

THE WORLD BANK (IBRD) AND  
INTERNATIONAL MONETARY FUND (IMF)

**Bank/Fund Collaboration on Public Expenditure Issues**

Prepared by the IMF's Fiscal Affairs Department and the World Bank's  
Poverty Reduction and Economic Management Network

In collaboration with other departments of the IMF and the World Bank

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## Acronyms

AAP	Assessment and Action Plan
AfDB	African Development Bank
AFRITAC	Africa Regional Technical Assistance Center
ADB	Asian Development Bank
CARTAC	Caribbean Technical Assistance Center
CAS	Country Assistance Strategy
CAW	Country Analytical Website
CD	Country Director
CDF	Comprehensive Development Framework
CFAA	Country Financial Accountability Assessment
CG	Consultative Group
CMU	Country Management Unit
CPAR	Country Procurement Assessment Report
DFID	Department for International Development
EC	European Commission
ECA	Europe and Central Asia
EFF	Extended Fund Facility
EU	European Union
FAD	Fiscal Affairs Department
FM	Financial Management
FMIS	Financial Management Information Systems
FSAP	Financial Sector Assessment Program
FSB	Fiscal Strategy Brief
FSU	Former Soviet Union
HIPC	Heavily Indebted Poor Country
HQ	Headquarters
IDB	Inter-American Development Bank
IDF	Institutional Development Fund
IFAC	International Federation of Accountants
IGR	Institutional and Governance Review
JSAs	Joint Staff Assessments
LAC	Latin America and the Caribbean
MDB	Multilateral Development Bank
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
MIC	Middle-Income Countries
MTEF	Medium-Term Expenditure Framework
NGO	Non-Government Organization
ODA	Official Development Assistance
OECD-DAC	Organisation for Economic Co-operation and Development/ Development Assistance Committee

OECD-SIGMA	Organisation for Economic Co-operation and Development/Support for Improvement in Governance and Management
OPCS	Operational Policy and Country Services
PEAS	Public Expenditure Analysis and Support
PEFA	Public Expenditure and Financial Accountability
PEFM	Public Expenditure and Financial Management
PEM	Public Expenditure Management
PEIR	Public Expenditure and Institutional Review
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Surveys
PFPSAL	Programmatic Financial and Public Sector Adjustment Loan
PFTAC	Pacific Financial Technical Assistance Center
PREM	Poverty Reduction and Economic Management
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSRL	Programmatic Social Reform Loan
QSDS	Quantitative Service Delivery Surveys
RAP	Regional Technical Assistance Plan
ROSC	Report on Standards and Codes
SA	South Asia
SAF	Structural Adjustment Facility
SPA	Strategic Partnership for Africa
TCAP	Technical Cooperation Assistance Program
TRM	Treasury Reference Model
UNDP	United Nations Development Programme
WBI	World Bank Institute

## Executive Summary

Following the Monterrey Consensus, the Development Committee of the World Bank and the Fund indicated that the two institutions would scale up and intensify efforts to assist countries to mobilize domestic resources and improve the quality of public expenditure. Against the background of the mandates of the two institutions and existing guidelines issued to staff, this paper reviews the experience of collaboration of the Bank and Fund on expenditure issues.

A survey of government officials, donors, and Bank and Fund staff found that collaboration is rated between adequate and effective by all groups, suggesting scope for improvement. Governments and staff rated collaboration slightly more positively than did donors, and the majority viewed the Bank and Fund as sharing common objectives and sharing information well. The same survey found that collaboration practices are stronger in PRSP countries, and vary from region to region. Staff rated collaboration as most problematic in the area of expenditure prioritization, and governments indicated that there was scope for better timing of missions.

While the Fund and the Bank have different approaches to public expenditure work in reflection of their different mandates, a review of experiences in low- and middle-income countries suggests that a clear government vision of reform can help ensure that these approaches are complementary. Processes that enable a government and its development partners to develop a shared vision of the reform program and a common understanding of the sequencing of reforms facilitate their implementation. Coordinating and synchronizing external technical assistance with the government's budget cycle is a good practice to emulate, to the extent feasible. In addition, predictable donor resource flows can enhance the credibility of budgets in aid-dependent countries. Improved collaboration between the Bank and the Fund can also be promoted through more systematic sharing of information and work plans, and through more frequent cross-participation in missions. It should be recognized, however, that even significantly enhanced collaboration between the Fund and the Bank would not ensure substantial progress on expenditure reform in the absence of adequate government commitment.

The paper proposes a new framework for support to countries and more effective collaboration among development partners on public expenditure work anchored on the following key principles: (a) government articulation of a public expenditure reform strategy in PRSPs or other country-owned documents; (b) an integrated and well-sequenced program of diagnostic work by development partners; (c) well-coordinated technical and financial support from development partners for implementation of the countries' public expenditure reform strategies; and (d) periodic reporting by countries of performance in public expenditure policy, financial management and procurement.

Consistent with the 2002 guidelines on Bank/Fund collaboration, the new framework calls for early consultation of country teams on work plans; communication of needs for expenditure work between the two institutions; formalization of the exchange of information on mission planning between the Bank and the Fund; increased cross-participation in

missions; strengthened collaboration on fiscal Reports on Standards and Codes (ROSCs) and Country Financial Accountability Assessments (CFAAs), including the sharing of databases; more systematic sharing of draft technical assistance reports and analytical work for review and comment; and improved information sharing with external partners. The Bank and the Fund also agree not to initiate any new public expenditure diagnostic instruments, pending review of experience under the proposed new framework. In addition, diagnostic work will be better coordinated among donors through the development of a modular approach that can be adapted to the specific needs of each country. More broadly, the proposed framework enables stronger collaboration among development partners in support of a country-led reform strategy.

The Bank is moving to further strengthen its public expenditure work to help facilitate implementation of the proposed new framework. The key elements include the consolidation of overlapping diagnostics through development of the modular approach and a medium-term work plan on public expenditure analysis and support (PEAS) in the country assistance strategy (CAS) to ensure coordinated cross-network support for governments' strategies for public expenditure reform. On the part of the Fund, the planning of FAD's technical assistance will be improved by the sharing of work plans with the Bank and further development of country-specific strategies for technical assistance.

In reviewing this paper, Executive Directors may wish to consider the following issues:

- a. Do Directors broadly agree with staff on the lessons learned from the experiences with collaboration?
- b. Do Directors support the proposed framework for strengthening Bank/Fund collaboration on public expenditure issues?
- c. Will the proposed framework adequately enhance collaboration among development partners and will it facilitate country-led public expenditure work?
- d. Do Directors agree to the publication of this paper?

## I. Introduction

1. **The Monterrey summit of 2002 proposed a new partnership based on mutual responsibility and accountability between developed and developing countries in support of sound policies, good governance and the rule of law.**<sup>1</sup> The summit emphasized the principle that each country has primary responsibility for its own economic and social development. Consistent with this principle of country ownership, the summit endorsed the role of the Fund and the Bank in enhancing participation to achieve the development goals of sustained economic growth, poverty reduction and sustainable development through the Comprehensive Development Framework (CDF) and Poverty Reduction Strategy Papers (PRSP). More recently, the Development Committee of the Bank and the Fund indicated that the two institutions would scale up and intensify their efforts in assisting countries to mobilize domestic resources and improve the quality of public expenditure.<sup>2</sup>

2. This paper begins with a discussion of the mandates of the Bank and Fund and of the general principles that have guided the division of labor and responsibility for public expenditure work (Section II). Section III reports on a survey of senior government officials, Bank and Fund staff, and donor representatives regarding their perceptions of Bank/Fund collaboration. Section IV describes the experience of collaboration and derives lessons for improving its effectiveness. Drawing on the results of the preceding analysis, Section V proposes a new framework for collaboration consistent with country ownership, recent guidelines on Bank/Fund collaboration, and the periodic country reporting on progress in strengthening public expenditure management.

## II. Mandates, Primary Responsibilities, and Protocols for Collaboration

3. **The role of the Bank and the Fund in country program design and policy advice is governed by their respective mandates.** The IMF's Articles of Agreement entrust it with the mandate to promote macroeconomic stability of its members and financial stability at the international level. The Bank's Articles of Agreement give it a mandate to promote economic development, increase productivity, and thus raise the standard of living of the less developed areas of the world.

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<sup>1</sup> See *Report of the International Conference on Financing for Development*, Monterrey, Mexico (United Nations, A/CONF.198/11), March 18-22, 2002.

<sup>2</sup> *Development Committee Communique*, April 21, 2002. See also *Financing for Development: Implementing the Monterrey Consensus*, Joint IMF-World Bank report to the Development Committee, April 12, 2002.

4. **To address the growing overlap created by Bank and Fund structural adjustment programs during the 1980s, the 1989 Concordat provided specific guidance on the division of activities between the institutions on the basis of their primary responsibilities.**<sup>3</sup> The Fund's primary responsibilities were defined to include aggregate aspects of macroeconomic policy and their related instruments including public sector spending and revenues; aggregate wage and price policies; money and credit; interest rates; and the exchange rate. Correspondingly, the Bank's primary responsibilities were defined to include development strategies; sector project investments; structural adjustment programs; policies which deal with the efficient allocation of resources in both public and private sectors; priorities in government expenditures; reforms of administrative systems, production, trade and financial sectors; the restructuring of public enterprises; and sector policies. The Concordat emphasized that the Bank and Fund must both be allowed to explore their legitimate concerns with regard to macroeconomic and structural issues, but that each institution should rely as much as possible on analyses and monitoring of the other institution in areas where it does not have primary responsibility. The Concordat called for regular meetings of the senior staff of each institution at the regional level; systematic exchanges of information on future country work; ad hoc study groups to examine analytical issues arising in common work; collaboration where members have overdue obligations to one or both institutions; and an exchange of staff on 2- to 3-year secondments to enhance mutual understanding.

5. **Specific guidelines for the coordination of work on public expenditure were issued by the two managements in 1995.**<sup>4</sup> Collaboration was to proceed through a number of channels. In particular, the guidelines proposed a framework of annual reviews by the staff to establish and coordinate work priorities and programs on public expenditure issues.<sup>5</sup> The guidelines envisaged regular exchanges of information between staff to ensure consistency of policy advice on public expenditure issues and macroeconomic policy, and laid down procedures for coordination of work on analytical issues.

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<sup>3</sup> The "Concordat" refers to the joint memorandum from the President of the World Bank and the Managing Director of the Fund entitled *Bank/Fund Collaboration in Assisting Member Countries* (SM/89/54, Revision 1 and R89-45), March 31, 1989.

<sup>4</sup> See *Bank/Fund Collaboration on Public Expenditure Work* (EBD/95/123), September 7, 1995. See also *Note on Bank/Fund Collaboration in Public Expenditure Work* (SM/99/16), January 22, 1999.

<sup>5</sup> Specific steps for collaboration include the following: "Each year, regional and area department senior staff will meet to review the experience with previous efforts and discuss priority countries and issues for public expenditure work;" "For each country for which public expenditure issues have been identified to be of priority importance in these meetings, the regional and area department staffs of the two institutions will meet to discuss and agree a specific work program and record the results"; and "...during the course of the year, Fund staff might request from Bank staff the preparation of short notes distilling the main results of existing public expenditure work and Bank staff may ask the Fund's country economists to provide the most recent fiscal projections, including the macroeconomic assumptions on which they are based."

6. **In 1998, a joint memorandum of the Managing Director of the Fund and the President of the Bank reaffirmed the responsibilities of the Bank and Fund in public sector reforms.**<sup>6</sup> The Bank was to have primary responsibility for public enterprise reform, the composition and efficiency of public expenditure, the environment, social protection, and administrative and civil service reform. The Fund's primary responsibilities encompassed aggregate aspects of public sector spending and revenue.<sup>7</sup> The memorandum noted that the Fund had provided "extensive advice on public expenditure management (PEM), including in support of the Bank's work." It identified tax policy and administration as an area of overlap together with issues in transparency, governance, corruption, legislative reform, trade policy, and debt. New areas of work identified as being the Bank's primary responsibility included corporate sector and judicial reforms, the environment, and social protection and development. Three principles were identified as *central* to strengthening collaborative arrangements: clarity as to which institution has primary responsibility in particular areas of reform, full prior consultation on key elements of a country's policies and reform agenda, and the accountability of each institution to its Executive Board for its own lending decisions.

7. **In 2000, the President of the Bank and the Managing Director of the Fund issued a joint statement on Fund/Bank partnership based on complementarities of the two institutions.**<sup>8</sup> The statement affirmed the common objectives and guiding principles, reaffirmed the core responsibilities of the Fund and the Bank and noted that, to be most effective, each institution needs to focus on its respective core tasks while working together in a complementary fashion in areas – such as the financial sector – where responsibilities overlap. In crisis situations, the Fund is expected to take the lead in negotiating an overall stabilization and reform program with a country. At the same time, the Bank should take the lead in the design of those structural parts of the program that fall within its area of responsibility.

8. **The 2002 guidelines proposed a strengthened framework for Bank/Fund collaboration.**<sup>9</sup> Two key elements of this framework are (i) early engagement between the staff of the two institutions in program design and country assistance strategies and (ii) transparent and systematic reporting of each institution's views in Board documents. In order to clarify the delineation of responsibilities, improve accountability, and increase transparency, the guidelines proposed explicit introduction of the "lead agency" concept. Under this approach, the Fund and Bank staff would agree on their assistance to countries in identifying key reform priorities, a division of responsibilities (a lead agency for each area),

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<sup>6</sup> See *Report of the Managing Director and the President on Bank-Fund Collaboration* (SecM98-733), September 4, 1998.

<sup>7</sup> For an examination of how the Fund's technical assistance is aligned with these responsibilities, see Annex 2 and *Ensuring Alignment of Technical Assistance with the IMF's Policy Priorities* (SM/00/284), December 20, 2000.

<sup>8</sup> See *The IMF and the World Bank Group: An Enhanced Partnership for Sustainable Growth and Poverty Reduction*, Joint Statement by Horst Köhler, Managing Director and James Wolfensohn, President (SecM2000-536), September 5, 2000.

<sup>9</sup> See *Operationalizing Bank/Fund Collaboration in Country Programs and Conditionality: Staff Guidance Note in Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality - Progress Report* (SM/02/271), August 20, 2002.

areas of future work, and mutual work commitments. In designating the lead agencies, teams are to be guided by the division of labor set out in the 1989 concordat and the 1998 joint memorandum. The guidelines do not indicate that the lead agency concept is applicable to areas of shared responsibility.

9. **The expansion of activities in public expenditure work in recent years reinforces the need for improved Bank/Fund collaboration.** First, the scope of work in public expenditure has significantly expanded to address a broader range of institutional issues, from policy and budget formulation, through budget execution and accountability, to service delivery and development impact. Second, the creation of new diagnostic instruments in the Fund and Bank and other agencies (e.g., CFAAs, Public Expenditure Tracking Surveys (PETS), ROSCs, and EU audits) has created new areas of overlap. Third, the decentralization of the Bank has posed new logistical challenges for Fund/Bank coordination. Fourth, and most importantly, the shift to the Comprehensive Development Framework (CDF) and PRSP approaches based on country ownership has underlined the need to update the old protocol and its narrow focus on Bank/Fund coordination, which largely excluded the perspectives of the country authorities and other donors.

### III. A Survey of Stakeholders: Findings and Implications

10. **A survey of key stakeholders' views on the effectiveness of Fund/Bank collaboration in the public expenditure area was undertaken, with a view to more firmly ground recommendations for improved collaboration.** The survey covered senior government representatives in ministries of finance in 83 countries, Bank and Fund staff engaged in public expenditure work on these countries, and representatives of 26 development agencies active in public expenditure work.<sup>10</sup> The survey sought to identify perceptions of effectiveness with regard to distinct functional areas of public expenditure work, as well as specific aspects of collaboration. The universe included 47 PRSP countries and 36 non-PRSP countries.

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<sup>10</sup> See Annex 3 for further details on the survey.

11. **All four stakeholder groups rated effectiveness of collaboration between “adequate” and “effective,” suggesting that there is scope for improvement. A five-point rating scale was used for the questionnaire.** Overall, collaboration was ranked highest by government officials and lowest by donor agencies, although the differences were modest (Figure 1). Roughly the same proportion of both governments and staff surveyed agree that problems of collaboration are reducing the effectiveness of the public expenditure advice of the Bank and the Fund (Figure 2). The standard deviation for responses was also sizeable for most questions (0.9 on a scale of 1 to 5 – see Annex 3), indicating considerable variation in the perceived effectiveness of collaboration.

12. **Collaboration practices tend to be stronger in PRSP countries.**<sup>11</sup> For example, a multi-year joint public expenditure work program is almost 50 percent more likely to exist in PRSP countries. Such a program is also more likely to be discussed and agreed with the government, be synchronized with the government’s budget cycle, feature cross-agency participation, and complement the contributions of other development partners. This mirrors the perceived strengthening of cooperation in program design indicated in the recent survey of country authorities with Poverty Reduction and Growth Facility (PRGF)-supported programs.<sup>12</sup>

13. **There are differences in perceptions regarding Bank/Fund collaboration in different regions.**<sup>13</sup> Bank and Fund staff indicate that collaboration is most effective in the South Asia (SA) and East Asia and Pacific (EAP) regions. Governments rank collaboration as working best in Africa (3.7 on a 5 point scale). Procedures for collaboration also vary across regions. For example, 71 percent of EAP staff refer to the existence of a joint Bank/Fund program for public expenditure work. In contrast, only 29 percent of the staff as a whole mention such programs.

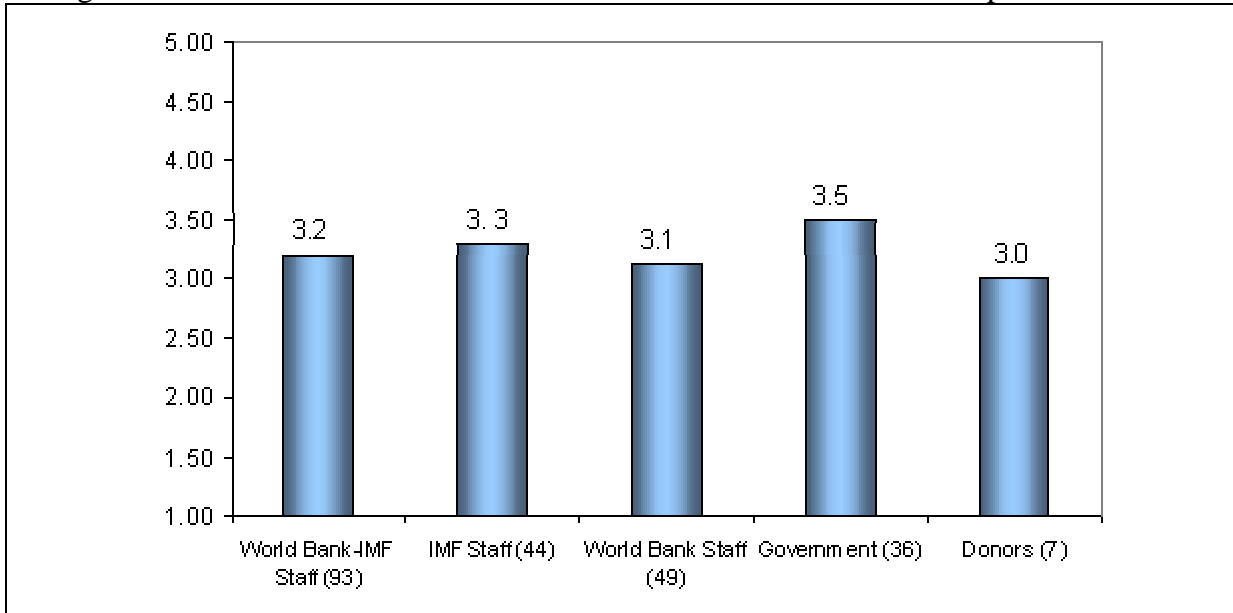
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<sup>11</sup> However, both indices measuring the perceptions of government and staff of the overall effectiveness of collaboration in PRSP countries were equal to the overall sample averages.

<sup>12</sup> See survey results reported in Appendix II of S. Gupta and others, *Is the PRGF Living Up to Expectations? An Assessment of Program Design* (IMF Occasional Paper No. 216), September 26, 2002.

<sup>13</sup> For staff as a whole, the overall index of collaboration was rated (out of a scale of 1 through 5) as 3.2 in Africa (based on 32 responses); 3.1 in Europe and Central Asia (30 responses); Latin America and the Caribbean (14 responses); 3.9 in East Asia and the Pacific (7 responses); 2.6 in Middle East and North Africa (7 responses); and 4.3 in South Asia (3 responses). Some caution should be used in comparing results across regions, given the small sample size in some regions.

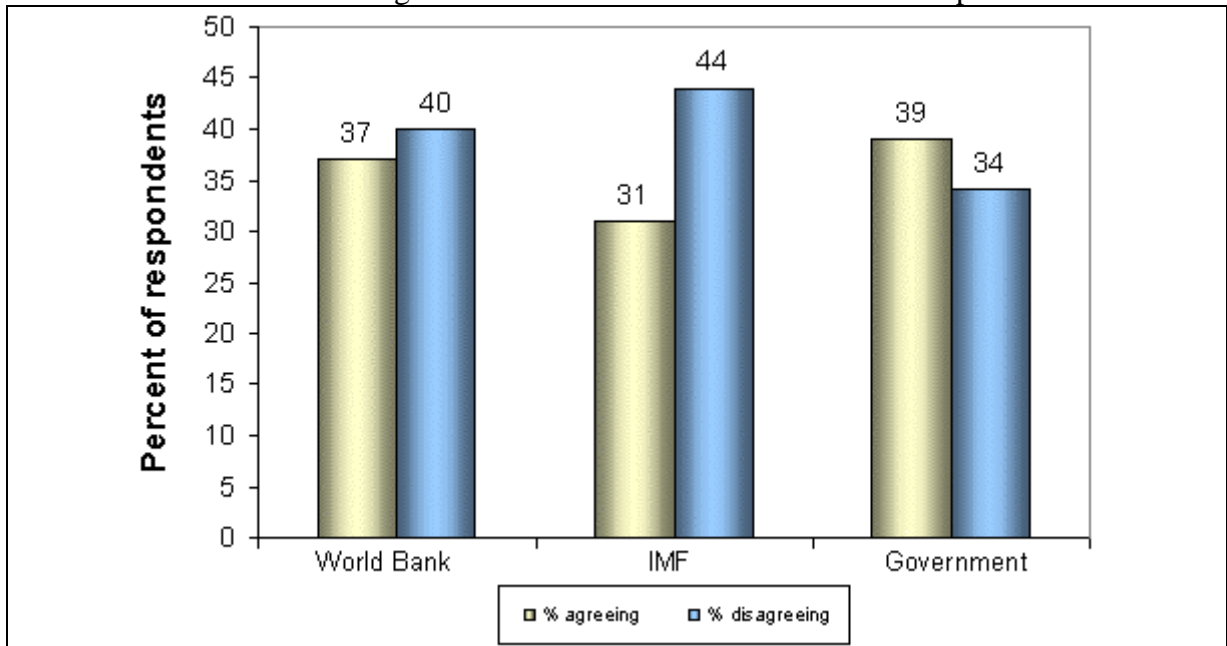
Figure 1: Overall Effectiveness of Bank/Fund Collaboration in Public Expenditure Work



Source: Survey results.

Note: Figures refer to mean value for responses to query asking respondents to evaluate. The overall effectiveness of Fund/Bank collaboration on expenditure issues, based on a scale of 1-5 in which 1=very ineffective; 2 = ineffective; 3 = adequate; 4 = effective; and 5 = very effective. Figures in parentheses refer to number of respondents in each category.

Figure 2: Percent of Respondents who Agree or Disagree that Problems with Collaboration are Reducing the Effectiveness of Bank/Fund Public Expenditure Advice



Source: Survey results.

Note: Numbers above do not add to 100 because responses of “neither agree nor disagree” are not included.

14. **Governments tended to view the Bank and Fund as pursuing common objectives and sharing information well.** There was also agreement that a clear division of labor existed between the Bank and Fund, and that there was not much duplication of advice. Officials indicated there was considerable scope, however, for better timing of Bank and Fund missions in order to reduce the burden on country authorities – a theme also echoed in responses to the staff survey.

15. **A more extensive statistical assessment of staff responses underscored the importance of specific functional areas and procedures for improved collaboration.** A multivariate regression analysis indicated that improving coordination on short-term expenditure prioritization, fiscal transparency and financial accountability would have, *ceteris paribus*, the largest effects on overall perceived effectiveness of Bank/Fund collaboration.<sup>14</sup> Other areas that had a statistically significant influence on overall staff perceptions were the fiscal framework and budget execution. The statistical assessment also indicated that improving collaboration on mission scheduling and information sharing would have a positive impact on the perceived effectiveness of collaboration.

16. **The survey results suggest a number of areas where collaboration could be strengthened.** In particular, the results underscore the need to better coordinate work on short-term expenditure prioritization, and on fiscal transparency and financial accountability; to plan missions better so as to reduce the burden on authorities; and to more widely disseminate the best practices of some regions. The relatively low scores from donors also suggests the need to further strengthen the collaboration with them on country-led reform strategies. Specific suggestions reflecting these findings are delineated in Section V.

#### IV. Experiences with Collaboration

17. **This section reviews a number of different experiences in Bank/Fund collaboration, with a view to distilling key lessons for improving such collaboration.** It begins with an overview of the institutional factors that shape Fund/Bank collaboration, followed by a review of experience in collaboration on specific issues and country groups. Some case studies in collaboration are also reviewed, as well as collaboration with other agencies. Finally, it concludes with an assessment of the lessons learned.

##### A. Institutional Factors Shaping Collaboration

18. **The differing mandates and time horizons of the Bank and the Fund provide complementary perspectives but require greater effort at collaboration.** The focus of the Fund on helping countries achieve macrofiscal stability – especially over the short run and during crises – can, at times, be at odds with the Bank’s objective of helping build institutions and country ownership. For example, the need to control public spending in the short term to secure macroeconomic stability may require fiscal measures and changes in public expenditure management that need to be carefully coordinated with longer-term reforms in the same areas.

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<sup>14</sup> Additional details on this analysis are reported in Annex 3. Given the requirements of sample size for multivariate analysis, a similar exercise for government or donor responses was not feasible.

19. **Differences in organizational structure also influence Fund/Bank interaction on public expenditure work.**<sup>15</sup> Fund expertise and decision-making is concentrated in the Fund's Fiscal Affairs Department (FAD) in Washington, while public expenditure work in the Bank is undertaken by staff in the regions under country directors in the field. This difference in structure may have hindered the implementation of the 1995 guidelines on collaboration.

### **B. Public Expenditure Policy**

20. **Surveys of Bank and Fund staff conducted over the period from 1995-2000 indicate that work programs in public expenditure policy were frequently not well coordinated.** Fund staff reported that the majority of their requests to the Bank for public sector work with respect to comprehensive public expenditure reviews and analyses of public investment, subsidies, wage policy, and civil service reform were not met. From the Bank's perspective, comprehensive public expenditure reviews (PERs) were seen as resource intensive and inconsistent with a shift toward government-led PERs. The gap also reflected the fact that the Bank's work was oriented toward the needs and requests of member countries, rather than the specific needs of Fund-supported programs. In some cases, Fund requests were made at short notice and could not be integrated into the Bank's work program.

21. **In the design of fiscal frameworks in country programs, differences can sometimes arise between the Bank and the Fund on the appropriate level of aggregate spending and the related size of the fiscal deficit, an area of Fund primary responsibility.** This can reflect not only a tension between the objectives of short-term stability and long-term development, but also differing views on what is necessary to achieve growth and macroeconomic stability over the longer term. For example, in Ethiopia, the Bank and a large number of donors have participated with the government in a series of annual PERs that have, over time, covered public expenditure issues at both the federal and the regional levels. Bank/Fund collaboration in countries like Ethiopia has included mission participation and contributions by Fund staff on the macrofiscal section of the PER. Nevertheless, in some instances, Bank and Fund staff initially disagreed on the appropriate deficit level, with the Bank arguing for a larger deficit on the basis of the growth potential of the additional public expenditure, while the Fund felt that such deficits would threaten debt sustainability. In most such cases, established channels of communication and dialogue between the two institutions facilitated eventual agreement on the appropriate fiscal stance.<sup>16</sup>

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<sup>15</sup> See Annexes 1 and 2.

<sup>16</sup> Under a PRGF-supported program, fiscal flexibility implies that fiscal targets should be designed so as to accommodate higher public expenditure in support of poverty reduction, provided this is consistent with a sound macroeconomic framework. For more details, see S. Gupta and others, *op. cit.*, September 26, 2002.

22. **As regards expenditure prioritization, in establishing the aggregate spending limit for the budget as part of program negotiations, Fund staff often have requested the Bank to provide a view on the composition of expenditures, which is the Bank's primary responsibility.** In some cases, the Bank provided policy notes derived from its ongoing work to support government efforts to rationalize spending. In many cases, however, the Bank did not consider such analysis, which would have to be undertaken annually to be current, as a priority or consistent with its longer-term, country-oriented approach that builds government capacity for its own public expenditure review. In a few cases, when no Bank PER was available or planned in the near future (e.g., Azerbaijan, Kyrgyz Republic, and Moldova), the authorities requested from the Fund's FAD an analysis of options for short-term expenditure rationalization. Such analyses typically have drawn on studies by the Bank and other development partners that focused on medium-term issues. In one instance, in response to a request from the authorities, the Fund undertook a mission to assess options for short-term expenditure rationalization shortly after a PER was completed jointly by the government and the Bank which reviewed expenditure policy and composition in a number of key sectors. The Bank staff saw the Fund's technical assistance as largely redundant, whereas the Fund felt that it provided the necessary quantification for short-term expenditure measures.<sup>17</sup>

23. **More generally, Fund-supported programs often incorporate expenditure measures without input from the Bank.** In this sense, the Fund has de facto played a role in advising countries on the composition of expenditure. These cases illustrate that, on occasion, there has been an unavoidable blurring of primary responsibility for the fiscal framework and expenditure prioritization between the two institutions.

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<sup>17</sup> The need for greater quantification of policy recommendations arising from the Bank's public expenditure work – with a view to facilitating their incorporation into the budget – has been recognized in the Bank's internal review of PERs. See *The Impact of Public Expenditure Reviews: An Evaluation* (Report No. 18573), Operations Evaluation Department, World Bank, November 13, 1998.

**Box 1: Bank and Fund Collaboration on Civil Service Reforms and Pension Reforms**

As noted in Section II, the Bank has the mandate and principal responsibility for administrative and civil service reform. Civil service reforms are often a key aspect of long-term expenditure rationalization supported by both institutions. Consistent with its lead role in this area, Bank operations over FY1999-01 included 62 projects with civil service components. Forty percent of PRGF-supported programs in 2000 included civil service reform measures as benchmarks or performance criteria.

The timing and sequencing of reforms in Bank- and Fund-supported programs, however, have not always been made explicit. Conflicts, when they have occurred, have reflected the absence of an articulated country strategy for the short and the medium term by the two institutions. This has made it difficult for governments to determine whether the Bank and the Fund are providing consistent advice. Timing inconsistencies of macrofiscal and structural reforms reflect the different time horizons of the programs supported by the two institutions. In some cases, short-term macroeconomic objectives have run counter to longer-term structural reforms.

Efforts to further strengthen collaboration in this area included a joint Bank/Fund workshop held in September 2001. The workshop identified six principles to guide collaboration between the Bank and the Fund on civil service reforms.<sup>18</sup> These are: (i) selectivity and consistency of objectives; (ii) placing civil service reforms in the context of a medium-term framework that incorporates the fiscal impact of the reform; (iii) fostering national ownership by making reforms politically feasible; (iv) focusing and streamlining conditionality, especially through the identification of the lead agency for each reform measure; (v) reaching agreement on sequencing and timing of reforms; and (vi) strengthening data collection.

Four principal lessons emerge from the enhanced collaboration on civil service issues piloted in six focus countries in 2002: (i) a civil service reform should be integrated into a medium-term expenditure framework to be effective; (ii) Bank and Fund staff need to agree explicitly on objectives, timing, and sequencing of reforms at an early stage; (iii) country ownership of reforms is strengthened through dialogue with stakeholders; and (iv) current efforts to streamline conditionality are beginning to have the desired impact and need to be sustained.

The Bank has taken the lead on pension reform, with the Fund complementing this assistance in a limited number of cases. Consistent with the guidelines on technical assistance priorities endorsed by the Board (SM/00/284), the Fund has focused its efforts on helping member countries assess and strengthen the macrofiscal sustainability of social security systems, including in the short run. On a more limited basis, the Fund has also provided advice on the design of pensions systems, but only in the absence of Bank involvement. In either case, the assistance is carefully coordinated with the Bank. Where the Bank is providing advice on structural reforms, the shorter-term policy measures of the Fund are designed to facilitate the implementation of these reforms. Close collaboration is often ensured by cross-participation by Bank staff in Fund missions that address pension issues.

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<sup>18</sup> See *Civil Service Reform: Strengthening World Bank and IMF Collaboration*, The World Bank (Report No. 22494), June 30, 2002.

## C. Public Expenditure Management

### **Budget Formulation: Design and Implementation of a Medium-Term Expenditure Framework (MTEF)**

24. **An effective MTEF enables governments to link policy objectives to budget formulation and execution.**<sup>19</sup> By enabling informed debate on the costs of policies within a realistic, predictable, and well-defined medium-term budgetary constraint, the MTEF contributes to fiscal discipline and clarifies the choices and the need for policymakers to prioritize policies, for instance, in the context of its poverty reduction strategy. The MTEF requires, and is not a substitute for, the fundamentals of good budgeting, including: comprehensive coverage, appropriate classification of expenditure, a functioning treasury system, effective internal controls, and timely reporting.<sup>20</sup>

25. **The Bank has taken the lead in supporting the design and implementation of MTEFs** although collaboration with the Fund remains important with regard to the aggregate fiscal framework. During FY 2000-02, the Bank undertook 64 lending operations in 41 countries that included the implementation of an MTEF as a central aspect of budget reform.<sup>21</sup>

26. **As governments take the lead in managing their budgets, greater effort is required on the part of the Fund, Bank, and other donors to support and enhance government-led processes necessary for an MTEF.** There is mixed evidence on how well this process is unfolding. In Tanzania, the Bank, Fund, and other donors support a government-led, annual PER/MTEF process that includes participation by the central and sector ministries and NGOs. The government's PER working group prepares an annual work program early in the fiscal year which is then supported by all development partners in line with the timetable for preparing the budget. The Fund has participated in the annual PER consultative meetings and in the working group's deliberations on macrofiscal issues through its resident representative, contributing to earlier convergence of the government, Fund, and Bank positions. Nevertheless, frequent revisions to the fiscal framework (owing to changes in the external environment and donor financing) close to the deadlines for finalizing the budget make it difficult to align sectoral spending plans agreed by the working group with the macrofiscal framework. On the other hand, in Albania, the Government's MTEF framework for 2003-05 was originally much more optimistic (on growth and revenues) than that of the Fund, but the differences were reconciled for the 2003 Fund-supported program, with the

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<sup>19</sup> See Chapter 6 on Public Spending in *A Sourcebook for Poverty Reduction Strategies, Volume 1: Core Techniques and Cross-Cutting Issues*, pp. 189-232, The World Bank, 2002.

<sup>20</sup> See *Poverty Reduction Strategy Papers: Progress in Implementation* (IDA/SecM2002-0453), August 9, 2002.

<sup>21</sup> The bulk of these operations were in AFR (34), but all regions featured such support including ECA (13), SAR (7), LAC (5), EAP (3), and MENA (2). MTEF-related actions were included in a variety of operations including Poverty Reduction Support Credits (PRSC) and loans and credits for structural adjustment, investment, and technical assistance. In a few countries, the operation was exclusively focused on public expenditure reforms, as with the Public Expenditure Reform Loan to Mauritius and the Public Expenditure Adjustment credits to Benin and Niger. In a number of cases, sector-specific operations in health or education included commitments relevant to the development of the MTEF.

Bank providing input on sectoral priorities for the budget. For many low-income countries, the unpredictability of donor resource flows is a major problem for establishing a credible MTEF. Improved donor coordination and more stable donor financial commitments would help mitigate this problem. From the standpoint of the Bank and the Fund, scheduling missions in line with the government budget timetable would contribute to helping countries align sectoral spending plans with the macrofiscal framework delineated in their MTEF.

### **Budget Execution: Design and Implementation of Treasury Systems**

27. **Both the Bank and the Fund have an active interest in effective budget execution in member countries.** A well-functioning treasury system aids budget execution by enabling a government to control and optimize its cash flow, make payments, and manage its debt. Also important for effective budget execution is the existence of financial management information systems (FMISs), which can generate real-time data on revenue collection and expenditure. In light of these considerations, Bank and Fund staff have actively collaborated in the development of the Treasury Reference Model as well as the design and implementation of FMISs in a number of countries.<sup>22</sup>

28. **At the operational level, Fund and Bank roles in treasury development tend to reinforce one another.** The Fund has concentrated on design of treasury systems for commitment control, monthly budget reporting, and short-run cash management, consistent with its focus on short-run macrofiscal management. Over the last ten years, the Fund has provided advice on treasury modernization to more than 50 countries and has taken the lead in designing treasuries in countries emerging from crisis such as Bosnia-Herzegovina, East Timor, Kosovo, and Afghanistan. The Bank, with a medium-term development focus, has been the primary vehicle for introducing and financing treasury projects, while both the Bank and the Fund have played a role in initial design. Since the late 1980s, the Bank has funded 34 FMIS projects as part of larger government reforms or as stand-alone projects in more than 27 countries, with lending totaling \$1.1 billion. The 34 projects include 15 in the LAC region, 7 in ECA, 6 in Africa, 3 in EAP, 2 in MENA, and one in SAR.

29. **The Fund and Bank have collaborated successfully in several countries.** In Kazakhstan, the government introduced a comprehensive and efficient treasury system and a state-of-the-art FMIS. Both the Bank and Fund contributed to the development of the modernization strategy, as well as providing ongoing support. In Russia, the Fund and the Bank were actively involved in the reform strategy and the functional and institutional design of the treasury, with ongoing assistance on implementation provided by the Bank. In a number of cases, Fund resident advisors and Bank staff played pivotal roles in coordinating activities between the two institutions. Key elements of successful collaboration included early agreement on the strategy, clear delineation of responsibilities prior to reform initiation, and regular, informal consultations by the regions, area departments, and FAD on treasury projects.

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<sup>22</sup> Hashim, Ali and William Allan, *Treasury Reference Model*, The World Bank, Washington, D.C., June 2000.

30. **In Africa, collaboration has been hampered at times by difficulties in coordinating the Fund's short-term objectives for strengthening budget execution with the Bank's medium-term reforms for expenditure management (e.g., Ghana, Malawi).**

In part, these problems arose because reform projects were initially designed by each institution without adequately taking into account the activities of the other. In Uganda, successful collaboration on PEM would have been enhanced by better synchronization of the Fund's technical assistance and the Bank's FMIS project. In Zambia, the cash budgeting system, introduced with Fund assistance, helped control the overall level of public expenditures, but owing in part to conflicting spending priorities by the authorities, a result was shortfalls in social and project spending of concern to the Bank. In each of these cases, collaboration problems were ultimately resolved, but could have been avoided through earlier and closer consultation to achieve a better balance between short- and medium-term objectives.

31. **There are some instances in which collaboration problems have reflected differences in viewpoint on strategy or sequencing of reforms.** In Mongolia, the Bank's experts initially supported an Asian Development Bank (ADB) proposal that the authorities delegate financial authority to line ministries and manage resources through output budgets whereas Fund experts argued that more basic treasury reforms were a priority to ensure financial compliance and regain effective fiscal control. Ultimately this disagreement was resolved by dialogue among the authorities, the ADB, the Fund, and the Bank, which resulted in a plan of reform that would accommodate both a strengthening of the treasury and delegation of some financial management responsibilities to line ministries. In Azerbaijan, the Bank supported a government request for an automated interim treasury system and sought to leverage client ownership into budget procedure reform. The Fund recommended budget procedure reform prior to automation. Strategy differences were resolved through discussions between the authorities, Fund, and Bank, leading to a decision to delay those aspects of automation that would interfere with procedural reforms.

32. **The PRSP process and the design of action plans to strengthen capacity to track poverty-reducing spending in HIPCs has helped some countries improve donor coordination.** These country-led processes have provided a forum for coordinating the government's short- and medium-term PEM reforms and the intended roles of each donor. Cross-participation in technical assistance by field-based staff has also been useful in resolving collaboration problems. In Ghana, for example, the Fund's resident budget advisor is advising on the implementation of the government's FMIS project, which is financed by the Bank. Bank and Fund teams are working with local authorities in other African countries on FMIS projects (Malawi, Niger, Tanzania, Uganda, and Zambia).

#### **D. Fiscal Transparency and Financial Accountability**

33. **Both the Fund and the Bank responded with new instruments to the financial crises of the late 1990s.** The Fund established the fiscal module of the ROSC to address a range of issues related to fiscal transparency. In response to concerns about fiduciary risk, the Bank introduced the CFAA in FY00 to assess financial accountability among its borrowers. As of end-October 2002, 45 fiscal ROSCs had been completed and posted on its website by the Fund, of which 8 were for advanced economies, 15 for emerging market economies, 7 for transition economies, and 15 for developing economies. The cumulative number of CFAAs completed has increased from 10 in FY2001 to 30 at end-FY2002, with most being undertaken for countries receiving adjustment or PRS credits. About 18 to 20 ROSCs and 20 CFAAs a year are envisaged over the near future.

34. **While there is potential synergy between these two instruments, the experience of collaboration on the fiscal ROSC and CFAA is mixed.** In general, there is greater scope for information sharing. In some instances, the work of both institutions would have been enhanced through prior consultations on mission planning and mutual peer review of reports. Positive examples of collaboration include cross-participation by Bank staff in fiscal ROSC missions (e.g., Bangladesh) and utilization of the results generated by the other institutions' relevant work (e.g., Pakistan and Peru).

#### **E. Case Studies of Collaboration**

##### **Low-Income Countries: Strengthening HIPC Capacity to Track Poverty-Reducing Spending**

35. **In 2000, the Boards of the Bank and the Fund requested staff of both institutions to assess how poverty-reducing spending would be tracked in a group of low-income countries benefiting from the Enhanced HIPC Initiative.** In response, Bank (Poverty Reduction and Economic Management (PREM)) and Fund (FAD) staff developed and applied an instrument for assessing public expenditure systems in HIPCs, as summarized in two subsequent Board papers.<sup>23</sup> During 2001-2002, for the latter Board paper, the Bank (through PREM) and the Fund (through FAD) managed a shared mission schedule to 24 HIPCs. PREM and FAD led the conceptual work, resulting in the assessment instrument and its distillation to 15 key indicators of PEM performance. FAD and PREM also served as focal points for the work, helped coordinate joint missions where feasible, provided quality assurance of reports and advice to country teams, analyzed results, and drafted the Board papers. To share the scheduling task, the Bank and Fund split the lead in organizing field assessments. Bank and FAD country teams worked together to schedule missions, and conducted joint missions where possible.

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<sup>23</sup> The two papers are *Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs) Revision 1* (IMF SM/01/16), March 28, 2001 and (IDA\SECM2001-51\1), March 30, 2001, and *Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs) Revision 2* (IDA/SECM2002-30/2), World Bank March 22, 2002, and (IMF SM/O2/30), March 28, 2002.

36. **The Fund and Bank organized their efforts quite differently, illustrating the different degrees of decentralization of the two institutions. Bank missions were carried out by country teams.** Fund missions were done by FAD. The Bank folded the assessment exercise into ongoing country work, by undertaking the missions as part of PERs or other planned country activities. Some of the Fund-led missions also prepared fiscal ROSCs for the relevant countries. Despite the differing organization of missions, the two institutions completed 24 of the planned 25 assessments for the Board paper. The value of this assessment exercise was that it provided a commonly agreed, compact, and relatively objective basis for evaluating progress. Nevertheless, the resource costs of this undertaking were substantial for both institutions. In the Fund, for example, the exercise cost several man-years, correspondingly reducing the amount of technical assistance that could be provided to the membership to improve PEM systems.

37. **Bank and FAD country team collaboration generally went smoothly and was reflected in agreement with governments on action plans.** Some early mission coordination problems occurred. In four countries, there was initial difficulty in reaching agreement between Bank and Fund staff on the assessment. These were resolved through regional management or FAD-PREM intervention. But these cases were the exception rather than the rule, and regular FAD-PREM communication and good collaboration ensured early detection and resolution of substantive problems. Bank/Fund agreement with countries on the assessment also went smoothly. Country consultations began by sending draft assessments in advance, followed by missions which worked with the government to complete the brief assessment. The focused, factual nature of the instrument facilitated quick agreement with the governments on the assessments and remedial action plans. Bank and Fund staff are currently collaborating in producing an update for the two Boards on the status of implementation of the action plans to strengthen capacity to track poverty-reducing spending.

### **Collaboration in Selected Middle-Income Countries**

38. **In Peru, Fund/Bank collaboration has been strong, productive and wide-ranging, despite the absence of formal procedures.** Work has spanned the design of structural fiscal benchmarks in the IMF program, a PER, the preparation of the Peru Country Assistance Strategy (CAS) and Programmatic Social Reform Loan (PSRL II), and the fiscal ROSC for Peru. The PER was a joint effort with the Inter-American Development Bank (IDB) and benefited from Fund contributions in pre-agreed areas such as tax reform, debt management and sustainability analysis, and revisions to the Fiscal Prudence and Transparency Law. Collaboration extended to joint dissemination conferences on fiscal laws and fiscal discipline that were organized by the Bank, the IDB, and the Fund.

### **Box 2: Turkey: Government Leadership of Reform**

As demonstrated in Turkey, government leadership in public expenditure work can have a very positive impact on Bank/Fund collaboration and outcomes. Recognizing the need to strengthen fiscal transparency as part of their adjustment and reform program, the authorities requested a fiscal ROSC in late 1999, followed by a request to the World Bank in early 2000 for a Public Expenditure and Institutional Review (PEIR).<sup>24</sup> A Bank proposal to undertake a CFAA at the same time as the PEIR was quickly integrated into the work plan of the PEIR. The government requested that the Bank and the Fund ensure close collaboration in the two reviews to ensure a consistent analysis and set of recommendations. The two task teams from the Bank and the Fund undertook effective *ex ante* consultations regarding the coverage of issues, exchanged and mutually reviewed draft documentation, and coordinated key tasks when possible.

The government requested that the Bank assist with a “process-oriented” PEIR, despite having itself undertaken a comprehensive and critical review of the budget system. The objective was to build an internal consensus on the identification of key problems and a reform strategy. The PEIR work was coordinated by a PER working group established under the Deputy Undersecretary of the Treasury and succeeded in assisting the government to develop a PEM reform strategy that was comprehensive in its framework and which adopted a sequence of reform actions on the basis of a consensus within the government. By drawing on the expertise of Bank Financial Management (FM) staff on accounting and auditing issues, as well as the CPAR that was undertaken over this period, the PEIR provided a more integrated and institutionally robust assessment of the economic and financial aspects of budget management than a traditional PER. The PEIR also drew on the Fund’s fiscal ROSC report, which provided a valuable technical perspective on the budget system and a “road map” for its reform in Turkey. Subsequent technical support from the Bank and the Fund has been closely coordinated and complemented by assistance from the European Commission, with a view to enabling the government to meet the European Union’s (EU) financial management guidelines.

The Bank and Fund maintained their close collaboration in Turkey during the period of economic turmoil in late 2000 and early 2001, facilitating the provision of timely financial support and well-coordinated policy advice. The support of both the Fund and the Bank was based on substantive government commitments to financial and public sector reform. Based on the work of the Bank, key reforms were identified and integrated into the Bank’s Programmatic Financial and Public Sector Adjustment loan (PFPSAL). The Bank was de facto the lead agency on public expenditure issues, but close collaboration with the Fund ensured that the Bank’s views on the protection of social expenditure and safety net expenditures were integrated into the Fund-supported program. In particular, the Bank PEIR team provided policy notes on expenditure issues in key sectors to the Fund and to the government, which enabled the Fund to design a fiscal framework consistent with appropriate expenditure programs in those sectors.

39. **In Bulgaria, the reform process has been marked by strong country leadership and cooperation between donors.** Following the crisis of 1997 and subsequent establishment of the currency board, a wide-ranging program of reform of expenditure policies and the PEM system was implemented, facilitating much improved control of public expenditure. Under the guidance of the Ministry of Finance’s budget and treasury directorate, technical assistance from the Fund, Bank, EU, US Treasury, the Organisation for Economic Co-operation and Development/Support for Improvement in Governance and Management (OECD-SIGMA), and the Dutch government was well-coordinated. Fund/Bank collaboration was based on a clear division of labor on expenditure policy and PEM issues. The World Bank took the lead in expenditure policy reform, primarily in the areas of health and social

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<sup>24</sup> PERs that analyze fiscal institutions for public expenditure management are sometimes referred to as PEIRs.

security. The Fund took the lead on PEM issues and was initially focused on improving budget execution. Given its focus on expenditure policy issues, the Bank was initially not involved in PEM reforms. More recently, the Bank undertook a PER which combined analysis of both expenditure policy and PEM issues, specifically on budget formulation and internal audit, to complement the work of FAD on budget execution.

## **F. Collaboration With Other Agencies**

40. **The Bank and Fund are just two of many agencies working with countries on public expenditure issues.**<sup>25</sup> Donor responses to the survey suggest that the complementarity of Bank/Fund and other donor activities on public expenditure work could be improved. As such, it is essential that the activities of the Fund and the Bank are integrated within the larger context of donor support to enhance the effectiveness of aid and to assist countries to improve the quality of public expenditure.

41. **The Fund collaborates actively with other donors.** FAD staff and donors meet on both a bilateral and multilateral basis (e.g., through the Strategic Partnership for Africa (SPA), a consortium of bilateral and multilateral agencies). In some cases, there are formal agreements between donors and FAD for the provision of technical assistance (e.g., Cambodia). The activities of other donors are carefully considered by FAD in planning its technical assistance and evaluating specific requests. In the field, technical assistance missions and resident advisors usually meet with donors to get a full picture of technical assistance activities underway in the country. Where relevant, area department teams also meet with donors to discuss major reform projects, including on public expenditure.

42. **The Bank collaborates closely with a wide range of multilateral and bilateral agencies in undertaking the full range of public expenditure work.** Collaboration has included joint missions and report preparation as well as participation in consultative group meetings with the government to discuss findings of the joint analysis. The SPA has long provided a forum for building consensus on public expenditure issues in Africa. The African Development Bank (AfDB) participates with the Bank in public expenditure work in selected country cases, as in Tanzania. In EAP and LAC, the collaboration on public expenditure work between the Bank and the regional development banks, ADB and IDB, is extensive and covers both analytical and technical assistance work.<sup>26</sup> CFAAs in the LAC region are generally undertaken jointly with IDB. Other donor partners involved in PERs and CFAAs include the aid agencies of Norway, Sweden, and the U.K. In ECA, the European Commission (EC) is collaborating closely with the Bank and the Fund in advising a number of EU-accession countries on specific aspects of their financial management reforms in order to ensure consistency with EU norms and practices.

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<sup>25</sup> In the public expenditure management area, for example, there are 25 donors involved in aiding the HIPC.

<sup>26</sup> Examples include the integrated public expenditure, procurement and financial management report for the Philippines (with ADB, Report 24256-PH), the PER for Peru (with IDB, Report 24286-PE), and the CFAA for Tanzania (with the U.K.'s DFID).

43. **The Bank has intensified collaboration with other donors on public expenditure work to reduce the burden on countries through harmonized operations.** The Bank and other Multilateral Development Banks (MDBs) reached agreement in March 2002 on collaboration in planning, conducting, and sharing the results of CFAAs. The Organisation for Economic Co-operation and Development/Development Assistance Committee (OECD-DAC) Donor Practices Task Force recently published good practices with respect to work and performance measurement in public financial management, including collaboration on diagnostic work. The Bank and EC will meet in early 2003 to consider collaboration arrangements between the CFAA and the Commission's compliance testing review. All MDBs have agreed to use the Bank's CPAR guidelines for the purpose of country procurement reviews. This work – guided by the principle of coverage without duplication – is expected to lead to a substantial reduction in overlap and costs to borrower countries beginning in 2003.

44. **The Public Expenditure and Financial Accountability (PEFA) program also seeks to improve donor collaboration.** Established in 2001, PEFA is a partnership of the World Bank, EC, SPA, and several bilateral donors, and includes the Fund as an observer. PEFA supports integrated and harmonized approaches to assessment and reform of public expenditure, procurement, and financial accountability systems. During 2002, PEFA prepared draft studies on cases of integrated reviews; the coverage of existing diagnostic instruments; the fiduciary safeguards used by the Bank and other MDBs, the Fund, and several bilateral donors to address weaknesses in public financial management systems; and the varying approaches to defining and assessing fiduciary risk.<sup>27</sup> These studies are expected to provide the basis for further initiatives for integration and harmonization.

### G. Lessons Learned

45. **The review of experiences of collaboration suggests the following lessons:**
- a. Strong government leadership and commitment is critical to successful public expenditure reform. At the same time, good Bank/Fund collaboration cannot ensure improvement in public expenditure management systems or expenditure policies in the absence of adequate government commitment.
  - b. The articulation of a government-owned plan of expenditure reform can help guide the respective roles of the Bank, Fund, and other donors on expenditure work, and thus facilitate effective collaboration among them.
  - c. Where a government has not articulated its reform strategy, collective processes (such as the PRSP process) that enable the government to articulate a shared vision of the reform program with other development partners should be encouraged.

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<sup>27</sup> See *Integrating PER, CFAA and CPAR – Recent Country Experience*, PEFA mimeo, October 2002 and *Assessing Public Expenditure, Procurement and Financial Accountability: A Review of the Diagnostic Instruments*, PEFA mimeo, October 2002.

- d. Effective support to the government by the Bank, the Fund, and other agencies will require a clear understanding of the appropriate phasing of reforms to achieve both short-term objectives and longer-term institutional development. Early consultation among the government, Bank, Fund, and other donors is necessary to ensure the appropriate sequencing of reforms.
- e. Predictability of donor resource flows can enhance the credibility of the budget in an aid-dependent country. Timely release of donor financial assistance should help governments to improve budget management and achieve reform objectives.
- f. The provision of technical assistance by the Fund, Bank, and other donors must also be guided by government priorities and processes. Good practice is suggested by a number of countries (e.g., Albania, Bulgaria, Burkina Faso, Tanzania, and Uganda) where donors provide support to specific aspects of the government reform strategy.
- g. Good communication between Bank and Fund teams and other partners is vital for effective collaboration. Improved sharing of work schedules and work plans can also be helpful in providing each institution a fuller picture of the others' activities and the appropriate sequencing of reforms. Early sharing of technical assistance reports and analytical work (including terms of reference) will also help each institution provide well-coordinated input into countries' public expenditure reforms.
- h. Good Fund/Bank collaboration can occur even when there are overlaps in areas of responsibility. While a sharp division of responsibilities can work well in some circumstances (e.g., Bulgaria, or the role of the Bank in supporting MTEFs), in many cases, work by the Fund and Bank in both expenditure policy and expenditure management can effectively complement each other, as long as there is good communication between country teams.
- i. A country-led process of periodic and objective reporting of progress in improving systems of public expenditure and financial management is critical to sustaining domestic and external support for reform and making real improvements in the use of public resources.

## V. Proposed Framework for Strengthening Bank/Fund Collaboration on Expenditure Issues

46. **Stronger public expenditure systems are essential to help countries implement poverty reduction strategies and achieve the Millennium Development Goals (MDGs).** A strengthened framework of collaboration on expenditure issues will be instrumental in helping countries reach these objectives. It will assist country-led efforts to improve the quality of public spending and PEM systems by better coordinating the efforts of donors and international partners.

47. **Based on the lessons from experience discussed above, a framework for strengthened collaboration on public expenditures is proposed, anchored on the following key principles:**

- a. Articulation of a public expenditure reform strategy in PRSPs or other country-owned documents;
- b. An integrated, rationalized, and appropriately sequenced program of diagnostics by all development partners;
- c. Well-coordinated technical and financial support from development partners for steady implementation of countries' public expenditure reform strategies; and
- d. Periodic reporting by countries of their performance in public expenditure policies and expenditure management (including financial management, and procurement).

### A. Framework for Country-led Collaboration

48. The new framework is largely defined with a focus on low-income countries, but could be flexibly applied to middle-income countries. It would entail the following elements:

#### Low-income Countries

- a. **Articulation of a public expenditure reform strategy in PRSPs or other country-owned documents.** Good models in this regard are provided by Tanzania and Uganda, where government-led working groups collaborate with donors to develop an MTEF and to define annual public expenditure policy and management action plans that are supported by donors. These strategies could utilize the benchmarks developed by the Fund and Bank staff to help evaluate and monitor progress on public expenditure management. Countries could also disseminate their public expenditure strategies at Consultative Group (CG) meetings to catalyze donor support and facilitate coordination.
- b. **Coordinated assistance from development partners to design expenditure reform strategies.** The ability to link poverty reduction strategies to the budget and to cost and prioritize public policies is a critical yet weak link in most PRSP countries. To facilitate reforms of both expenditure policy and budgetary institutions, countries

could request assistance from their development partners (including from the Bank and/or Fund) to design a well-sequenced strategy of reforms, as they often do in formulating their PRSPs. Bank and Fund staff would also have an opportunity to comment on these plans in the context of the Joint Staff Assessment (JSA) of the PRSP.

- c. Coordinated support from development partners for implementation of the government's public expenditure reform strategy, including a lead donor agency where requested by government. The design and implementation of such a strategy should be supported through an integrated and sequenced program of diagnostics and technical and financial support. Countries with weak capacity could, at their discretion, request one of the donor institutions to take the lead role in coordinating this assistance. The decision regarding the appropriate response to such requests would still rest with each institution, consistent with available resources.
- d. **Monitoring and reporting on progress.** Reports by countries on progress in implementation of public expenditure reform could be disseminated in country documents, including their PRSP progress reports and the national budget reporting process. Countries could initially seek the assistance of the Bank, Fund, and other donors in preparing these reports, but phasing out the role of external donors and having such reports prepared by domestic oversight agencies (e.g., parliamentary commissions, supreme audit institutions or NGOs chosen by government for this purpose) would be consistent with the longer-term goal of establishing an integrated, self-regulating budget and financial management system accountable to national authorities and civil society.

### **Middle-Income Countries**

49. **Middle-income countries (MICs) represent a diverse set and pose a variety of challenges.** At one end of the range, MICs with weak institutions and limited capacity require the same kind of support and approach as low-income countries. Other MICs that have made progress in improving economic policies need to strengthen social, sectoral, and structural policies, and institutions. Many need assistance in strengthening budgetary institutions and outcomes.<sup>28</sup> Some advanced MICs attempting to reform systems of entitlement and social insurance require specialized technical and implementation assistance from the Bank. Some MICs are EU-accession countries and receive significant financial and technical assistance from the EC, EBRD, and others. This requires the Bank and Fund to consult and coordinate their activities with such donors. Others, such as Chile, the Czech Republic, South Africa, and Thailand, borrow infrequently from either the Bank or the Fund, but nevertheless, on occasion, request technical assistance from either institution.

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<sup>28</sup> Many MICs display marked weakness with regard to public sector management and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA). See Peter Fallon, et al., *Middle Income Countries: Development Challenges and Growing Global Role* (WPS 2657), World Bank, August 31, 2001.

50. **The proposed framework is flexible and consistent with the recommendations of the Bank's Task Force on Middle Income Countries.**<sup>29</sup> Countries should articulate their public expenditure reform strategies and request assistance consistent with the principles delineated above. For their part, the Bank and Fund, within their resource constraints, should respond flexibly and effectively to such requests, taking into account the different characteristics and technical needs of MICs. The effectiveness of these responses will be enhanced by early and full consultation on the proposed work.

### **B. Bank/Fund Collaboration**

51. **Collaboration between the Bank and Fund on public expenditure issues should be guided by the following principles and understandings:**

- a. The Fund should be the lead agency on the aggregate aspects of macroeconomic policy and their related instruments, including public sector spending and revenue.
- b. The Bank should be the lead agency on all issues relating to public expenditure composition and efficiency, including related areas such as public enterprise reform, administrative and civil service reform, pension reform, and social protection and development.
- c. Public expenditure management is an area of shared responsibility.
- d. In the interest of streamlining conditionality, each institution will restrict its use of conditionality to its core areas of responsibility. Early consultation between the two institutions will be used to ensure that any exceptions to this rule are identified through staff consultations. Conditionality will only be duplicated when a policy measure is critical to the success of both the Bank and Fund programs.
- e. PEM reforms often involve simultaneous efforts in all three areas of budget formulation, execution, and reporting. In practice, reforms in these areas are interlinked, so it is not practical to rigidly allocate specific responsibilities to one or the other institution.
- f. Since the Fund has to meet the needs of its entire membership, it must retain some capacity for assistance in all PEM areas. At the same time, the Fund has insufficient resources to cover any one aspect of PEM for its entire membership.

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<sup>29</sup> In proposing an approach to MICs for the World Bank, the Task Force recommended application of CDF principles of building on a country's development vision, comprehensive diagnosis, and an informed view of what others are doing. See *Report of the Task Force on the World Bank Group and the Middle Income Countries*, World Bank, 2001.

## Complementary Procedural Reforms

52. **Implementation of the framework will also be enhanced by complementary procedural reforms.** This will entail the following:

- a. **Systematic and early consultation on work plans for expenditure issues.** This will involve better sharing of plans for technical assistance between FAD and the Bank, as well as the incorporation of these plans into the dialogue between Bank and Fund country teams.
  - **Collaboration between FAD and Fund area department teams and the Bank:** FAD will discuss its work plan on expenditure issues with Fund area department country teams in the context of the Regional Technical Assistance Plan (RAP) exercise and the mid-term review of the RAP. These discussions will take into account the aggregate budgetary envelope of fiscal technical assistance allocated to each area department. They will be informed by Fiscal Strategy Briefs (FSBs) prepared by FAD staff where these are available, and by input from Bank staff and staff at the Fund's regional technical assistance centers and the Bank. Relevant Bank staff will be invited to participate in discussions of the FSB. At the same time, Bank country teams will also prepare country-specific public expenditure work plans (PEAS), which will be shared with Fund staff.
  - **Collaboration between Bank country teams and Fund area department teams:** Discussions between Fund area department teams and Bank country teams on expenditure issues will follow the protocol of the 2002 guidelines on Bank/Fund collaboration. Country teams should coordinate these discussions to be consistent with the government's budget cycle and timetable for implementation of reforms, to the extent feasible. Senior staff in the Fund's area departments and the Bank's regional departments will encourage their staff to engage in early consultation as a standard practice in Bank/Fund collaboration.
- b. **Improved communication of needs for expenditure work between the institutions.** Country team meetings can also provide a forum for communicating issues and needs for inputs from the other institution. For example, Bank staff could request early discussions on the macrofiscal framework and ask for needed inputs to design medium-term expenditure reforms. Fund staff could also request early discussions on expenditure composition issues germane to the discussion of Fund-supported programs. Such an approach could strengthen collaboration on short-term expenditure prioritization, an area where the staff survey suggests there is sizeable scope for improvement.

- c. **Formalize the exchange of information sharing on mission planning between the Bank and the Fund.** To lighten the burden on country authorities, the Bank and the Fund will periodically share information, by country, on planned tasks and missions.<sup>30</sup> In addition, draft terms of reference for technical assistance missions by FAD and analytical work by the Bank in the public expenditure area will be sent for comments to each other at the same time they are sent to other departments or regions for review and comments.<sup>31</sup> This exchange of terms of reference will provide an opportunity for each institution to share suggestions for improving the quality of its proposed work and to further update the other on recent developments in its activities in related areas.
- d. **Increase cross-participation in missions.** Cross-participation on missions will be undertaken on a more systematic basis, consistent with staff resource availability. This will be encouraged on the understanding that each institution will continue to cover the costs of its staff's travel.
- e. **Strengthen collaboration on ROSCs/CFAAs.** Each organization will draw on the work of the other to the maximum extent possible to minimize the burden on country authorities. Furthermore, CFAAs and ROSCs will each make extensive use (with appropriate citation) of work undertaken by the other institution. As standard practice, neither of the institutions would recommend to the authorities that a ROSC and a CFAA take place within a year of the other. Were the authorities to make such a request, consultations would take place between staff teams during the mission-planning phase to ensure a well-sequenced program of diagnostic work.
- f. **Share common databases from ROSCs/CFAAs.** To reduce the burden on country authorities during missions and facilitate the completion of as much work at headquarters as possible, common databases with the results of past work will be shared. This will be expected to increase the degree to which CFAA findings (and findings of other Bank tools) are incorporated into ROSCs, and vice-versa.<sup>32</sup>

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<sup>30</sup> Several steps have already been taken in this direction. Fund staff, for example, can access information on the Bank's planned missions for CFAAs and CPARs. Steps are planned to facilitate access of Bank staff to FAD's mission schedule.

<sup>31</sup> These terms of reference for FAD missions would initially be sent to the Country Director and representatives of the PREM and FM networks in the regions, while the Bank country team would have responsibility for sending their terms of reference on public expenditure work to FAD.

<sup>32</sup> Work is currently underway to develop a system to allow sharing of data derived from different diagnostic instruments, including those from CFAAs and ROSCs. The Fund has also established a database of budget and related laws for many countries, most of which have completed ROSCs. Plans are also underway to make parts of the IMF's internal Fiscal Transparency website available to Bank staff.

- g. **More systematic sharing of draft technical assistance reports and analytical work for review and comment.** FAD staff will send to the appropriate Country Director and PREM and FM anchor representatives in the Bank copies of its draft technical assistance reports at the same time they are sent to the area department for comment and review, subject to the confidentiality guidelines approved by the IMF Executive Board for distribution of technical assistance reports. The Bank will also send documents to FAD when circulating analytical work for comment within the Bank before its finalization.
- h. **Strengthen information sharing with external partners.** The Fund and the Bank have similar disclosure policies on diagnostic work. Consistent with this policy, the Country Analytic Website (CAW) will provide links to the Fund's website for fiscal ROSCs and the Bank's website for its analytical and diagnostic work. Governments will be encouraged to disseminate through this medium the reports prepared by the Bank and the Fund on other public expenditure issues. It would be desirable for other development partners to adopt a similar practice. Mission teams will be expected to meet with donors working in this area to exploit potential synergies and avoid duplication and overlap. Donors will be encouraged to provide input on their plans to Bank and Fund staff in this area on a regular basis.
- i. **The Bank and the Fund agree not to initiate any new public expenditure diagnostic instruments,** pending the implementation and review of experience under the proposed new framework.

### C. Strengthening Internal Bank Coordination

53. **The Bank is moving to further strengthen its public expenditure work in terms of both substance and process.** The elements include: an integrated work plan across networks and sectors to support the country-owned strategy; guidelines for a program of assessment and capacity building; and improved integration of overlapping Bank diagnostic work pending development of a modular approach described in Section D.

- a. **Development of a medium-term public expenditure analysis and support (PEAS) work plan for each country as part of the CAS.** As an element of the development of the Bank's CAS, country teams will articulate a public expenditure work plan and corresponding resource requirements to develop or support a government's public expenditure reform strategy. Within the CAS, the PEAS work plan will set out a sequence of analytical/diagnostic, technical and other assistance needed over the medium term to (i) improve budget policies and outcomes; (ii) help reform budget institutions and practices; and (iii) assess progress. In contrast to the typical one-year ESW model, the medium-term perspective of the Bank's work plan will be better synchronized with the government budget cycle and allow a more in-depth exploration of the sources of weaknesses in public expenditure policy and management, including those related to problems with governance. The PEAS will help (i) strengthen internal Bank coordination of the various network staff on each country team and (ii) strengthen external coordination with the IMF and other donors

in order to coordinate a medium-term donor work plan to support a program of reform. If the country authorities so request, the work plan could also serve as the Bank's formal contribution to the donor coordination process.

- b. **Guidelines for assessment and capacity building.** The Bank's public expenditure analytic work at present combines both assessment and capacity-building objectives. A staff guidance note will be prepared to clarify the different objectives of analytic work and to ensure that the PEAS work plan achieves the appropriate balance in its choice and sequencing of analytic work as well as the appropriate instruments to support capacity building.
- c. **Improved integration of PER, CFAA, and CPAR work.** Pending adoption of the full modular approach (see Section D below) and implementation of the PEAS, PREM and FM staff (including staff in the field) will strengthen collaboration through sharing information, seeking mutual comment and concurrence on outputs and scheduling joint missions, producing joint outputs, and conducting joint report disseminations, as appropriate. This will build on the collaboration already underway, as set out in Annex 1, para 8. The HIPC expenditure tracking work will continue to be integrated into ongoing work programs, and guidance to further integrate it with existing diagnostics will be issued.

#### **D. A Modular Approach to Diagnostics**

54. **A modular approach to public expenditure diagnostics offers the potential of reduced transactions costs for both governments and donors.** Modules required to fit individual country needs could be combined at one time or coordinated over time. Agreement among development partners on the scope, content, and methodology used in any specific module would rationalize the multiplicity of current approaches, reduce the costs to countries, and enable donors to sign off on results obtained through a diagnostic exercise carried out by one of them. A promising example of this approach is the acceptance of the CPAR guidelines as the standard by all the MDBs. Discussions are already underway between the EC and the World Bank to achieve a common focus in the area of the CFAA and EU audit, and between the Department for International Development (DFID) and the Bank on procurement assessment. The modular approach is also expected to strengthen Bank and Fund collaboration on fiscal transparency and financial accountability. Another positive development has been the degree of bilateral and multilateral donor interest in the HIPC expenditure tracking assessment instrument. The Bank and Fund are revising the instrument with the intention of discussing it with donors before end-2003. Further work will be needed to make the modular approach operational.

## **VI. Issues for Board Discussion**

55. This paper reports on how the mandates of the Fund and the Bank have evolved over time and how this has shaped the division of labor on expenditure issues. It also assesses the experience of collaboration and the view of key stakeholders. The paper proposes a framework for collaboration on expenditure issues consistent with country ownership, recent guidelines for Bank/Fund collaboration, and the periodic country reporting of progress in strengthening public expenditure management.

56. Executive Directors may wish to consider the following issues:

- a. Do Directors broadly agree with staff on the lessons learned from the experiences with collaboration?
- b. Do Directors support the proposed framework for strengthening Bank/Fund collaboration on expenditure issues?
- c. Will the proposed framework adequately enhance collaboration among development partners and will it facilitate country-led public expenditure work?
- d. Do Directors agree to the publication of this paper?

## **Bank Organization and Instruments for Public Expenditure Work**

### **A. Organization**

- 1. The organizational structure of the Bank is more decentralized than the Fund at both headquarters and in the field.** Most of the expenditure work<sup>1</sup> is undertaken by each of the Bank's regions, in contrast to the Fund, where specialized expenditure work is undertaken by the Fiscal Affairs Department. The World Bank maintains a relatively small pool of staff with public expenditure expertise in central departments. This staff supports the (decentralized) operations of the Bank through training activities, quality reviews, knowledge management through thematic groups, development of best practice approaches, and some limited direct operational support. PREM anchor staff are responsible for Board papers on public expenditure issues, including joint Bank/Fund papers such as the present paper.
- 2. The role of country-based staff has increased in recent years.** Over the past seven years, the Bank has comprehensively implemented the decentralization of its operations so that Country Directors (CDs) based in the field supervise the Bank's programs through Country Management Units (CMUs).<sup>2</sup> Consistent with the decentralization of management, the importance of field-based country staff has also been enhanced, and a significant proportion of the Bank's public expenditure work is undertaken by field-based economists (e.g., Benin, Nicaragua, Nigeria, Uganda, Tanzania, and Indonesia). Even where such analysis is led by headquarters-based staff (e.g., Zambia and the Philippines), the Bank has utilized its resident staff to support government counterpart teams through frequent engagement and in-depth discussion. In Morocco, Bank staff have worked closely with local working groups to catalyze and support government formulation of a public expenditure reform strategy. This collaborative approach proved to be a highly effective way of building and enhancing government capacity and commitment and implementation of PEM reforms (e.g., Tanzania, Uganda, and Turkey). The decentralized structure has also permitted the Bank to tailor its response to country circumstances.

### **B. Analytical and Diagnostic Work**

- 3. The public expenditure work of the Bank is central to its broader approach to improving governance and public sector management in member countries.**<sup>3</sup> The PER, CFAA, and CPAR are the three principal instruments used for analytical and diagnostic work in this area and are designated as three of the five core country diagnostic reports.<sup>4</sup>

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<sup>1</sup> Expenditure work in the Bank includes public expenditure, financial management and procurement.

<sup>2</sup> Field-based CDs now constitute 66 percent of the total, with some directors responsible for more than one country.

<sup>3</sup> See *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy*, The World Bank, November 2000, and the subsequent *Implementation Update*, The World Bank (forthcoming) [available on-line since April 2002 at <http://www1.worldbank.org/publicsector/strategy.htm>].

<sup>4</sup> The five-core country diagnostic reports are: PER, CFAA, CPAR, Poverty Assessment, and Country Economic Memorandum/Development Policy Review.

Corresponding to the growing involvement of the Bank with subnational governments, such analysis is also undertaken at the provincial and state level in a number of countries.<sup>5</sup>

4. **The PER is a flexible instrument that has evolved over time.** It spans both expenditure policy and expenditure management issues.<sup>6</sup> In many countries, the PER is undertaken collaboratively with government counterparts and serves to provide a critical review of the composition and efficiency of expenditure, to highlight issues of unsustainable expenditure trends, to identify weaknesses in policy formulation and budgetary management, and to investigate the incidence of public spending. It is considered a critical instrument in PRSP countries for assisting governments to adopt a medium-term perspective to budget formulation and to adopt practices that strengthen fiscal discipline, prioritization, and operational performance. Recent PERs have made explicit efforts to link more effectively public expenditure with its impact on the poor.<sup>7</sup>

5. **The CFAA is a diagnostic tool to assess the overall quality of the public financial management system both from a developmental and a fiduciary perspective.** A full-scope CFAA would address public sector budgeting (especially execution, internal control, and monitoring), accounting, external reporting, audit, and legislative oversight. In practice, the content varies from country to country, reflecting several factors such as availability of information, particular conditions and circumstances in the country, and the expected size and nature of the Bank's program.

6. **The CPAR is a tool to establish the need for and guide the development of an action plan to improve a country's system for procurement.** The CPAR provides a comprehensive analysis of a country's public sector procurement system, including the existing legal framework, organizational responsibilities and control and oversight capabilities, the risks associated with the procurement process, and the adequacy of commercial practices and competitiveness of local private industry with regard to participation in public procurement. While helping governments improve the value for money in expenditure, the CPAR also serves Bank needs by helping to identify the operational risks in a country and set appropriate Bank supervision standards and by contributing to the design of risk mitigation plans, especially for countries that will receive sector and programmatic loans.

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<sup>5</sup> Recent examples include provincial PERs in China, India, and Indonesia. State level financial accountability assessments are underway in some states in India and Pakistan and are planned for Brazil and Mexico. Subnational procurement assessments have been undertaken in a number of Indian states and in Yugoslavia as part of a CPAR. A state level CPAR has recently been initiated for Lagos state in Nigeria.

<sup>6</sup> For a discussion of the evolution of the Bank's work on public expenditure issues, see *Public Expenditure Management and Accountability: Evolution and Current Status of World Bank Work*, Informal Board Paper, PREM-OPCS Networks, April 18, 2001.

<sup>7</sup> See *Zambia: Public Expenditure, Growth and Poverty: A Synthesis* (No. 22543-ZA), December 2001; *Peru: Restoring Fiscal Discipline for Poverty Reduction* (No. 24286-PE), October 2002; *Ethiopia: Focusing Public Expenditures on Poverty Reduction* (No. 23351-ET), December 2001; and *Nicaragua: Improving the Poverty Focus of Public Spending* (No. 23095-NI), December 2001.

7. **The knowledge provided by the PER, CFAA, and CPAR as well as country sources and the work of other development partners is an essential input to the Bank's fiduciary work.**<sup>8</sup> The Bank has proposed that a fiduciary assessment provide a key input to CASs and underpin the development of an adjustment-lending program in a country.<sup>9</sup> Bank staff would use the assessment to identify specific measures to address identified weaknesses.

8. **The Bank is moving to integrate these instruments within a coherent diagnostic approach.** In various regions, efforts to integrate the PER, CFAA, and CPAR have been piloted (e.g., Bosnia-Herzegovina, Mongolia, Philippines, Turkey, and Yemen). Ongoing integrated reviews include Cambodia and Zambia. In all regions, integration of processes is being brought about through combinations of parallel missions, mutual peer review and overall coordination through CMUs. Recent examples include Brazil, Guinea, Iran, the Kyrgyz Republic, Niger, Pakistan, Senegal, and Tajikistan.

9. **The Bank supplements its core diagnostic reports with additional instruments.** It undertakes Institutional and Governance Reviews (IGRs) to diagnose a broader range of institutional/political economy factors that impair governance, including PEM. Public Expenditure Tracking Surveys (PETS) and Quantitative Service Delivery Surveys (QSDS) are being undertaken to evaluate the quality of PEM and service delivery. PETS have been undertaken or are underway in Ghana, Honduras, Peru, Rwanda, Tanzania, and Uganda and QSDS have been conducted in Chad, Laos, Madagascar, Mozambique, Pakistan, Papua New Guinea, West Bank/Gaza, and Zambia.

### C. Grants and Lending Instruments

10. **The Bank's lending operations seek to support country efforts to tackle the weaknesses in public expenditure policy and management identified in PERs, CFAAs, and CPARs.** Public expenditure and financial accountability work has also become a focus area for the Institutional Development Fund (IDF), following a strategic review of this facility. These operations provide targeted assistance as a stand-alone loan, credit, or grant as a component of investment and adjustment lending. The Bank's lending operations cover all aspects of public expenditure policy and management, including long-term institution building. They include a comprehensive overhaul of all aspects of budget management (e.g., Niger, Benin, and Mali); improving the accountability and transparency of resource use and effective service delivery (e.g., Burkina Faso and Cote D'Ivoire); consolidating and reforming a fragmented budget system while undertaking a modernization of the budget law (e.g., Turkey); establishing a modern integrated financial management system and adopting a Medium-Term Expenditure Framework (MTEF) for budgeting (e.g., Chile and Guatemala); improving financial reporting and auditing at both the national and provincial government level (Pakistan); and implementing a comprehensive treasury system (Russia).

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<sup>8</sup> In FY2002, 14 CPARs and 20 CFAAs were delivered, as were 27 PERs and one integrated report combining all three for the Philippines. The 27 PERs included two sectoral expenditure reviews, three provincial expenditure reviews and one public expenditure management report.

<sup>9</sup> See *From Adjustment Lending to Development Policy Support Lending: Key Issues in the Update of World Bank Policy*, Discussion Draft (CODE2002-0036), May 20, 2002.

11. **The Bank's support for public expenditure has increased substantially over time both in absolute terms and relative to the Bank's overall resources.** The proportion of new lending operations with public expenditure and financial management components jumped from 9 percent in FY1997 to 31 percent in FY2002. In FY2002, in the Africa region alone, the Bank approved a sum in excess of \$2 billion in credits for 20 countries through 26 operations that included public expenditure and financial management components. The corresponding lending for ECA, LAC, SAR, EAP, and MENA was \$4.1 billion, \$1.7 billion, \$1.8 billion, \$.17 billion, and \$.01 billion, respectively. Bank support to governments implementing MTEFs is substantial. During FY2000-02, the Bank undertook 64 lending operations in 41 countries that included the implementation of a MTEF as a central aspect of budget reform.

12. **Virtually all of the Bank's investment projects touch on public expenditure management.** Reflecting the experience that donor project implementation units make systemic PEM reforms more problematic, there is a move towards integrating project management and financing arrangements into existing government budget and financial management processes, while assuring satisfactory safeguards for Bank (and other donor) financing.

13. **The Bank's analytical work and lending operations are supported by a capacity-building strategy aiming at reinforcing local capabilities through a range of workshops, learning events, regional networking, and knowledge partnerships.** The Bank's operational work increasingly incorporates learning and training components that target sustainable improvements in the capacity of local institutions to carry out their mandate. Under the leadership of the World Bank Institute (WBI), programs are organized to define methodologies, build skills, and elaborate organizational rules in core functional areas, including public finance, tax design and implementation, expenditure analysis, budget formulation within a medium-term perspective, budget execution, auditing, monitoring, and oversight, among others. As part of the CAS exercise, WBI is working on capacity-building Country Briefs intended to highlight the complementarity between lending operations and knowledge sharing, and to set up specific targets in connection with the MDGs.

## **Fund Organization and Instruments for Public Expenditure Work**

### **A. Organization**

1. **As noted above, the Fund's organizational structure and mode of delivering advice on expenditure issues differ from those of the Bank.** Public expenditure issues are part of the policy dialogue with country authorities in the context of the Fund surveillance and use of Fund resources. FAD provides specialized input into this dialogue and supports the design and implementation of reforms in this area through its technical assistance and surveillance work. FAD allocated 47 man-years to work on expenditure issues in FY2002.<sup>1</sup>

### **B. Surveillance and Fund-supported Programs**

2. **Fund policy advice on expenditure issues is provided through surveillance and in Fund-supported programs, and in the latter is frequently reinforced by conditionality.** Reflecting the critical role of expenditure reform in underpinning durable fiscal adjustment and public sector reform, the average Fund-supported program includes about nine expenditure measures, of which about half are subject to some form of conditionality (prior actions, performance criteria, or structural benchmarks).<sup>2</sup> These draw on a number of sources, including the work of the Bank, the Fund's technical assistance, and, in the case of low-income countries, PRSPs. About two-thirds of these measures are directed toward improving public expenditure management. In addition, FAD contributed to the assessments and action plans for 24 HIPC's, as well as the subsequent Board papers reporting on progress in implementing the action plans. A larger number of measures are found in PRGF-supported programs (10 per country) than under Stand-By or Extended Fund Facility (EFF) arrangements (six per country).

### **C. Fiscal Modules of Reports on Observance of Standards and Codes (ROSCs)**

3. **A special aspect of surveillance is represented by the fiscal ROSCs. These assess the extent to which countries observe the IMF's Code of Good Practices on Fiscal Transparency and suggest priorities for improvement.**<sup>3</sup> ROSCs address a range of issues related to transparency, including relations between levels of government and how comprehensively the budget captures fiscal or quasi-fiscal activities. As a diagnostic tool, ROSCs are complementary to technical assistance efforts by the Fund and other institutions, in particular, assistance in the PEM area. Participation in ROSCs is voluntary. As of end-October 2002, 45 fiscal ROSCs had been completed and posted on the Fund website, of which 8 were for advanced economies, 15 for emerging market economies, 7 for transition

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<sup>1</sup> This estimate excludes 23 man-years of expenditure work of its resident advisors and consulting experts participating in technical assistance missions.

<sup>2</sup> Based on a survey 53 Fund-supported programs approved by the Executive Board in 2000 and 2001. The sample comprises 35 PRGF-supported programs, 16 Stand-By arrangements, and 2 programs supported by the EFF.

<sup>3</sup> The financial crises of the late 1990s provided the main impetus to the standards and codes initiative now led by the Fund and the Bank.

economies, and 15 for developing economies. About 18 to 20 ROSCs per year are envisaged over the next few years.

4. **There are important differences between the Fund's fiscal ROSCs and World Bank CFAAs, although they share a number of common features.**<sup>4</sup> The objective of ROSCs is to assess and promote transparency, while CFAAs also assess other aspects of the public financial management system, such as effectiveness of control processes. Furthermore, ROSCs are intended to cover all Fund member countries, while CFAAs cover only active borrowers from the Bank. Some of the information generated is common to both instruments. Furthermore, the Bank's recent revision of CFAA guidelines makes extensive reference to the Fund's code of fiscal transparency. As such, there is scope for further exploiting synergies between these two instruments, as proposed in Section V above.

#### D. Technical Assistance

5. **The Fund's technical assistance on expenditure issues focuses on core areas essential for macrofiscal management.** These core areas were discussed and endorsed by the Board in 2001.<sup>5</sup> Technical assistance on expenditure issues is provided by FAD and is geared toward providing strategic advice, rather than assistance in implementation of reforms. This technical assistance encompasses missions provided from headquarters, the selection and supervision of resident and short-term experts; and on-the-job and more formal training at headquarters and regional training institutes.<sup>6</sup> Reflecting the focus on macrofiscal management, technical assistance in the PEM area mostly covers the upgrading of budget classification systems; the introduction of expenditure commitment control mechanisms; and treasury reforms aimed at improving budget execution and reporting. During FY1998-2002, an average of about 175 expenditure-related missions per year were fielded (excluding multi-topic missions), which accounted for roughly 25 percent of total missions fielded by FAD in all areas. About 85 percent of these expenditure-related missions addressed PEM issues, and the remaining 15 percent addressing expenditure policy issues. In addition, FAD supports 25 resident and peripatetic advisors and advisors in three regional centers (Africa Regional Technical Assistance Center (AFRITAC), Caribbean Technical Assistance Center (CARTAC), and the Pacific Financial Technical Assistance Center (PFTAC)). For low-income countries, the Fund provides its TA on a grant basis.

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<sup>4</sup> Other Bank instruments that may touch on issues of fiscal transparency are the PER, CPAR, and IGR. For a description of these instruments, see Annex 1.

<sup>5</sup> These areas comprise public expenditure management (including reforms in budget preparation, execution, and reporting), short-term expenditure rationalization, incorporation of social safety nets into the design of Fund-supported programs, and analyses of the macrofiscal sustainability of social security systems. See *Ensuring Alignment of Technical Assistance with the IMF's Policy Priorities* (SM/00/284), December 20, 2000.

<sup>6</sup> In FY2003, FAD is offering six such courses at regional institutes, as well as the public finance course at headquarters.

**6. Recent steps by FAD to better prioritize and integrate its technical assistance with area department operations will facilitate implementation of the new framework.**

These efforts include the introduction of a new process for evaluating technical assistance requests on a regional basis, and greater interaction of FAD staff in meetings with the area departments in mid-year reviews of the allocations of technical assistance by region. To aid such interaction, short Fiscal Strategy Briefs (FSBs) have been prepared on selected countries and discussed with area departments.

## Stakeholders' Survey

1. A survey of senior government officials in ministries of finance in 83 countries, Bank and Fund staff engaged in these countries, and representatives in 26 donor agencies engaged in public expenditure work was undertaken to assess the views of various stakeholders on Bank/Fund collaboration in this area.<sup>1</sup> The survey was undertaken by an independent survey firm (MEMRB Custom Research Worldwide) in order to assure respondents of confidentiality. The survey period was October 29-November 21, 2002, based on self-completion of a web-based questionnaire (by staff and donors) and self-completion and return by fax (by government officials).
2. Response rates were as expected for a self-completion survey (45 percent of government officials, 60 percent of Bank staff, 54 percent of Fund staff, and 38 percent of donors). Respondents to the questionnaire roughly mirrored the population of stakeholders surveyed.
3. The questionnaire was divided into three parts. The first asked for an assessment of the effectiveness of Bank/Fund collaboration by area (expenditure policy, expenditure management, and fiscal transparency and accountability). For these questions, a scale of 1 through 5 was used, with 1 indicating a rating of very ineffective; 2, ineffective; 3, adequate; 4, effective; and 5, very effective. Mean values and the number of respondents per question for governments, Bank and Fund staff, and donors are provided in Annex Tables 1a, 2a, and 3a, respectively.

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<sup>1</sup> The survey was sent to countries in which the Bank and Fund had both undertaken public expenditure work over the period 2000-02. The regional distribution of the 83 countries is indicated below:

**Africa** (27): Benin, Burkina Faso, Cameroon, Chad, Cote d'Ivoire, Cape Verde, Democratic Republic of Congo, Ethiopia, Ghana, Guinea, Guinea Bissau, Gambia, Kenya, Lesotho, Madagascar, Malawi, Mali, Mozambique, Mauritania, Niger, Rwanda, São Tomé & Príncipe, Sierra Leone, Senegal, Tanzania, Uganda, and Zambia;

**Europe and Central Asia** (26): Albania, Armenia, Azerbaijan, Belarus, Bosnia & Herzegovina, Bulgaria, the Czech Republic, Croatia, Georgia, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, the Russian Federation, Slovakia, Slovenia, Tajikistan, Turkey, Ukraine, Uzbekistan, Yugoslavia – Serbia, Yugoslavia – Montenegro;

**Latin America and the Caribbean** (13): Argentina, Bolivia, Brazil, Chile, Colombia, Guatemala, Honduras, Mexico, Nicaragua, Peru, Uruguay, Guyana, and Jamaica;

**East Asia and the Pacific** (9): Cambodia, China, East Timor, Indonesia, Laos, Mongolia, Papua New Guinea, Philippines, and Vietnam;

**Middle East and North Africa** (4): Algeria, Djibouti, Jordan, and Yemen;

**South Asia** (4): Afghanistan, Bangladesh, India, and Pakistan.

The survey was also sent to development agencies that are active in providing technical assistance in the public expenditure area. These included the bilateral aid agencies of Australia, Belgium, Canada, Denmark, France, Germany, Ireland, Japan, Norway, Netherlands, Portugal, Sweden, Switzerland, the United Kingdom, and the United States. Also included were the AfDB, ADB, IDB, EC, OECD, and the UNDP.

4. The second part queried views on various aspects of collaboration (on whether there was a clear division of labor between the Bank and Fund, whether information was well shared between Fund and Bank teams, etc.). For these questions, a scale of 1 through 5 was also used, with 1 indicating strongly disagree; 2, disagree; 3, neutral; 4, agree; and 5, strongly agree. Mean values and the number of respondents per question for governments, staff, and donors to these questions are provided in Annex Tables 1b, 2b, and 3b.

5. The third part of the questionnaire was open-ended and asked for written comments on suggested priority areas for improvement and recommendations to improve collaboration.

6. An econometric assessment of the determinants of perceived effectiveness of collaboration was also undertaken by the independent survey firm for the responses of the staff. Due to the limited number of responses for government and donors, a similar analysis could not be undertaken for their responses. Two separate regressions were undertaken. One regression sought to identify which topic areas had the largest impact on the perceived effectiveness of overall collaboration on expenditure issues. In this regression, the dependent variable was the perceived overall effectiveness of collaboration. The independent variables were the responses for each major topic area (fiscal framework, short-term expenditure prioritization, long-term expenditure prioritization, budget preparation, budget execution, and fiscal transparency and systems of financial accountability (see Table 2a for mean values for these responses). In the second regression, the overall perceived effectiveness of collaboration was regressed on various aspects of collaboration, such as the sharing of common objectives, a clear division of labor between the Bank and Fund, etc. (see Table 2b for mean values for these variables).

7. The first regression indicated that short-term expenditure prioritization (beta coefficient of .32), fiscal transparency and systems of financial accountability (.27), the fiscal framework (.22), and budget execution (.20) had a statistically significant effect on overall perceived effectiveness. Other categories of expenditure work had no statistically significant effect. The results imply that an increase of one point in a staff member's evaluation of effectiveness of collaboration on short-run expenditure prioritization would, holding constant her/his evaluation of effectiveness in other areas, increase overall perceived effectiveness by .32 (i.e., about one-third of the amount needed to raise the evaluation from "adequate" to "effective"). For the second regression, better mission timing to reduce the burden on authorities (beta coefficient of .24), the sharing of common objectives (.22), good information sharing (.16), and the provision of similar advice (.14) were statistically significant.

Table 1a: Government: Effectiveness of Bank/Fund Collaboration on Public Expenditure Work by Functional Area\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
Overall effectiveness of Bank/Fund on public expenditure	36	3.5	0.8
Expenditure policy			
Fiscal framework	34	3.6	0.8
Short-term expenditure prioritization	34	3.3	0.8
Long-term expenditure prioritization	35	3.3	0.8
Expenditure management			
Budget preparation	33	3.3	0.9
Budget execution	35	3.3	0.7
Fiscal transparency and accountability			
Fiscal transparency and systems of financial accountability	35	3.7	1.1

\*Based on a scale of 1-5 with 1=very ineffective; 2= ineffective; 3=adequate; 4=effective; 5=very effective

Table 1b: Government: Effectiveness of Different Aspects of Collaboration on Public Expenditure Work\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
Aspect of collaboration			
The Bank and Fund teams share common objectives in providing assistance for public expenditure reforms	36	3.7	0.9
There is a clear division of labor between the Bank and the Fund on			
Public expenditure policy	36	3.6	0.9
Public expenditure management	34	3.6	0.7
Fiscal transparency/accountability	34	3.8	0.8
The Bank and the Fund recognize and complement the public expenditure related assistance provided by other development/donor agencies	34	3.6	0.8
Information is shared well between Fund teams and Bank teams	36	3.8	1.0
Bank and Fund public expenditure missions are scheduled so as to reduce the burden on government officials	36	3.2	1.0
There is not a great deal of overlap and duplication in advice on			
Public expenditure policy	35	3.5	0.9
Public expenditure management	36	3.6	0.8
Fiscal transparency/accountability	33	3.6	0.8
The Bank and the Fund provide very similar advice on specific public expenditure issues	34	3.8	0.6
Problems with collaboration are reducing the effectiveness of public expenditure advice of the Bank and the Fund	36	3.1	1.0

\*Based on a scale of 1-5 where 1=strongly disagree; 2=disagree; 3=neither agree nor disagree; 4=agree; 5=strongly agree

Table 2a: Staff: Effectiveness of Bank/Fund Collaboration on Public Expenditure Work by Functional Area\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
Overall effectiveness of Fund/Bank collaboration on public expenditure	93	3.2	0.8
Expenditure policy			
Fiscal framework	92	3.3	1.0
Short-term expenditure prioritization	92	3.0	0.9
Long-term expenditure prioritization	88	3.0	0.9
Expenditure management			
Budget preparation	85	3.1	1.0
Budget execution	84	3.0	1.0
Fiscal transparency and accountability			
Fiscal transparency and systems of financial accountability	88	3.1	1.0

\*Based on a scale of 1-5 with 1=very ineffective; 2= ineffective; 3=adequate; 4=effective; 5=very effective

Table 2b: Staff: Effectiveness of Different Aspects of Bank/Fund Collaboration on Public Expenditure Work\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
The Bank and Fund teams share common objectives in providing assistance for public expenditure reforms	79	3.6	0.9
There is a clear division of labor between the Bank and the Fund on			
Public expenditure policy	91	3.3	1.0
Public expenditure management	93	3.3	1.0
Fiscal transparency/accountability	90	3.1	0.9
Information is shared well between Fund teams and Bank teams	91	3.6	1.1
Bank and Fund public expenditure missions are scheduled so as to reduce the burden on government officials	91	3.0	1.1
There is not a great deal of overlap and duplication in advice on			
Public expenditure policy	92	3.2	0.9
Public expenditure management	91	3.3	0.9
Fiscal transparency/accountability	88	3.4	0.9
The Bank and the Fund provide very similar advice on specific public expenditure issues	91	3.4	0.8
Problems with collaboration are reducing the effectiveness of public expenditure advice of the Bank and the Fund	90	2.9	1.1

\*Based on a scale of 1-5 where 1=strongly disagree; 2=disagree; 3=neither agree nor disagree; 4=agree; 5=strongly agree

Table 3a: Donors: Effectiveness of Bank/Fund Collaboration on Public Expenditure Work by Functional Area\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
Overall effectiveness of Bank/Fund on public expenditure	7	3.0	0.6
Expenditure policy			
Fiscal framework	6	3.5	0.5
Short-term expenditure prioritization	6	2.8	0.8
Long-term expenditure prioritization	6	2.8	0.8
Expenditure management			
Budget preparation	6	3.2	0.8
Budget execution	5	3.2	0.8
Fiscal transparency and accountability			
Fiscal transparency and systems of financial accountability	6	3.0	0.9

\*Based on a scale of 1-5 with 1=very ineffective; 2= ineffective; 3=adequate; 4=effective; 5=very effective

Table 3b: Donors: Effectiveness of Different Aspects of Bank/Fund Collaboration on Public Expenditure Work\*

Descriptive Statistics	Number of respondents	Mean	Standard deviation
Your agency has adequate mechanisms to inform and coordinate your public expenditure work program with the Bank and the IMF	8	3.3	0.9
The PRSP process offers an effective mechanism to coordinate the public expenditure work program of the Bank, IMF, donors and other development agencies	7	3.4	0.8
The Bank and IMF recognize and complement the public expenditure-related assistance provided by your agency	6	3.0	1.1
The Bank and Fund teams share common objectives in providing assistance for public expenditure reforms	8	3.3	0.7
There is a clear division of labor between the Bank and the Fund on			
Public expenditure policy	8	2.4	1.1
Public expenditure management	8	2.5	0.8
Fiscal transparency/accountability	8	2.9	0.6
There is not a great deal of overlap and duplication in advice on			
Public expenditure policy	8	2.9	1.0
Public expenditure management	8	2.8	0.9
Fiscal transparency/accountability	8	3.3	0.7
The Bank and the Fund provide very similar advice on specific public expenditure issues	8	3.3	0.9
Problems with collaboration are reducing the effectiveness of public expenditure advice of the Bank and the Fund	8	2.3	0.5

\*Based on a scale of 1-5 with 1=strongly disagree; 2=disagree; 3=neither agree nor disagree; 4=agree; 5=strongly agree