and worked for 4 years in the OECD on public sector management reform. Prior to that, he held senior positions in the federal and state governments of Australia, including Deputy Secretary of the Victorian Treasury and Queensland Public Service Commissioner. He also taught public sector accounting and finance at the Australian National University and Victoria University of Wellington, New Zealand. Mr. Shand holds dual New Zealand and Australian nationality. He currently resides in Auckland, New Zealand. He is a graduate in accounting and economics from Victoria University of Wellington and is a Fellow of the Australian Society of CPAs.

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His experience includes technical assistance in implementing budgetary reforms, public expenditure programming, debt management and preparing economic strategy and fiscal policy. He has frequently provided training to government officials in the area of public finance. He is currently providing training to the European Commission officials in public financial management. He has participated in the preparation, negotiation and supervision of several programs supported by the IMF and the World Bank, either as a consultant for the World Bank or as an advisor for various governments. He has participated in several public expenditure reviews and public expenditure management assessments for international organizations.

Mr. Tommasi is the author of several papers on expenditure management and the co-author of two manuals: *Managing Government Expenditure*, published by the Asian Development Bank in 1999; and *Managing Public Expenditure: A Reference Book for Transition Countries*, published by the OECD in 2001.

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