Implementing the Paris Declaration in Public Finance – Challenges by Capacity Development

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### Acronyms

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<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>BMZ</td>
<td>Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung</td>
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<td>CABRI</td>
<td>Collaborative African Budget Reform Initiative</td>
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<td>CdC</td>
<td>Ministère Chargé du Contrôle d'Etat</td>
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<td>CGR</td>
<td>Contraloria General de la República</td>
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<td>CFAA</td>
<td>Country Financial Accountability Assessment</td>
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<td>CPAR</td>
<td>Country Procurement Assessment Report</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>DANIDA</td>
<td>Danish International Development Agency</td>
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<td>DIAN</td>
<td>Dirección de Impuestos y Aduanas Nacionales</td>
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<td>EC</td>
<td>European Commission</td>
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<td>EU</td>
<td>European Union</td>
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<td>GFG</td>
<td>Good Financial Governance</td>
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<td>GG</td>
<td>Good Governance</td>
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<td>GTZ</td>
<td>Gesellschaft für Technische Zusammenarbeit (GTZ)</td>
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<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
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<td>(I)FMIS</td>
<td>(Integrated) Financial Management Information System</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
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<td>IoF</td>
<td>Institute of Finance</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<td>MFMA</td>
<td>Municipal Finance Management Act</td>
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<td>MNAO</td>
<td>National Audit Office of Mongolia</td>
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<td>MoF/MF</td>
<td>Ministry of Finance</td>
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<td>MTEF</td>
<td>Medium Term Expenditure Framework</td>
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<td>NORAD</td>
<td>Norwegian Agency for Development Cooperation</td>
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<td>NT</td>
<td>National Treasury</td>
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<td>ODA</td>
<td>Overseas Development Assistance</td>
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<td>ODI</td>
<td>Overseas Development Institute</td>
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<td>Abbreviation</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>PBA</td>
<td>Programme Based Approaches</td>
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<td>PEFA</td>
<td>Public Expenditure &amp; Financial Accountability</td>
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<td>PER</td>
<td>Public Expenditure Review</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<td>PRSC</td>
<td>Poverty Reduction Strategy Credit (World Bank)</td>
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<td>PRS(P)</td>
<td>Poverty Reduction Strategy (Paper)</td>
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<td>RAS</td>
<td>Revenue Administration Support</td>
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<td>SAI</td>
<td>Supreme Audit Institution</td>
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<td>SIDA</td>
<td>Swedish international development cooperation agency</td>
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<td>SNC</td>
<td>Sistema Nacional de Control</td>
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<td>SWAP</td>
<td>Sector Wide Approach</td>
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<td>TRA</td>
<td>Tanzanian Revenue Authority</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>VAT</td>
<td>Value Added Tax</td>
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<td>WB</td>
<td>World Bank</td>
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Abstract

Public Finance systems in developing countries are regarded as one of the central impediments for implementing the Paris Declaration. This holds for both, Tax and Fiscal Policy as well as Public Financial Management (PFM). Reforms of public finance systems are usually highly sensitive issues, as they often touch upon politically sensible topics. In order to accomplish a sustainable reform outcome it is necessary to obtain country ownership and leadership. Only if the responsibility lies in the hands of the partner country, the necessary reforms, which often consist of disadvantages for involved persons, can be sustainably implemented. This becomes even more important under the Paris Declaration, which highlights reforms of public finance systems as core issues for improving the effectiveness of development aid.

The purpose of this paper is to highlight some of the experiences the German Technical Cooperation (GTZ) has made to effectively implement the Paris Agenda and to draw up the challenges by capacity development in the realm of public finance systems and its subsystems (budget planning and execution, revenues, internal and external audit, parliamentary oversight and intergovernmental fiscal relations). It commences by illustrating the importance of Good Governance in the field of public finances (Good Financial Governance) and derives the relevance of the topic for the development cooperation discourse. Subsequently, the essential importance of Capacity Development concerning the implementation of public finance reforms is identified and experiences of implementing reforms are presented. Based on country experiences, the good practice examples of Good Financial Governance provided here are not intended to be exhaustive or prescriptive, but rather to illustrate how effective support of capacity development is beginning to take shape in a few countries. It closes with Lessons Learned, which draw upon common principles that can/should be applied to capacity development in public finance, though the application of them will vary across countries.
1 Introduction

1.1 Good Financial Governance

The state of public finances serves as an excellent indicator for a society’s capacity to promote its economic and social development. There is an extensive body of literature on the economic effects of public finances in general, and fiscal policy in particular. Just as a prudent fiscal policy can contribute to long-term economic growth, imbalances in this area often have an adverse effect: High budget deficits can limit the redistributive capacity of the state, making it difficult to pursue an active social policy that aims to set the economy on a pro-poor growth path. Similarly, a high tax burden tends to curb investments and thus reduces the prospects for sustainable economic growth.

The shortcomings of partner countries’ public financial systems have been discussed at length. IMF and World Bank have made a significant contribution to this field, concluding that there is an urgent need for reform [IMF/World Bank (2005), p. 9-15]. There is a clear consensus that public finance reform requires an analysis of the status quo (what system is in place and how does it work), as well as a thorough understanding of what constitutes a more reliable system and how (and by whom) it can be implemented.

While the economic impact of public expenditure has been extensively discussed elsewhere, this paper focuses on a less familiar aspect of the relationship between government finances and development. Specifically, it looks at what determines Good Governance in public finance policy and management, and how public finance systems can be significantly improved in this context. The underlying idea is that a transparent, effective and efficient administration of public resources increases the citizens’ ownership of state policy. The extent to which citizens accept and identify with government decisions depends on the credibility of the political process, rather than on any single material decision on tax rates, expenditure ceilings or budget items. This underlines the outstanding importance of a credible decision-making process. Of course, this process is shaped by the country’s legal framework; less apparent, however, is the fact that the formal legal structure often affords considerable leeway for individual decision-making within the administration. This is especially true for the budgetary process. Our analysis thus falls short if we concentrate exclusively on the legally defined roles of actors in formulating their reform agenda. To gain a comprehensive understanding of the institutional set-up, it is imperative to also take into account the informal rules, customs and traditions that exist within any institution.

Good Governance in public finance is critical to countries striving to reduce poverty. Thus, the UNDP Millennium Development Report emphasises the commitment to Good Governance in public finance as a requirement for the successful implementation of strategies to achieve the Millennium Development Goals (MDGs) [UNDP (2005), p. 110]. German development cooperation understands Good Governance in this area as a responsible and transparent management of public resources that is reflected by appropriate budgetary and financial policies. This applies to revenue collection (fair tax policy, efficient tax administration, responsible debt policy) and the allocation of funds (rational budgeting, use of resources according to political priorities, budget procedures), as well as to control mechanisms by audit courts and parliaments [BMZ (2002), p. 14]. Due to the key role of budgetary and financial policies for a country’s development and the implementation of a
national poverty reduction strategy, Good Governance is crucial for public finance [BMZ (2002), p. 13].

In this chapter, the system of public finance is assumed to include all activities related to the fiscal interest of the state, including those at the sub-national layers of government. Public finance is also concerned with certain crosscutting issues such as preventing corruption and participation of civil society. Figure 1 below provides an overview of the system of public finance and its three core subsystems: the control, policy, and management spheres of governance. Each of these is characterised by specific policy constraints, institutional arrangements and actors, and is subject to a specific legal framework and control mechanism.

**Figure 1: The System of Public Finance and its Subsystems**

Overlapping areas exist between the subsystems: thus, Debt Management and Intergovernmental Fiscal Relations have a policy as well as a management dimension, while Monetary Policy and Trade Policy are an exception in that they affect the system of public finance but are not subject to parliamentary control.

Below, we will briefly describe the subsystems of public finance:

- **Revenue policy and administration** – this area comprises tax policy, tax administration and customs administration. Measures in the area of trade policy have a strong influence, as they affect customs revenue. Formulating tax policy and administering taxes and customs in a fair, efficient and effective manner enhance Partner countries’ capabilities. Increasing the fiscal strength of a country paves the way for improved self-financing. This stimulates growth, alleviates poverty and thus contributes to an enhanced development in line with the requirements of the Monterrey Consensus.
Budgetary policy and expenditure management – a country’s strategic policy orientation is reflected by the volume and composition of its public budget. Reforms in the field of budgetary policy aim at redefining policy priorities, focusing on developmental goals such as poverty reduction and at supporting the transition to a market-oriented economy. In contrast, the main objectives of expenditure management reforms are (1) to strengthen the administration’s capacity to implement government policy and (2) to enhance transparency and accountability of spending entities. While government and parliament are the main stakeholders with an interest in accountable public financial management, external donors have begun to pay increasing attention to this issue in recent years. This is mainly due to the trend of providing external support in the form of budgetary transfers. The ministries of finance (MoF) of many developing countries have undertaken reforms to improve strategic planning and budget formulation (e.g. medium-term expenditure frameworks – MTEF), budget preparation (e.g. comprehensiveness, classification system), budget execution and accounting (e.g. performance orientation, cash management, procurement), and monitoring and evaluation (e.g. integrated financial management information systems – IFMIS). Incidentally, it is in the area of expenditure management that the differences between the budget systems of anglophone and francophone countries are most significant [Lienert (2003), p. 2].

Financial management in line ministries – traditional public financial management systems, especially in francophone countries, tend to give the MoF a prominent role in budget execution. The scope of line ministries is limited to drafting sector policies and administering their execution; financial responsibility remains mostly with the MoF. In modern public financial management systems, line ministries increasingly assume responsibility for managing finances in their respective sectors. Hence, there is a growing need for capacity development in the sectors. In order to avoid the development of sector systems that are incompatible with the national system, it is necessary to coordinate capacity development at the sector level with the MoF [SIDA (2005), p. 15].

Parliamentary oversight and Supreme Audit Institutions – a prerequisite of Good Financial Governance is an effective system of checks and balances that is subject to the rule of law. External auditing contributes to detecting irregularities in the administration of public funds and identifies related management and control weaknesses. These problems can seriously undermine the administration’s integrity and, thus, the legitimacy of policy decisions (see Box 1).

Box 1: The Role of Supreme Audit Institutions (SAIs) in Public Finance

With the Lima Declaration, the International Organisation of Supreme Audit Institutions (INTOSAI) has agreed on internationally recognised standards for Supreme Audit Institutions (SAIs); most notably guaranteed independence of the institutions and its members, reliance on audit procedures, and mechanisms to impose sanctions. In particular, the existence of a well-functioning SAI is key for the quality of the budgetary process. SAIs often help to strengthen the reliability of budget execution by identifying instances and patterns of waste and inefficiency and development proposals for reforming institutions and procedures that, if corrected, will permit a more efficient use of available budget resources.

Debt management – economic policy and fiscal management are particularly interdependent in the area of debt. Domestic and international debt represents a key budget constraint, while monetary policy sets the payments on outstanding debt and thus burdens the actual budget. However, developing countries often struggle with the
techniques of recording debt and managing the schedule for repayment. A transparent and reliable system of debt recording becomes even more important with any attempt to raise new credits or reschedule existing debt, for example under HIPC arrangements. Efficient debt management can thus be of crucial importance as a prerequisite for implementing poverty alleviating policies.

**Intergovernmental fiscal relations** – according to the principle of subsidiary, political and financial responsibility should reside at the layer of government where public goods issues arise and can be settled best. An adequate design of intergovernmental fiscal relations allows for decision-making on the sub-national level. It thus helps to align various local preferences with public spending and contributes to a fruitful competition between different fiscal agencies. Overall, it enhances the efficient use of public resources.

The HIPC Debt Initiative underscored the link between the quality of public finance systems and poverty reduction several years ago. Most poverty-reduction strategy papers developed by partner countries today explicitly recognise that poverty reduction is not merely a question of spending more, but of maximising resources. If progress toward implementing the Millennium Agenda and the Millennium Development Goals is to be made, it is doubly urgent to improve public finance systems. Partner countries are beginning to recognise that many problems in sectors such as health, education, and agriculture may have a common origin: weak public finance systems. Making aid flows more predictable, improving procurement systems and granting budget support requires adequate capacities in public finance. While capacity development is central for all modes of development aid delivery, the growing interest among donors to move to budget support as an alternative to project-based lending has fuelled increased concerns over capacity development in public finance. Although the Paris Declaration endorsed in 2005 calls for the use of partner country’s own institutions and systems, where these provide assurance that aid will be used for agreed purposes, increases aid effectiveness by strengthening the partner country’s sustainable capacity to develop, implement and account for its policies to its citizens and parliament [OECD / DAC (2005b), p. 4]. Furthermore, the Monterrey Consensus of 2002 emphasised the importance for partner countries to mobilise their own revenues to provide a stable environment for sustainable growth. In the international development discourse, however, this topic has so far not received adequate attention.

An efficient and transparent public finance system also plays a key role in reducing security risks and is therefore key for post-conflict state building. In general, the sustainable development of failing states depends on strengthening the state’s three core functions: security, representation and welfare [SWP (2004), p. 10]. The expenditure allocation and the extent of public revenues represent an indicator for the welfare function, which includes *inter alia* the allocation of public resources.

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1. This discussion is particularly relevant for donors of Financial Cooperation. Project-based lending, including segregated project management units, has ensured to some extent that funds would be used properly, but the parallel systems have undermined capacity development. Resources that could have gone directly into public finance enhancement instead went into setting up external structures. For budget support to gain wider use, donors must still find ways to respond to the fiduciary concerns of their national stakeholders. Improving the capacity of public finance systems is one of the ways adopted by partner countries in addressing fiduciary concerns.
Good Financial Governance means the application of the principles of Good Governance (e.g. accountability, performance, participation, rule of law) to the system of public finance and its subsystems.

**Accountability** in Good Financial Governance requires above all the transparency of public finances. As a lack of transparency makes it impossible to control public financial policy and management, accountability is a key condition for Good Financial Governance. Transparency in the budgeting process contributes to finding viable solutions by taking into account the preferences and stakes of all actors and interest groups involved. Monitoring and supervision by institutions that are not part of the executive branch of government (e.g. parliaments, SAI or NGOs) exerts control over the management of revenues and donor funds, and thus ensures accountability toward civil society. Furthermore, a judiciary for the public sector is required to guarantee that the relevant rules are applied and adhered to. This, in turn, depends on the free flow of information. Through a publication of relevant information and through the media, civil society is further empowered to actively participate in political decision-making. The most important source of information on political priorities and resource allocation is the budget. The more governmental activities are run off-budget, the weaker is transparency and the lesser are the possibilities of control, and the higher is the potential for corrupt practices. The budget thus needs to be comprehensive. Indeed, international observational studies advise that more than 50% of corruption occur in areas of public finance [GTZ (2005a), p. 8]. To prevent corruption and enhance transparency by automation in administration is one of the main fields of public finance reform.

To ensure **performance**, public processes and institutions must be able to provide public goods and services that meet needs while making best use of available resources (i.e., to provide them effectively and efficiently). Efficiency of public financial management can be enhanced through a reduction of administrative barriers as well as the simplification and clarification of legislation. Furthermore, a mentality change among the actors involved is required. A fair and efficient system of public finances contributes to the allocation of funds to development-orientated and poverty-reducing activities and can create an economic environment suitable for private investments. This will have a substantial positive impact on poverty reduction and sustainable economic development.

Good Financial Governance encompasses all measures that lead to an adequate financial policy formulation, management of public revenues and expenditures, and supervision of these processes. The concept is as broad as that of Good Governance itself, and all aspects of Good Governance are closely related to issues of public finance.

### 1.2 Capacity Development in Public Finance

Capacity development has been one of GTZ's core tasks since its foundation. The United Nations Development Programme defines capacities as comprising “the ability of people, institutions and societies to perform functions, solve problems, and set and achieve objectives” [UNDP (2002), p. 2]. GTZ considers capacity development “as the process of strengthening the abilities or capacities of individuals, organisations and societies to make effective and efficient use of resources, in order to achieve their own goals on a sustainable basis” [GTZ (2003a), p. 3]. Capacity development in public finance refers to the process of strengthening the political framework, the organisational structures, and the abilities or capacities of administrative staff as well as of civil society. The aim is to create an environment in which public goods are provided in an effective and efficient manner. This
understanding is in agreement with the approaches of other bilateral donors: The Norwegian Agency for Development Cooperation (NORAD) and the Swedish International Development Cooperation Agency (SIDA) state that Capacity Development in PFM aims at developing the rules and procedures in PFM, organising the work and providing resources (physical, human, financial) in a way that facilitates their efficient implementation; and equips people in the organisations with competencies to operate efficiently [NORAD/SIDA (2002), p. 9]. In addition, capacity development in public finance also includes support to civil society. The overall aim of capacity development in this field is to make public finance an efficient tool for implementing policies and producing services for the benefit of the people, as well as providing an accountability mechanism for controlling government and the public service.

Within the scope of budget support, increasing emphasis is placed on the adequate mode of delivery for partner countries on the donor side (including stand-alone bilateral technical cooperation, technical assistance within pooling arrangements, Sector Wide Approaches (SWApS) and budget support) and on its relationship with budget reform activities, especially with regard to sequencing. For instance, while some donors argue that budget support has beneficial effects (e.g. initiating budgetary reforms in partner countries), others stress that establishing a reliable public finance system in the framework of technical cooperation should be a pre-requisite for providing efficient budget support. Donors therefore need to focus on both, the developmental and fiduciary aspects of budget support and on the importance of strengthening public revenues. A good example is Cambodia: The main goal of international donors is to provide a significant proportion of the total external assistance to Cambodia as budgetary support. However, the country’s public finance systems have been assessed by international donors as being weak, coupled with a low administrative capacity and frequently unreliable financial management. More specifically, corruption is identified as rampant, being one of the key impediments to an improved performance in governance and economic development [EIU (2005), p. 16]. In order to prepare budgetary aid, a thorough multi-donor financial management reform programme is under preparation, which concentrates on budgetary reforms, internal auditing and management of public expenditure. The main focus of the programme is on reforming core techniques of expenditure management and reporting. To complement these activities, Technical Cooperation has joined forces with the National Audit Authority to foster democratic decision-making and participation of the legislator in the control of public finances.

Regardless of what instrument donors regard as most suitable in supporting public finance reforms, all agree on the capacity development principles stated by the OECD-DAC (e.g. supporting country ownership; acknowledging specific circumstances; taking into account the institutional, organisational and individual level of capacity; assessing technical and managerial aspects; and coherent, coordinated and programmatic donor support). There is also a broad consensus that capacity development in public finance is at the core of the aid policy debate. Therefore, the public finance dimension of development should receive even more attention than it has in the past. For instance, a lot of work has already gone into improving existing diagnostic instruments for public financial management, like Public Expenditure Reviews (PER) or Country Financial Accountability Assessments (CFAA). Analysing selected aspects at single points in time on a highly aggregated level within the
new PFM Performance Measurement Framework\(^2\), these tools are extremely useful for assessing public financial management systems in specific national contexts. Defining a longer-term reform strategy may thus need to be based on additional information and even more sophisticated tools.

In the last decade, most donors focused on what public finance reforms should look like (e.g. enhanced practices and procedures in organisations), but only a few assessed how capacities are developed in public finance. To move forward, much more attention should be paid to the process of capacity development in this area. A new paradigm is needed, one, which places less importance on imposing a particular blueprint of public finance systems and concentrates more on facilitating an environment in which public finance capacities can be built progressively.

Capacity development in public finance has two dimensions, the technical and the political. The focus of the technical dimension is to establish and develop efficient and effective organisational structures and to develop a legal framework in which the institutional setting for these structures can be built. But public finance systems also have an inherently political dimension. Reforms in public finance always lead to changes in the political balance between governmental levels, administration units and ministries, as well as between government and society. Thus, reforms of budgetary systems require high-level political support if they are to be realised. This political dimension, as well as the technical complexity of the reform process, means that more – and better – donor harmonisation is needed to reduce transaction cost on both sides and to maximise the efficient use of development resources in partner countries.

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\(^2\) Developed by the Public Expenditure and Financial Accountability (PEFA) Programme. PEFA is a partnership between the World Bank, European Commission, UK Department for International Development, Swiss State Secretariat for Economic Affairs, French Ministry of Foreign Affairs, Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa.
2 Good Practices

An overarching principle that guides our work is that capacity development is not a donor activity, but a task for partner country governments. In other words, capacity development is primarily endogenous to a country, based on voluntary action and motivation. Exogenous aid initiatives can support capacity development, but they are not a substitute for it. Capacity development efforts should therefore be rooted in the partner country’s goals and strategies. Furthermore, the motivation for capacity development should not depend on the mode it is to be delivered. This requires a process in which the partner country can set its own reform agenda. Hence, in order to make sure that capacity development is imbedded in a country’s political and institutional framework, donors have to be aware of country leadership and ownership and adapt the strategies of capacity development to a country’s specific circumstances. As outlined above, reforming public finances impacts the state’s policy, management, and control spheres. Therefore, any strategy directed towards facilitating sustainable changes in the system of public finances must integrate political reforms, institutional changes, and managerial and technical capacities of the partner country. In addition, a consistent donor strategy is characterised by providing external support in a coordinated and programmatic manner that makes as much use as possible of the partner country’s system of public finance.

2.1 Facilitating country leadership and ownership for reform processes

Capacity development has often been supply-driven (by donor needs) rather than demand-led (by the partner government’s agenda). Regardless of the level of funding, commitment or technical expertise of the donor agency, investments in capacity development have rarely proved significant or sustainable without national champions for reform. Capacity development reforms are most likely to succeed when they are perceived to be in the country’s own interest, and partner governments are therefore committed to the implementation. Donors have little ability to create an incentive for capacity development where it does not already exist. Thus, making capacity development part of the conditionalities for loans or grants has been largely unsuccessful in generating true country ownership. Many countries, however, already have some form of capacity development strategy in their public finance system. The donors’ role is therefore to facilitate rather than to direct the process of turning broad goals and strategies into an actionable plan. Nevertheless, partner countries must be prepared to decide on the degree of support that they require from donors in managing financial contributions. By encouraging the partner country to take the lead in developing a vision of the state’s future role, and, more specifically, in drafting capacity development efforts in public finance, the donor agency can identify key entry points and develop suitable recommendations for the country’s context. Because capacity development in public finance tends to entail major changes in politically sensitive aspects like organisational behaviour or incentive structures, those who understand these changes should be involved in the programme design. However, country ownership implies participation throughout the entire value chain of problem definition, diagnostic analysis, design of the action plan and proposed interventions, and implementation. Country leadership may mean that some donor-specific interests or requirements cannot be pursued immediately. However, donor facilitation of country leadership throughout each phase of capacity development is essential for making a genuine impact.
Although country leadership and ownership are undoubtedly beneficial, they are sometimes difficult to achieve. Incentives within donor organisations themselves can mitigate against the slower, more facilitative approach that is needed to encourage country leadership. Pressures like the need to conduct diagnostic analysis and/or show results on the ground can lead to donor agencies pushing ahead with certain activities, even when a partner government is still questioning their utility or timing. Similarly, the objectives and goals of donors and partner countries sometimes diverge; they may not agree on priorities, or donor objectives may seem more ambitious than those of the partner country. There can also arise situations in which donors harbour doubts about a partner government’s ability, for example, to diagnose the areas of weakness and to prescribe appropriate remedies.

Although there are differing approaches, some examples of how to encourage country leadership and ownership have emerged in recent years:

- **Take a long-term view and develop a common language for dialogue.** The complexities of capacity development in public finance require a long-term perspective in planning and executing activities. Potential backlashes need to be taken into account. Getting partner governments to embark upon a capacity development programme may often have to start by simply reaching a shared understanding of the current situation (see Box 2). A sustained dialogue and the willingness to adapt to country-specific circumstances will help a partner government to develop home-grown reforms in public finance.

**Box 2: Long-Term Engagement: Budget Reform in Jordan**

In 1999 the Hashemite Kingdom of Jordan developed a master plan for the reform of its budget system. This put the implementation of performance budgeting on the government’s agenda, which stimulated support from bilateral and multilateral donors. GTZ supported the reform right from the start. During the reform process, the concept turned out to be too ambitious and complex, as well as being unsuited to the specific context of Jordan. Furthermore, ownership on the partner side was insufficient.

GTZ’s flexibility in changing basic programme parameters prevented the breakdown of the overly ambitious and complex reform programme run by the Jordanian government. Given these changes in priorities and the increased communication between GTZ and the Ministry of Finance (MoF), the ministry’s ownership was enhanced. Furthermore, support was concentrated on tackling substantial problems in budget management and its relevance for Good Governance. The reform programme was radically re-aligned in 2002, which generated new motivation. Capacities for anticipating relevant data were created with the support of GTZ, and in 2004 a binding upper expenditure limit, essential for fiscal discipline, was implemented.

This re-orientation was dependent on a high level of flexibility and substantial personal input, creating a thorough understanding of the political environment and sensitivity in handling the political process. For the first time in Jordan, realistic and binding upper limits for expenditures were introduced by establishing a new procedure plan for budget preparation. Hence, budget proposals were improved significantly. Furthermore, anticipatory and analytical capacities in the Jordan MoF were developed to improve ownership inside the ministry. These changes have enabled the Jordanian government to explicitly implement its priorities through the budget. So, on the one hand, a decision on the public spending ratio and thus for the scope of the private sector was made. On the other hand funds could be allocated transparently and in line with governmental priorities. For the first time, Jordan uses the budget as an instrument for political steering.

*Source: GTZ (2005b), internal mimeo.*

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3. It can take decades rather than years to achieve sustainable public finance reforms, depending on the objectives and a country’s specific circumstances. According to NORAD/SIDA, a period of 15 to 25 years might be appropriate for public financial management reforms. See NORAD/SIDA (2002), p. 26f.
**Use joint diagnostics to facilitate ownership.** The preparation phase should be used to carry out diagnoses as well as to identify the required input: reviewing existing capabilities and institutional arrangements; investigating and building linkages; exploring sequencing and priorities; preparing the training required for reform, etc. If this occurs late or not at all in the process of conducting a technical diagnosis, it may lead to overly ambitious plans and a delayed implementation. In Tanzania, the government and donors re-defined the traditional public expenditure review, turning it from a study that primarily fulfills fiduciary requirements to one that is part of the government’s work plan and helps to feed into the annual budgetary decision-making cycle. Although the public expenditure review (PER) still provided key information to donors working in critical sectors, the process was primarily organised in the context of the government’s own budget process. A joint government-donor workshop was held to discuss the findings and recommendations of the PER. In Senegal, a different approach was taken, but the process for conducting public financial management diagnostics included an extensive government counterpart team. A joint government-donor workshop on the findings and recommendations provided the government with a platform to formulate its own action plan for capacity development.

**Build upon external incentives for reform.** In some countries, external influences or political crises can contribute towards making capacity development a government priority. An important factor in this respect is the drive to join regional organisations. Thus, the EU accession countries in Eastern Europe have revised their public finance systems over the last fifteen years to comply with Union standards. Similarly, in Benin, the government’s participation in regional bodies such as the West African Economic and Monetary Union provided an additional incentive for embarking on capacity development in public financial management in order to meet new standards (e.g. in budget nomenclature) that were being established for member countries. A more direct example for external influence is the practice of multilateral donors to attach strings to their lending. For example, in the case of Nepal, a loan was made conditional on the establishment of a large taxpayers office. Generally speaking, this approach has advantages as well as drawbacks. On the one hand, there is a risk that ownership decreases. On the other hand, multilateral donors themselves act as drivers of change, activating essential reforms. Another external reform stimulus is public pressure. For example, in both Colombia and Guatemala – two countries that successfully implemented new information systems for financial management – there was strong public demand to tackle corruption and improve transparency in public finances. This made finance reforms politically important. A closer public eye on the use of state resources also strengthens the role of external audit institutions. Here, the press may become an important ally for external audit institutions in recipient countries. In a similar vein, taxpayers associations and tax consultants unions draw attention to inefficient or inappropriate uses of public funds. Activating civil society and the press is a promising approach for public finance reforms in partner countries.

**Step back to create space for government to lead.** Donors face a challenge wherever partner governments do not appear to be leading the reform process. Where adequate information is available about the nature of the problems, donors may simply have to allow governments more time to respond. In Madagascar, various donors had conducted a substantial body of analytical work on the system of public finances, little of which had
been incorporated into the government’s strategy. When a new government committed to public finance reform was elected in 2002, donors chose to stand back and allow the government to develop its own reform agenda and action plan. Once the 2003 Action Plan had been unveiled, donors accepted it as the focus for a government-donor dialogue on capacity development and external assistance. In this situation, the German government provided support to reforming core subsystems of policy management and public finances. The objective was to assist the Madagascan government in defining its priorities, transferring government responsibilities according to the principle of subsidiarity, and redrafting certain rules that had become cumbersome in recent years.

Another good example of how ownership in partner countries can be raised is provided by the cooperation with the Collaborative African Budget Reform Initiative (CABRI). This initiative aims at sharing knowledge on successful reforms in public expenditure management and, thus, facilitating reforms that aim at a more reliable and accountable finance system. This is a key issue as, according to the IMF / Worldbank, public finance systems in most African countries are unreliable and thus represent a central impediment to the continent’s economic development [IMF/World Bank (2005), p. 9-15]. Systems of public finances, and especially expenditure management, have accordingly been subject to comprehensive reform processes in recent years. However, international expertise has often been provided in the form of replacing domestic systems or applying standard solutions. CABRI’s thus aims at fostering domestic solutions.

- **Rely on the leadership of the ministry of finance and beyond.** It is critical that a partner country’s ministry of finance assumes leadership in implementing capacity development and public finance reform. Although the active participation of the ministry’s senior personnel is of particular importance, reforms can still be derailed if operational staff does not understand and/or support the process. This implies involving middle management in the design of activities, creating a broad “culture of ownership” of the reform process among all staff. Therefore, it is desirable that information on progress is communicated at each stage of the process, and that feedback is encouraged and respected. In some cases it could be advantageous to establish an independent downstream training and communication institute. An example of this is the Lebanese Institute of Finance, which has synergetic effects with other parts of the government as well as the region (see Box 3). The broader the scope of a capacity development, the more it will require champions beyond a single ministry. In Nicaragua, for example, the president himself presented the tax administration’s web page to the public, as he had become aware of the crucial role played by transparency in increasing public tax revenues.

In general, any attempt to reform public finance systems should take into account the need for strengthening democratic transparency, accountability and control. Institutions and organisations that are outside the executive branch of government can also be important in building a commitment to capacity development. Moreover, in situations where support from the executive is weak, donors may need to reach out to the legislative body, the SAI, or civil society in general. By informing the public and the legislature about public finance reforms, an initial constituency for reforms can be nurtured, which may eventually influence the executive.
Box 3: Successful Agents of Change: The Institute of Finance, Lebanon

In 1993, the Lebanese Ministry of Finance (MoF) embarked on a number of initiatives to implement the government’s strategy of modernising the economy to pave the way for sustainable growth. The development of training programmes to establish more professional working practices and to capacitate a new generation of skilled staff was critical to the reforms’ success.

In 1996, the Lebanese MoF established the Institute of Finance (IoF) (a training and communication centre supported inter alia by Adetef). As an agent of change, the IoF was commissioned to carry out the first-ever in-house assessment of MoF staff: it was given access to a database of all employees.

One of the IoF’s major tasks was to help improve internal communication at the MoF, thus ensuring that senior management had a good understanding of the aims and benefits of the new systems being introduced, and identified with them. By involving current and new staff in the reform process and encouraging them (through dialogue, learning and exposure) to adopt modern working methods, procedures, and information tools, the IoF helped the MoF to foster ownership of the reform efforts. This has also led to creating, within the MoF’s various directorates, an enabling environment for staff to continuously develop their knowledge, upgrade their skills, and provide orientation, coaching and clear career paths to the new generation of young staff.

In 2003-04, the IoF became a resource centre for other Lebanese public institutions, and has been instrumental in training staff in ministries of finance in various Middle East and Arab countries. Today, it is one of the most successful public sector institutions in terms of learning processes / institutional learning in Lebanon and the Arab region. The IoF has also been successful in building partnership schemes with specialised local, regional and international institutions. In this context, the IoF has facilitated the participation of Lebanese MoF staff in training and learning events outside Lebanon.

Source: Institute of Finance / Adetef (2004), mimeo.

Finally, it is helpful to clearly define responsibilities for managing the complex reform process. Thus, with the proper incentive structure in place, an agent of change can be created that assumes a strong ownership of the reform process. Identifying and supporting agents of change is all the more helpful in partner countries that show a weak demand for reforms.

Strengthening Supreme Audit Institutions and parliamentary oversight as agents of change. Due to their internationally defined function as independent bodies of control, Supreme Audit Institutions (SAIs) can cooperate with parliaments to become agents of change. If their independence is strengthened, for example by fostering an esprit-de-corps and simultaneously conferring additional audit and control competencies, an increased demand for reforms in various fields of government may arise. This kind of progress depends, however, on political support, especially by parliaments (see Box 4).

Box 4: Linking Parliamentary Oversight and Supreme Audit Institutions: The Case of Mauritania

The establishment of a Supreme Audit Institution (SAI) in Mauritania followed the adoption of a new constitution in 1991. The SAI emanated from the Ministère Chargé du Contrôle d’Etat (CdC) founded in 1987. GTZ has been supporting the CdC since 1991. In 2005 the programme „Promotion of Good Governance“, which includes support for parliament, amplified GTZ’s contribution.

So far, parliament has not played a significant role in the political system of Mauritania. Parliamentary oversight of budget implementation is consequently marginal, and there is little exchange between CdC and parliament. One of the programme’s key goals is to increase the cooperation between SAI and parliament and to enhance the capacity of parliamentarians to analyse the budget.

Source: GTZ (2004a), internal mimeo.
Build awareness and ownership in line ministries. While support for capacity development tends to be cultivated at senior levels of government and within ministries of finance, the close involvement of line ministry staff can be an important factor for success. In Guatemala, the development of a Financial Management Information System generated support within line ministries to see the changes implemented. Training and outreach extended to a wide range of users, which helped build interest in the new system - even at the level of the technical staff. Similarly, in Bangladesh, the project team managed to create a “bottom-up” interest in capacity development and the public financial management reforms. Success stories were publicised and support broadened. Formal and informal teams, as well as functional and cross-functional teams, were promoted and nurtured to facilitate the exchange of ideas and identify common ground for cooperation.

Generally speaking, the stronger and more widespread the level of political commitment, the higher the complexity of capacity development that can be aimed at. Where country ownership and political support are weak or narrowly focused, capacity development is thus more likely to centre on routine or technical issues. In contrast, projects that involve major shifts in institutional responsibility should be backed by a strong political and administrative commitment, and some degree of capacity. For example, in Bangladesh, a strategic decision was made to start with more technical aspects (e.g. budget classification and accounting practices) before endeavouring to change areas that would create strong bureaucratic resistance.

2.2 Adapting strategies to country circumstances

Capacity development efforts must be oriented to the partner countries’ needs if they are to succeed. NOSFA (“No One Size Fits All”) should be the guiding principle of any approach: Instead of being based on standard or imported solutions, design and sequencing must take into account the specific circumstances of a country. Timing and scope of interventions should be consistent with a country’s capacity – be it political, social, or managerial – to implement change. Effective capacity development starts with a premise of building upon what already exists, rather than transplanting entirely new systems. In the field of fiscal decentralisation, for example, the structure and interaction of a country’s political and administrative layers – central, regional, local – must be accounted for. Likewise, the sequencing of reforms in public finance needs to be adapted to country-specific factors, including the political climate for reform, institutional incentives, and managerial capacity. All too often, ambitious capacity-development programmes have fallen short by over-stretching key government officials. Well-sequenced capacity development also takes into account the building blocks of a public finance system that must be in place for subsequent reforms to succeed. It balances the need to generate short-term “gains” with a longer-term view of how comprehensive and permanent change can occur. In addition, some segments of a public finance system may have to be addressed first as a foundation for making progress in other areas later.

Be responsive to government’s most pressing needs. The entry point for capacity development will vary from country to country; there are no fixed parameters on what aspect of public finance should be tackled first (see Box 5). Some countries, like Hungary in its post-communist transition, require the building of a reliable treasury system as a first step. In Sierra Leone, starting up the payroll system again was a priority after the end
of civil war. Other countries may begin with revisions to the legal framework. Romania, for example, first created a law on public finance and then went on to reform the revenue subsystems (taxes and customs) and integrate fiscal relations. Although a diagnosis might indicate what donors regard as the weakest areas of a public finance system, it provides little indication of a partner government’s priorities. The areas that appear weakest may not necessarily be the most critical to improving a public finance system - or the most feasible in a specific political or institutional climate.

Box 5: Responding to Government Needs: Capacity Development in the Tanzanian Revenue Authority

The semi-autonomous Tanzanian Revenue Authority (TRA) has been supported by GTZ since its establishment in 1997. The most urgent need for the government was to increase public revenues through taxes in a relative short timeframe. Tanzania’s tax administration was riddled with corruption and the tax assessment basis was small and not fully utilised. Thus, TRA decided to reform inter alia the administrative structure.

GTZ supported TRA in the automation of the organisational structure to quickly increase tax revenues. In consideration of the existing organisational structure, an individual automation system was developed. This contributes to preventing corruption, as it limits the contact between officials and tax payers.

In accordance with its autonomy, TRA is allowed to operate under private sector labour laws. To boost moral and efficiency, TRA decided to pay salaries based on comparable employment in the private sector, resulting in much higher average salaries. Executives all have limited employment contracts and an extension depends on their performance.

The TRA thus contributes to fighting corruption and improving administrative efficiency, meeting one of the major reform goals of the government of the United Republic of Tanzania

Source: GTZ (2003b), internal mimeo.

- **Support government in setting clear objectives and advancing incrementally.** In a complex system like public finance, it is impossible to identify all relevant reform variables ex ante (they may be subject to unpredicted change). The process needs to be reviewed continuously to ensure that reform activities are on track. Adjustments should be made where necessary. This requires a clear set of objectives, priorities and activities, as well as output and performance indicators. A reform agenda should be clear in its objectives, but flexible in its approach. “Trial and error” is the underlying principle in achieving these objectives. This implies that the reform process should be broken down into small steps that allow for quick re-orientation. Monitoring and evaluation should be impact-oriented and cost effective. It may be advantageous to initially focus on the improvement of routine processes, as this requires less managerial capacity and is easy to monitor.

- **Focus on a specific public finance outcome, rather than a department or function.** Partner country officials make judgments about the nature of institutional incentives, and they must balance long-term strategic objectives with the need to show short-term gains. In Sierra Leone, the failure to introduce a payroll system represented a substantial risk, which government felt had to be addressed immediately. This became an approach for developing capacity development elements that supported effective payroll management, including strengthening the internal audit of payroll. Thus, capacity development initiatives that focused on specific outcomes guided the design of the training measures.
Reform fundamental procedures and structures first. Capacity development should be appropriate to the status of a country’s public financial management system. Procedures and practices that are used elsewhere may not necessarily be appropriate in the partner country, especially if certain preconditions do not exist. For example, in a system where annual budgets have little meaning because of large reallocations during the year, introducing a MTEF may be premature. Governments and donors, therefore, need to assure that the basics are being addressed first; particularly as they have an impact on other parts of the public finance system (see Box 6).

Box 6: Getting the Basics Right
1. Foster an environment that supports and demands performance before introducing performance or outcome budgeting.
2. Control inputs before seeking to control outputs.
3. Account for cash before accounting for accruals.
4. Establish external controls before introducing managerial accountability.
5. Operate a reliable accounting system before installing an integrated financial management system.
6. Budget for work to be done before budgeting for results to be achieved.
7. Have effective financial auditing before moving to performance auditing.
8. Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them.


Extract key concepts in lieu of replicating whole systems. Rather than wanting to replace entire systems, effective capacity development attempts to build on what is already in place. Easy-to-handle instruments and procedures can often be more effectively implemented than sophisticated ones. Some advanced concepts can be introduced gradually, but only by extracting the elements that are most practical for the country. Programme budgeting, for example, may have some useful concepts that can be applied to a developing country’s public finance system. But the focus should be on slowly introducing the basic principles without trying to replicate a system found in more industrialised countries.

2.3 Integrating political reforms, institutional changes, and managerial and technical aspects

Reforms in public finance are politically sensitive and require broader political alliances than other change processes. To ensure sustainability, it is necessary to involve all parties with a potential stake in the reform (MoF, line ministries, SAI, parliament, civil society). Also, their roles and responsibilities must be clearly understood. This requires, first and foremost, a comprehensive analysis of the public finance system and its subsystems of oversight, policy and management.

Successful reforms do not just depend on an understanding of the political economy (e.g. who is currently the most powerful driver of change?), actors must also be aware of the mechanisms of the political process. This applies to rules and procedures, as well as to specific “tools”. For example, francophone countries tend to have a more formalistic and control-oriented system, while the Anglo-Saxon tradition is focussed less on rules than on
trial and error. Thus, reform aims (e.g. new tools for expenditure management or Medium Term Expenditure Planning) must be in harmony with a given social and political context.

Furthermore, any public finance reform requires political support and a firm leadership from the MoF. Partner countries are often not able to assess and manage reforms on their own. Therefore, macroeconomic research and modelling capacities must be established to make an informed analysis of reforms and their effects. Moreover, a functioning budget system is crucial for implementing poverty reduction strategies and achieving the MDGs. In terms of transparency, the public budget must be used as a political steering instrument.

Donor experiences show that effective capacity development should also include change-management. How government will manage the process of building capacity can be as important as the public finance proposals themselves. Managers are often busy and overstretched with day-to-day responsibilities; many capacity development efforts require thinking about activities that will have a longer-term impact. Use of external technical assistance may fill gaps, but this is not a solution in itself. In this respect, training of individual staff should not be ignored.

The institutional, organisational and individual levels of capacity development, including the political implications of reforms as well as managerial and technical aspects, should all be taken into account in programme design and implementation. Capacity development must be viewed from a holistic or systemic perspective, and not merely as a transfer of skills or methods. Although new equipment, training programmes, and updated procedures all play a role, the design of effective capacity development also takes into account the political, institutional and organisational context in which change must occur. Solutions should also be supplemented by reviewing the broader social and political context, incentives for various stakeholders, the impact of human resource policies and practices, as well as the culture of the public service as a whole. In promoting change, and in order to achieve sustainable results instead of temporary islands of excellence, it is important to understand how these various system levels interact. (see Box 7). Changes in one area are likely to be influenced by changes, or the lack thereof, in other areas. No component of the public finance system stands in isolation; the technical aspects of public finance in individual, institutional and organisational terms cannot be separated from their managerial context or even the culture at large. The legal framework, the institutional incentives, and the human resource policies can all have an impact on whether capacity development efforts succeed. Moreover, civil servants may already have the required technical capacity, but the institutional setting and incentive structure hamper an effective application. Although these issues may not all be addressed at once, they should nevertheless be factored into the design of a capacity development programme.
Box 7: Linking Public Finance Subsystems in Partner Countries

1. The distribution of responsibilities between the treasury department and the budget department should be clarified and their coordination should enhance the preparation of the budget implementation and cash plans.

2. Debt management departments should be unified. Linkages between debt management, preparing budget implementation and cash plans are required.

3. Coordination between tax administration and departments responsible for preparing tax forecasts, and continuously updating them, might be reinforced.

4. Inter-ministerial cooperation needs strengthening at the political and operational level, e.g., Ministry of Finance – Ministry of Economy – National Statistics Office.

5. Parallel reforms at the central and sector level are required, e.g., improving investment budgeting depends on the effectiveness of procedures to screen and select projects within the line ministries; dealing with the problem of generating arrears requires an efficient internal control within line ministries. Conflicts between the central and the sector level should be avoided.

6. Attention should be given to the linkage between the central and sub-national layers. Devolution requires, e.g., improved circulation of information and increased awareness of fiscal problems within sub-national authorities.


Box 8: The Strategic Role of Reforms in Public Finance: The Case of Peru

When GTZ supports the Contraloria General de la República (CGR) in supervising the national system of financial control (Sistema Nacional de Control, SNC), it plays a strategic role in the government’s broader political vision of democratisation and decentralisation. GTZ contributes to implementing the national strategy on promoting the rule of law and fighting corruption. Furthermore, by modernising the national system of financial control, the SNC contributes to improving the public’s trust in the financial conduct of the state.

The supreme audit authority (CGR) has two major tasks. Firstly, the CGR has to assure an orderly budget in all areas of government activity. To this end, GTZ supports the CGR in examination techniques and procedures, and in training staff to use them. Furthermore, GTZ advises the CGR in process and organisation design and development. Secondly, the CGR is to train public employees at all government levels in orderly budget management. In this context, the CGR assumes great responsibility for the administrative implementation of politically sensitive decentralisation processes.

Improved auditing standards and practices increase efficiency and lead to a better control of public spending. Thus, public resources are used more efficiently, and the organisational structure helps to reduce corruption. This increases the public’s trust in the government. Moreover, due to the involvement of the national and local level, public finance reform facilitates the decentralisation process.

Source: GTZ (2003c), internal mimeo.
Furthermore, public finance systems are embedded in the society as a whole. In order to avoid creating islands of success in oceans of failure, citizens must be willing to bear the tax burden and make use of their rights. Good Financial Governance is therefore closely related to general social issues like the respect for human rights (and a denunciation of corruption, bribery, and tax evasion). Thus, as mentioned above, successfully supporting reform activities requires an understanding of a country’s context. On the one hand, normative rules defining constituency rights and obligations (e.g. on which incomes to report) need to be followed. On the other hand, rights have to be utilised (e.g. making use of tax allowances or complaining against improper tax assessment). Thus, civil society has to be informed about the changes arising from reform. Raising public awareness is especially important in terms of gaining wide-spread support and legitimacy (see Box 9).

**Box 9: Involving the Public: The Case of Armenia**

GTZ supported the government of Armenia in turning its poverty reduction strategy (PRS) into a participative but still implemental planning document. This won high praise from the IMF. Due to political interests and the balance of power, the PRS has still not been successfully integrated into the budget process. The implementation and integration of the PRS is to be established through a multi-stakeholder-platform, which includes representatives of civil society, academia, parliament and government. Other donors also use this platform for discussion and allocation of bilateral financial aid. Televised discussions provide a forum for platform members to question the government on its priorities and the implementation of sectoral strategies. In this way, civil society is given a voice in revising and monitoring government policy goals.

*Source: GTZ (2005c), internal mimeo.*

*Integrate institutional and organisational issues.* Some forms of public finance capacity development may encourage substantial institutional resistance. In the case of Turkey, the PER exercise was extended beyond the typical assessment of the strengths and weaknesses of public financial management: Carrying out the PER was turned into a form of capacity development. The PER became a vehicle to bring together different institutional interests in discussing critical public financial management issues. Consensus within government on a plan of action was reached through the PER exercise, and major legal reforms were subsequently implemented.

Implementation of integrated financial management information systems (IFMISs) is another area with a strong technical focus that will nevertheless fail if wider institutional and managerial issues are not well integrated. IFMIS projects can involve major shifts in responsibility from the ministry of finance to line ministries, substantial changes in the incentives and power relations within ministries, and implications for recruitment and retention. Guatemala is one of the success stories of FMIS implementation (change management issues were a key part of project design). The implications for organisational structures, job descriptions, and how staffing needs should be aligned with the new informational outputs and decision-making procedures were considered. The ministry of finance was reorganised in preparation of its new role, and new accounting units were created in the line ministries that used to have a lower stake in the old system. In addition, a wide range of users was trained in financial management, which led to a greater acceptance and understanding of the new system.
Use training strategically to support institutional and organisational changes. Although the focus is often on improving organisational performance, training individuals remains an important component of capacity development. In other words, changes in procedures and policies need to be accompanied by extensive on-the-job training to ensure that the new concepts can be implemented. In Guatemala and Bangladesh, for example, thousands of individuals were trained in public financial management to facilitate the implementation of the new procedures. In Benin, workshops on programme budgeting began well before a formal project was established. In this way, key ministry officials could be acquainted with the concepts and make decisions on the project’s implementation. The project in Benin also entailed an extensive hands-on training, as donor experts would review draft programme budgets and provide specific guidance. In all cases, training was not viewed as an end in itself; it was used to support other organisational or institutional changes. Effective capacity development requires well-functioning partner organisations with a trained, motivated and committed staff. On the donor side, capacity development must involve the transfer of practical know-how that meets the recipient’s requirements.

While it is necessary to build upon existing capacities, it is important to bear in mind that, in some cases, individual capacities exist that are detrimental to successful reform. These detrimental capacities are the skills individuals have accumulated (often over many years) in order to abuse the system in their own interest. As for the public sector in general, corruption, nepotism and embezzlement are major reform challenges that obstruct a well-functioning public finance system. Effective capacity development in public finance can reduce these impediments. This requires not only organisational restructuring, but also changes in personnel (see Box 10). While new employment should be merit-based, competitive wages and other incentives help to retain well-qualified staff. The importance of this is underscored by cases in which successful capacity development efforts in public finance have not led to an improved administration – simply because newly-trained civil servants, who had perhaps been underpaid, left their positions to join the private sector for higher salaries. The incentive structure within public organisations has to be designed in a way that deters “brain drain” and allows for career development.

Structure project management roles realistically. The form and quality of project management is another important consideration. The programme needs to have competent staff with the authority to guide and facilitate decision-making at key junctures. In the Colombia FMIS case, it was concluded that it would be unrealistic to expect busy line managers to devote adequate attention to long-term capacity development efforts. Instead, they formed a group of individuals who could be devoted full time to the implementation of project activities, but would work closely with line staff. The project also benefited from a coordination committee of senior officials who met frequently enough to resolve inter-institutional issues.

Balance local and international expertise in the implementation. The composition of the implementation team was an important success factor in the case of Bangladesh. The team was made up of government officials, international consultants, subcontracted national consultants, and retired senior officers. Experience in Latin America, however, suggests that the use of long-term consultants should still be carefully managed. Some capacity development efforts have suffered from too many individual consultancies,
which become difficult to coordinate and control, and costly to administer. With this in mind, the Guatemala FMIS project was designed to keep the number of long-term consultants relatively low. During Uganda's economic reforms in the early to mid-1990s, foreign advisors were assigned to specific departments of the ministry of finance and coordinated by one senior advisor.

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<th>Box 10: Capacity Development in Changing State Structures and Functions: The Case of Colombia</th>
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<td>At the end of the 1980s, Colombia’s tax administration was mired in corruption and on the verge of collapse. The tax agency neither recruited experienced professionals, nor provided training. As a result, revenue collection declined. Thus, the government decided to reform tax policy and administration. In the 1990s it attempted to merge the tax and custom administrations into a semi-autonomous revenue authority, the National Tax and Custom Directorate (Dirección de Impuestos y Aduanas Nacionales [DIAN]). One key element was to implement radical personnel reform and to develop a plan for a comprehensive staff evaluation and replacement programme.</td>
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<td>All staff members, who were inherited from the previous agency, were given the choice of either opting for voluntary retirement or applying for a position in the newly established DIAN. Those who applied were subject to a three-phase exam. The first phase consisted of a psychological evaluation that focused on personality, intelligence, and moral judgement. The second phase evaluated knowledge, reasoning, and professionalism. The third phase consisted of personal interviews. Additional information from third-party sources, such as the public register and the general accounting office, was also used to evaluate the suitability of existing staff for employment in the new superintendence. Only those who satisfied all these requirements were rehired. Despite strong resistance from the union and staff, DIAN managed to carry out the initiative, which sheared major parts of its staff. Reducing the number of employees to the extent needed, the final step was to recruit new staff members through rigorous selection processes at universities.</td>
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<td>Staff evaluation and replacement programme was just the beginning. As part of DIAN’s autonomy, it was allowed to operate under private sector labour laws, permitting the agency to design its own professional personnel system. This was seen as instrumental to the reform’s success. To boost morale and efficiency, DIAN decided to pay salaries based on comparable employment in the private sector. As a result, the average monthly salary jumped. The new salary policy also included a provision to maintain the competitiveness of DIAN’s salary structure relative to the private sector.</td>
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**Source:** GTZ (2003d), internal mimeo.

- **Linking theoretical and practical issues.** Sustainable capacity development requires a link between theory and practice. German Technical Cooperation has been establishing a strong cooperation with public administrations and semi-public organisations in Germany and elsewhere (partnership approach), which can be of great use for partner countries. By means of exchange programmes, study tours etc, experts in the partner countries are brought together with their counterparts in donor countries. The partnership approach as a tool for capacity development is to help partner countries in their development of modern and efficient administrations (see Box 11). It is supplemented by carefully planned and timed activities by specialists, training events, awareness-raising visits, etc, to accompany the reform process towards the targeted result. The Chinese SAI, for example, visited the German federal SAI, giving staff the opportunity to exchange their professional experiences. German institutions have extensive knowledge of transition processes as a consequence of Germany’s reunification.
Merging International Good Practice with Local Expertise: Strategic Use of Training in Mongolia

With the “Law on State Audit and Inspection”, (1995) the Government of Mongolia set the foundation for the establishment of audit authorities. Based on this law, the National Audit Office of Mongolia (MNAO), 27 Aimag (audit authorities on the provincial level) and one capital city audit and inspection committee were introduced. GTZ supported the process of establishing a democratic external financial control, one of the core pillars of the Mongolian transformation and modernisation process.

This far-reaching institutional change implied a profound re-orientation for the staff. A change from a pure control to an auditing and advisory function can only succeed when the mentality and work culture changes. Thus, the GTZ contribution included a change-management and training component, aiming at the role of external audits for promoting efficient and orderly work in Mongolian administrations.

Furthermore, a critical factor for success in terms of a sustainable change of governance was the intensive partnership with the audit courts of the German federal states of Berlin and Hesse (partnership approach). The partnership continues beyond GTZ’s contribution. GTZ’s contribution imparts basic knowledge about general legal foundations, tasks and functions, international standards of external financial auditing, etc. As a next step, the focus of the contribution is presently on implementing and adopting the learned material in daily accounting practice. GTZ’s continuous commitment and the resulting trust of the partners were essential factors of the support. Numerous practical excursions were held to audit courts in Germany as well as seminars at the MNAO with German experts, including a workshop on organisational and economic efficiency audits in Berlin, which enhanced economic understanding.

Three institutional prerequisites were crucial for the success of the Mongolian-German Cooperation. Firstly, the contribution was based on cooperation between state institutions – the MNAO and Courts of Audit of the German federal states, which provided high credibility. Furthermore, the monitoring process continuously examined the strengths and weaknesses of the teaching instruments and enhanced the adoption of inputs. Secondly, there developed a remarkable relationship of trust on the management level, which facilitated cooperation. Thirdly, practitioners on both sides had profound expertise, training experience and practical experience about the role and function of Supreme Audit Institutions.

Source: GTZ (2004b), internal mimeo.

Coordinated, programmatic support from donors

Donor support should be provided in a coherent, coordinated, and programmatic manner. One of donors’ primary responsibilities should be to minimise the transaction costs (of working with multiple donors) for the partner government. Wherever possible, donors should thus strive to harmonise procedures and monitoring mechanisms. As to the content of capacity development, the government’s own action plan should be the focal point for determining support. Though donors may have varying areas of expertise within the overall programme, their support should be complementary rather than competitive or duplicative. Support should be phased over a multi-year horizon in order to take into account the long-term nature of capacity development. Likewise, interventions should be programmed in accordance with the partner country’s development objectives.

Donor support for capacity development is often fragmented and inconsistent, making assistance duplicative or competitive rather than complementary. Although the aim may be to respond to the needs of the partner country, many donor practices are in fact geared towards their domestic stakeholders. This leads to separate funding mechanisms and a pressure to show results within relatively short timeframes. Funding is often unpredictable over the medium-term, and even technical support comes with significant restrictions. Shifting to a
demand-driven (needs-driven) approach within a coordinated donor context, however, creates the flexibility governments need to decide how to maximise donor support.  

- **Coordinate activities to support the government’s plan.** It is critical to align all donor support to a coherent national plan for capacity development in public finance. In several countries, including Tanzania, Mozambique, and Cambodia, donors have formed a coordinating group. This supports government activities through a jointly funded programme and seeks to establish common procedures and monitoring mechanisms. As they work together under the government’s leadership, donors reach compromises on public finance issues that can be addressed in the agreed timeframe. There is still room left for donors to target specific areas of interest, but on the whole, support must fit into a common framework. Ideally, donor coordination goes beyond harmonising single donor activities and exchanging information, by setting up an institutionalised platform for both donors and partner countries. This can also help in designing and monitoring a joint reform process. Donor coordination becomes even more important, but also more difficult, in countries that work with a multitude of donors or engage in sophisticated public finance reform processes. While there has been significant progress in harmonising donor budget support, the coordination of specific contributions of technical cooperation requires further cooperation.

- **Make donor approaches more compatible.** Coordinating and aligning different donor approaches allows for efficiency gains. General benefits from donor coordination include: improved exchange of information and experiences; an acceleration of the reform process; decreased organisational costs; positive linkage effects and synergies; greater impact from donor recommendations; an improved cooperation on the partner side; and enhanced ownership and leadership. Coherent donor support allows donors to make more efficient use of their resources and increases the chances of successful capacity development.

Donor harmonisation is facilitated by a common understanding of issues like technical cooperation (including similar objectives), complementary reform areas, and compatible planning instruments and methods. Ultimately, harmonising donor activities need to be initiated and executed locally, based on the local staff’s willingness and ability to collaborate (see Box 12). However, donor harmonisation itself generates costs. Finding the right balance between cost and effectiveness, and choosing the most suitable form of achieving donor harmonisation, thus depends on the specific context of the partner country and the project at hand.

Donors use different selection criteria when deciding on the best support for a partner country. Some, for example, will pay more attention to a partners’ absorptive capacity than others. Agreeing on a common set of high-level performance indicators in public finance is one way of achieving greater coherence among the different stakeholders when it comes to setting priority areas for capacity development. It also helpful if monitoring is centred on the performance and impact of a reform rather than on process-based milestones. These high-level indicators do not serve as a yardstick for grading a

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4. Pooling arrangements, including the provision of technical assistance, involve harmonising donor procedures and practices. The level of the partner country’s control over donor support can vary widely. Future experience will show which level of partner control can reduce fragmentation and increase the scope for national ownership.
country’s performance: they yield valuable information that should be applied flexibly by donors.

Box 12: Harmonising Technical Cooperation: Joining Forces in Nepal

Joining forces with the Danish International Development Agency (DANIDA), GTZ assisted the government of Nepal in supporting its revenue administration. As DANIDA and GTZ had previously promoted independent activities in the areas of VAT and income tax, the Ministry of Finance asked both agencies in 1999 to build the capacities of the Inland Revenue Department (IRD), in which the administration of income tax and VAT had recently been merged.

GTZ and DANIDA established the joint “Revenue Administration Support” (RAS) to help increase the effectiveness and transparency of the tax system by reforming the administrative procedure and introducing an IT system. Since the establishment of RAS, tax revenues have increased at a higher rate than GDP growth. Developing and implementing new laws on income tax and VAT, combined with suitable administrative measures, have contributed greatly to this success. Furthermore, RAS launched extensive public information campaigns to raise taxpayers’ awareness and increase trust in the administration. The joint activity also developed long-term training plans on management functions and operations. Furthermore, RAS contributed to harmonising financial and technical cooperation. Both the IMF and the Asian Development Bank asked for changes in the tax system as conditions for financial support. RAS provided assistance to HMG/N in order to comply with these conditionalities.

The coordination between GTZ, DANIDA and multilateral donors, which was initiated and executed locally and founded on a common understanding of technical cooperation and the staff’s willingness and ability to collaborate and respond, has been absolutely critical to RAS’s success. Represented jointly by both donors, RAS is considered a well-integrated and effective resource centre within the Nepalese IRD.

Source: GTZ (2004c), internal mimeo.

- **Support team spirit as a key element.** To make donor harmonisation work, staff must create and nurture a “spirit of cooperation”. Professional competence and personal skills are important, and joint activities should be characterised by synergies of cooperation rather than competition. This requires a certain amount of sensitivity and the ability to respond to changing circumstances.

- **Show flexibility in the timing of interventions.** Experience shows that donors can be flexible in setting the focus and timing of capacity development activities (see Box 13). Obviously, flexibility is easier when both sides can keep their focus on a common long-term objective, and have a realistic approach to potential obstacles. When, for example, catastrophic weather conditions affected Benin’s primary export sector, donors shifted their focus to helping government obtain supplemental credit to address the external shock.
Box 13: Showing Flexibility in South Africa

Since 2002, GTZ has supported the National Treasury (NT) of South Africa in improving financial management at the municipal level. Municipal budgets are to be planed and managed via the Municipal Finance Management Act (MFMA) developed by the NT.

The MFMA was adopted after three years of debate. Due to the length of this process and the increasing pressure on the capacities of the municipalities, the will to reform flagged as uncertainties about the success of the venture spread. The NT was forced to renew motivation and energy for the essential and complex implementation process at the local level.

GTZ, as a flexible and reliable partner of the NT, supported the NT in mastering the logistics and professional moderation of the national information campaign that aimed at increasing the public’s faith in the decentralisation process. The success of the campaign was also dependent to the extensive knowledge of the partner country’s circumstances. This engagement went beyond the initially planned activity.

Source: GTZ (2005), internal mimeo.
3 Lessons Learned for supporting public finance reforms in developing countries

- **Good Financial Governance requires a systemic view.** Public finance comprises a complex set of closely interrelated subsystems (e.g. tax and customs, budgets, expenditure, inter-governmental finance, parliamentary oversight, internal and external financial control). Reforming a particular subsystem may have consequences for a number of related areas. For example, tax reforms may have profound repercussions for the budget. Thus, designing successful and sustainable interventions – especially through technical cooperation – does not just depend on a long-term view: It is also essential to adopt a systemic approach that includes a thorough understanding of how the different layers of a public finance system interact. As public finance systems are embedded in a context of laws, procedures and traditions, reforms in this area can have a much wider impact. For example, to achieve a sustainable reduction in corruption, it is not enough to establish an SAI. Raising public awareness of the ills of corruption and linking the budget and public revenue system to the reform agenda are equally important. Similarly, public revenue reforms need to be designed in combination with budget reforms to provide an impetus for poverty reduction. Adopting a systemic view thus requires that the subsystems of public finance are addressed in a consistent reform programme.

- **Link between poverty reduction strategies (PRS) and public finance reforms.** A sound public financial management system is crucial for the sustainable and successful implementation of PRS. Changes in sector policies and management, especially in the social sectors (health, education) and infrastructure, are regarded as core contributions to reducing poverty reduction and reaching the MDGs. However, reforming financial management in these sectors has not yet received the necessary attention. This is despite the fact that insufficient public financial management impairs the planning of sector strategies, budgeting and expenditure management, and that the efficient and effective use of public funds within the sectors are a prerequisite for accountability and effective monitoring by parliament and government.

- **Better understanding of the political economy.** The various stakeholders in public finance reforms (MoF, line ministries, parliament, SAI, central bank, civil society) pursue different strategies in accordance with their - sometimes constitutionally defined - roles. This holds especially true for budgetary reforms and expenditure management. Therefore, a better understanding of the political economy of public finance reforms is crucial for a successful implementation of government programmes. Of course, the political economy of donor interventions should also be taken into account. Excellent insights on this topic can be found in Martens et al (2002).

- **Include all stakeholders by reforming public finance.** To implement successful and sustainable reforms in public finance, it is necessary to include all stakeholders. So far, reforms in public finance have tended to disregard the role of parliamentary oversight. A key role of parliament in a functioning democracy is the control over the annual spending and revenue plans that make up the national budget. As parliamentarians in partner countries often lack the capacity for a detailed financial oversight of the budget process, this key parliamentary function is frequently lacking [GTZ (2005d), p. 21].
Design intergovernmental fiscal relations. An adequate design of intergovernmental fiscal relations allows for decision-making at the sub-national level. This contributes to aligning the various local preferences with public spending and fosters a fruitful competition between different fiscal agencies. Overall, public resources are used more efficiently.

Preventing corruption in public finance. As mentioned above, public finance is particularly susceptible to corruption. This is due, on the one hand, to the unusually large gains that corrupt individuals or enterprises can reap in this field. On the other hand, corruption is facilitated by the normally complex and opaque system of public finance. Preventing fiscal corruption is best achieved by maximising transparency - one of the central elements of Good Financial Governance. Further measures for preventing corruption can be found in GTZ (2005a).

The NOSFA principle (No One Size Fits All). In our view, capacity development must include country-specific circumstances in the design and sequencing of reforms. Often partner countries seem to have similar problems, e.g. tax base not fully utilised, or no link between government programmes and national budget. However, strategies to address these shared problems vary from country to country. They must fit the specific context, regardless of existing and approved approaches to fundamental issues.

Windows of opportunity. Changing political constellations, approaching general elections, job rotations in ministries - these factors often mean that far-reaching reform processes can only be implemented in a narrow time frame. These so-called windows of opportunity are crucial for initialising reforms in public finance. However, using them effectively requires a long-term engagement with a local presence.

Country ownership through flexibility and continuity support. Capacity development requires a long-term and consistent approach. On the one hand, capacity can only be built over a period of time. If they are not maintained and utilised, developed capacities can erode quickly. On the other hand, ownership of executing structures is crucial for effective and sustainable reforms. GTZ therefore strives to cooperate with a wide range of executing structures that are willing to invest in capacity development and identify with these activities. In addition, long-term assistance with a local presence makes it possible to adjust to changes in the partner country.

Link bilateral donor contributions to international programmes. On the whole, donor support must fit into a common framework. There is still room left for donors to target specific areas of interest. Ideally, donor coordination goes beyond harmonising single donor activities and exchanging information. It optimally includes the establishment of an institutionalised platform for both donors and partner countries. This can also be used to deal with the design and monitoring of the reform process. Donor coordination becomes even more important, but also more difficult, in countries that work with a multitude of donors or engage in sophisticated public finance reform processes. At least, donors must understand that their activities are complementary.
Sources

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