

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

**Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily
Indebted Poor Countries (HIPC)s)**

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

AFR	Africa Region
AFRITAC	Africa Regional Technical Assistance Center
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Review
DANIDA	Danish Agency for Development Assistance
DFID	Department for International Development
ESAF	Enhanced Structural Adjustment Facility
ESW	Economic and Sector Work
EU	European Union
FAD	Fiscal Affairs Department
HIPC	Highly Indebted Poor Countries
IDF	Infrastructure Development Fund
IFI	International Financial Institutions
IFMIS	Integrated Financial Management Information Systems
IGR	Institutional and Governance Review
MDG	Millennium Development Goals
MTEF	Medium-Term Expenditure Framework
NORAD	Norwegian Agency for International Development
OECD-DAC	Organization for Economic Cooperation and Development—Development Assistance Committee
PEFA	Public Expenditure and Financial Accountability
PEM	Public Expenditure Management
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Surveys
PREM	Poverty Reduction and Economic Management Network
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credits
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
ROSC	Report on the Observance of Standards and Codes
SECO	Secrétariat d’Etat à l’Economie (Swiss State Secretariat for Economic Affairs)
SPA	Strategic Partnership with Africa
USAID	United States Agency for International Development
WAEMU	West African Economic and Monetary Union

EXECUTIVE SUMMARY

This paper is a follow-up to the March 2001 Board paper entitled “Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs)” and seeks the Board’s concurrence on the approach to tracking poverty-reducing spending. In that paper, staff reported on the preliminary desk assessments of the capacity of 25 HIPCs to track poverty-reducing public spending. The preliminary assessments found that two of the 25 HIPCs should be able to carry out satisfactory tracking with a small amount of upgrading of their public expenditure management (PEM) systems, seven would require some upgrading, and the remaining sixteen would require substantial upgrading. The Board discussions of that paper identified four follow-up tasks to be undertaken in conjunction with country authorities: to finalize the assessments, to prepare action plans to improve PEM systems, to identify existing and planned donor assistance and any gaps that may remain, and to report on progress in reforming PEM systems as part of regular reviews of Bank- and Fund-supported programs.

The preliminary assessments were finalized during April-November 2001 through detailed discussions with country authorities. The final assessments presented here produced overall results that are broadly similar to the preliminary desk assessments, but with some significant differences in particular country cases. The assessments are based on the same methodology that was adopted for the earlier Board paper. Of the 24 countries included in the current assessment, nine require some upgrading to be able to track poverty-reducing spending satisfactorily, and the remaining fifteen require substantial upgrading. However, with some effort and commitment, most HIPCs can significantly strengthen their PEM systems within the next 1–3 years. Despite the overall weakness of PEM systems, a small number of HIPCs are currently providing data on poverty-reducing spending in a manner that is consistent with their PRSPs. For a larger number of countries, it is possible to establish a broad mapping of budget data to the poverty-reducing spending categories defined in PRSPs and interim PRSPs (I-PRSPs). An even larger number of HIPCs are providing broad-brush functional data on social spending.

The discussions with country authorities also focused on the preparation of action plans to strengthen PEM capacity in HIPCs in both the short and medium term. Short-term actions include broadening the coverage of government expenditures, upgrading classification systems, introducing functionally based in-year reporting, and piloting of integrated financial management information systems (IFMISs). Most countries are introducing bridging mechanisms, such as “virtual” poverty funds, to facilitate immediate tracking. Bridging mechanisms are short-term adaptations of the existing PEM system to produce the requisite data on poverty-reducing spending. In the case of “virtual” poverty funds, the existing budget classification system is used to tag and track poverty-reducing spending without the setting-up of separate institutional arrangements. Medium-term actions focus on strengthening overall legal and regulatory frameworks and budget formulation and monitoring processes, full implementation of IFMISs, and the development of human resources.

More than 25 bilaterals and multilaterals are currently providing assistance to HIPCs on PEM, and only a small number of gaps in assistance were identified. Bank- and Fund-supported programs place a heavy emphasis on strengthening PEM capacity of HIPCs. Both institutions continue to deepen the dialogue with country authorities on PEM to define country assistance programs in light of the agreed assessments and action plans. The specific activities and instruments of the Bank and Fund are to a large extent complementary, and staff are working further to strengthen these complementarities.

Countries should now be encouraged to incorporate the action plans into PRSPs and other country-owned documents. This can serve as the basis for marshaling the remaining assistance and reinforcing ownership. Staff will continue to report on progress in implementing PEM reforms in HIPCs as part of the normal review of Bank- and Fund-supported programs. Staff intend to carry out the next comprehensive review of country PEM capacity for tracking poverty-reducing public spending in HIPCs in 2004.

The assessment and action plan approach outlined in the paper carries significant risks. The first is the risk of weak ownership by governments and partial or ineffective implementation of action plans. A counterpart to this is the risk of unrealistic expectations on the part of the development community. Institutional reform is a long-term process, and progress inevitably proceeds at varying speeds in different settings and over different time periods. A further risk is the over-interpretation or misuse of the assessment results. And finally, there is the risk that assessment results could reduce donor support for system-wide approaches to policy-reform and institution-building. Should the first risk materialize, progress in improving PEM systems will follow a slower path. Should the latter risks materialize—unrealistic expectations, over-interpretation or misuse of the results, or reduction in donor support for system-wide approaches—the level or poverty-impact of donor assistance could be adversely affected.

I. INTRODUCTION

1. **This paper is a follow-up to the March 2001 Board paper entitled “Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs).”**¹ In that paper, staff reported on the preliminary assessments of the strengths and weaknesses of public expenditure management (PEM) systems in HIPCs,² and the ability of these countries to track³ poverty-reducing public spending. This paper presents finalized assessments and plans to strengthen PEM systems that have been agreed with authorities in 24 HIPCs.⁴

2. **Directors had identified four follow-up tasks for Bank and Fund staff:**

- finalization of the preliminary assessments of PEM systems in consultation with country authorities;
- together with country authorities, development of an action plan to strengthen their PEM systems in light of the agreed assessments, including any short-term (bridging) mechanisms envisaged for tracking poverty-reducing spending;
- assessment of current and planned donor assistance in building PEM capacity, including identification of any additional assistance that will be required in support of country action plans; and
- continued reporting on the progress made in strengthening PEM systems in the context of regular reviews of Bank- and Fund-supported programs.

3. **The results presented here are the outcome of collaboration among World Bank and IMF staff and country authorities.** The work was coordinated by the Poverty Reduction and Economic Management Vice-Presidency (PREM) and the Africa (AFR) and Latin America and the Caribbean (LAC) Regions in the Bank and led by the Fiscal Affairs Department (FAD) in the Fund. It involved 24 Bank and Fund country teams in Africa and Latin America.

¹ IMF SM/01/16, Revision 1, March 28, 2001; and World Bank March 30, 2001, IDA\SECM2001-51\1. See also: <http://www.imf.org/external/np/hipc/2001/track/index.htm>; and <http://www1.worldbank.org/publicsector/tracking.pdf>.

² The March 2001 Board paper included 25 countries: Benin, Bolivia, Burkina Faso, Cameroon, Chad, Côte d’Ivoire, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Tanzania, Uganda, and Zambia.

³ “Tracking” is defined as the identification and reporting of budgeted and actual outlays for poverty reduction.

⁴ Ghana was added after the February 2001 Board discussion. Assessment missions were not carried out for Côte d’Ivoire and Guinea-Bissau due to scheduling difficulties and the relative inactivity of the Bank- and Fund-supported programs.

4. **The rest of the paper is organized as follows:** Section II discusses the objectives and principles underlying the assessments and action plans. Section III describes the follow-up process to finalize the assessments and action plans. Section IV reports on the assessments and describes the nature of the data on poverty-reducing spending that countries are currently providing. Section V describes the key actions envisaged by countries to strengthen PEM systems. Section VI discusses assistance currently being provided by bilateral and multilateral donors, as well as by the Bank and Fund, and identifies gaps in assistance. Section VII discusses next steps. Section VIII identifies risks to the assessment and action plan approach.

II. OBJECTIVES AND UNDERLYING PRINCIPLES

5. **Public expenditure is an important instrument for reducing poverty.** The Enhanced HIPC Initiative seeks to strengthen the link between HIPC assistance and poverty reduction. Consequently, HIPCs have an obligation to track the changes in the composition of their spending towards pro-poor programs. More generally, a key feature of the Fund's PRGF, the Bank's PRSC, and the PRSP approach is that the budgets of low-income countries should become more pro-poor. Tracking poverty-reducing expenditures is therefore relevant to all PRSP countries. The designation of poverty-reducing spending is expected to be provided in countries' PRSPs and hence will be country specific, although there are common elements of such spending among countries (see below). As PRSPs are updated and revised in light of the poverty impact of existing programs, the definition of poverty-reducing spending is expected to be refined.

6. **The Boards of the World Bank and the IMF emphasized four key issues in their earlier discussions.**⁵ First, the ultimate responsibility for reporting on poverty-reducing public spending lies with the country. Second, HIPCs should track all poverty-reducing public spending (and not just spending financed by HIPC assistance). Third, the Poverty-Reduction Strategy Papers (PRSPs) should be the basis for identification of relevant poverty-reducing programs for tracking purposes. Fourth, countries should establish short-term "bridging" mechanisms, where necessary, to facilitate immediate tracking of poverty-reducing public spending. These short-term mechanisms could include "virtual" poverty funds. "Virtual" poverty funds rely on existing budget classification systems to tag and track poverty-reducing spending and do not involve the setting up of separate institutional arrangements.

7. **Tracking the use of HIPC assistance alone is inadequate.** Resources are fungible, and therefore a country can offset HIPC assistance earmarked for poverty-reducing programs by lowering its own spending in those areas. Such narrow tracking would not ensure the additionality of resources allocated to poverty-reducing programs in the context of the HIPC Initiative, nor necessarily result in a shift in the overall composition of spending toward pro-

⁵ See Mr. Sandstrom's Summing-Up of the Bank Board Informal Meeting, February 6, 2001 and the Acting Chairman's Summing-Up, IMF Executive Board Meeting 01/12, February 5, 2001.

poor programs. Moreover, a narrow tracking of only one element of public spending could undermine ongoing efforts to strengthen overall public expenditure management systems by creating a parallel system and diverting scarce human resources. In addition, as donors move toward providing general budget support, an overall improvement in PEM systems would provide assurances that these resources were being used for their intended purposes.

8. Tracking changes in the composition of overall expenditure should demonstrate that resources released through the Enhanced HIPC Initiative facilitate an increase in poverty-reducing spending. HIPC assistance inflows need to be identified in the fiscal accounts, which then become part of the general pool of resources available to the budget. The identification of these inflows could be facilitated by the establishment of HIPC sub-accounts at the central bank. However, tracking only outflows from this sub-account would not be adequate. As discussed above, all poverty-reducing programs need to be identified in the budget. The outlays on such programs can then be compared to the pre-HIPC spending level.⁶

9. This approach requires PEM systems that are able to record accurately the level and composition of spending. The systems should ensure that actual spending is consistent with the budget, that reports on spending are accurate and timely, and that spending reaches the intended recipients.

10. Both Boards recognized that developing adequate PEM systems in HIPCs will take time. In the preliminary assessments reported earlier to the Board, only two of 25 HIPCs demonstrated the capacity to carry out satisfactory tracking within one year. However, it was recognized that more can be done to strengthen public expenditure management in the short run in all countries. In this context, a number of Directors suggested that short-term (bridging) mechanisms for tracking, consistent with longer-term goals, be implemented while effective and comprehensive PEM systems are being put in place.

11. Countries also need to develop the means to assess the effectiveness and social impact of poverty-reducing expenditures. This involves monitoring whether spending on poverty-reducing programs provides the intended benefits. It is important for countries to incorporate poverty and social impact analyses (PSIA) of various policy measures and poverty-reducing programs in their PRSPs.⁷ While some countries have begun to undertake and use such analyses, methodological and analytical challenges suggest that countries will,

⁶ For a detailed discussion, see SM/01/16, Revision 1, March 28, 2001. Several countries have established HIPC subaccounts, and some have started to track outflows on HIPC projects. Countries have not been advised to dismantle these accounts, but instead to broaden this tracking to all poverty-reducing spending.

⁷ PSIA is defined as the analysis of the positive and negative consequences of changes in policy on the well-being of different groups in society, with an explicit focus on the poor and vulnerable. Depending on country circumstances, PSIAs may make use of a variety of methodological tools to gauge the impact of policies. These include incidence analyses, social impact surveys, micro-simulation models using household surveys, and computable general equilibrium models.

in the near term, need to develop their capacities to do PSIA, including through assistance from development partners.⁸ Countries also need to monitor the impact of poverty-reducing expenditures on key outcome indicators, especially with regard to the Millennium Development Goals (MDGs).⁹

III. FOLLOW-UP BANK/FUND MISSIONS TO FINALIZE ASSESSMENTS AND ACTION PLANS

12. **Almost all Bank/Fund missions to the 24 countries were carried out during the second, third, and fourth quarters of 2001.** Most missions included at least one Bank and one Fund staff member. The Bank and Fund each took the lead in organizing missions for half the countries. Within the Bank, the focal point for doing the assessment was the country team. For the Fund, the Fiscal Affairs Department took the leading role, with area department consultation.

13. **Most missions were combined with existing work programs.** This approach reduced the burden on the country and on Bank and Fund resources. For Bank-led countries, the missions were typically combined with its analytic or lending activities. The Fund-led missions typically took place in tandem with those to compile Reports on Observance of Standards and Codes (ROSCs).

14. **Governments were partners in finalizing assessments and developing action plans.** The country authorities have already endorsed the finalized assessments and action plans. The assessment questionnaire was provided to country authorities in advance of the mission. The assessment was discussed and in nearly all cases agreed to with the authorities during the mission. This questionnaire covered the same indicators used in the preliminary assessment (Box 1). The missions discussed action plans and any ongoing reforms to strengthen public expenditure management with the authorities in the context of the assessment. The missions also worked with country authorities to identify current and planned donor assistance. Following the completion of missions, draft assessments and action plans were reviewed and discussed in the Bank and Fund. Any changes were sent back to the authorities for review and agreement.

⁸ See the recent Bank-Fund Board paper, "Poverty-Reduction Strategy Papers: Progress in Implementation," (www.imf.org/external/np/PRSP/2001/091401.htm). The forthcoming PRGF review also assesses the state of PSIA in Fund-supported programs. The appropriate treatment of PSIA is expected to be addressed as part of the Bank's planned update of adjustment lending policy.

⁹ The MDGs align the International Development Goals agreed to at various international fora with the Millennium Declaration by Heads of State in September 2000. The MDGs consist of 8 goals and over 40 indicators.

Box 1. Salient Features of the Assessment Approach

The assessments were based on 35 questions covering the critical elements of PEM systems. From these questions, 15 indicators (shown below) were chosen as representative of the PEM system capabilities deemed necessary for tracking poverty-reducing public spending. Seven of the indicators relate to budget preparation and four each to execution and reporting.

The total number of benchmarks met can be viewed as an indicator of the quality of a country's PEM system. However, results based on this approach that suggest a substantial need for upgrading do not imply that countries cannot track poverty-reducing spending at all. What they suggest is that the accuracy and timeliness of data is likely to be relatively weak. Effective tracking of poverty-reducing spending requires PEM systems with some minimum level of capacity in each of the three areas: budget formulation, execution, and reporting.

Budget Management		Benchmark Description
Formulation	Comprehensiveness	Meets Government Finance Statistics definition of general government Extra- (or off-) budget expenditure is not substantial Level and composition of outturn is "quite close" to budget Both capital and current donor-funded expenditures included Functional and/or program information provided Identified through use of classification system (e.g., a virtual poverty fund) Projections are integrated into budget formulation
	1. Composition of the budget entity	
	2. Limitations to use of off-budget transactions	
	3. Reliability of budget as guide to outturn	
	4. Data on donor financing	
	Classification	
	5. Classification of budget transactions	
6. Identification of poverty-reducing expenditure		
Execution	Projection	Projections are integrated into budget formulation Low level of arrears accumulated Internal audit function (whether effective or not) Tracking used on regular basis Reconciliation of fiscal and monetary data carried out on routine basis
	7. Quality of multi-year expenditure projections	
	Internal Control	
	8. Level of payment arrears	
	9. Quality of internal audit	
Reporting	Reconciliation	Reconciliation of fiscal and monetary data carried out on routine basis Monthly expenditure reports provided within four weeks of end of month Timely functional reporting derived from classification system Accounts closed within two months of year end Audited accounts presented to legislature within one year
	10. Use of tracking surveys	
	Reporting	
	11. Quality of fiscal/banking data reconciliation	
	12. Timeliness of internal budget reports	
Reporting	Final Audited Accounts	Accounts closed within two months of year end Audited accounts presented to legislature within one year
	13. Classification used for budget tracking	
	14. Timeliness of accounts closure	
	15. Timeliness of final audited accounts	

15. **The assessment results should, however, be used with caution.** The assessment instrument was developed specifically for the current purpose,¹⁰ and caution needs to be exercised in using the assessments for other purposes or for cross-country comparisons. The instrument represents a set of measures deemed indicative of the overall quality of a country's PEM system, and includes both performance (level of arrears, timeliness of reporting) and institutional indicators (internal audit, medium-term expenditure framework). However, to keep the exercise manageable, the indicators used in the assessment were limited in number and designed to capture readily observable variables. Many important elements of well functioning PEM systems (for example, procurement systems) are not directly included,¹¹ and many subtleties that are difficult to measure are inevitably missed. In addition, not all indicators necessarily have equal importance in the abstract or in any given country context. Moreover, the instrument and benchmarks were developed bearing in mind reasonable expectations of the current capacity and likely progress of PEM systems in HIPCs. For example, the existence of audit functions and whether they seem to be functioning are assessed (a process measure) rather than the impact of audit reports (an outcome measure). In some cases the benchmarks may differ from a country's own performance goals (for example, adoption of West African Economic and Monetary Union regional standards). The rating system used does not indicate the degree of effort required to meet the benchmark for a particular indicator. However, the qualitative assessments in the background paper do suggest the degree of effort that would be required to meet such benchmarks. Finally, the assessments were conducted by different mission teams, and some element of judgment in the assessments is inevitable. Given the limitations, the assessment instrument and results are better used to measure progress over time in improving PEM systems in a given country, rather than to compare the state of systems across countries.

IV. ASSESSMENTS OF PUBLIC EXPENDITURE MANAGEMENT SYSTEMS

A. Benchmark Assessments

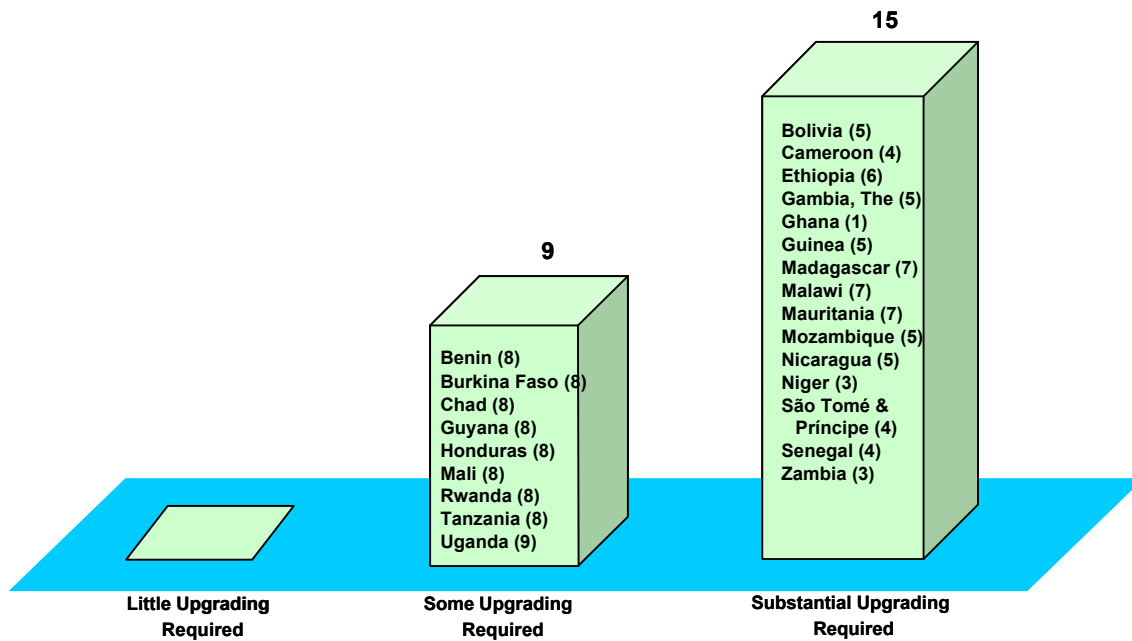
16. **The finalized assessments produced results broadly similar to the preliminary desk assessments.** Changes in finalized assessments in relation to preliminary ones reflect both information gathered by missions that was not available in the desk assessments and changes in PEM systems in 2001 (see discussion below on PEM reforms in Bank- and Fund-supported programs). As shown in Figure 1, the agreed assessments indicate that nine countries require some upgrading and 15 countries require substantial upgrading. A country is deemed to require "little or no upgrading" if at least 11 of the benchmarks were met;

¹⁰ Countries were not requested to agree to the use or dissemination of the results beyond this exercise, other than to share them with assistance providers.

¹¹ Some of these issues are indirectly included within the set of indicators. For example, a basic function of an internal audit/control system (whether French-tradition *ex ante* control or English-tradition *ex post* auditing systems) is checking compliance of expenditures with current laws and procedures, including procurement.

“some upgrading” is required if between 8 to 10 benchmarks were met; and “substantial upgrading” is required if less than half (7 or fewer) of the benchmarks were met. (See background paper for more detail on quantitative and qualitative assessments of individual country PEM systems and capacities to track poverty-reducing spending.) While no country can be described as needing little upgrading of their PEM systems (as was the case in the

Figure 1. Relative Need for Upgrading PEM Systems
(Numbers in parentheses indicate total of benchmarks met)



preliminary assessments), the total number of benchmarks met by all countries taken together was similar. For the 24 countries with complete assessments:

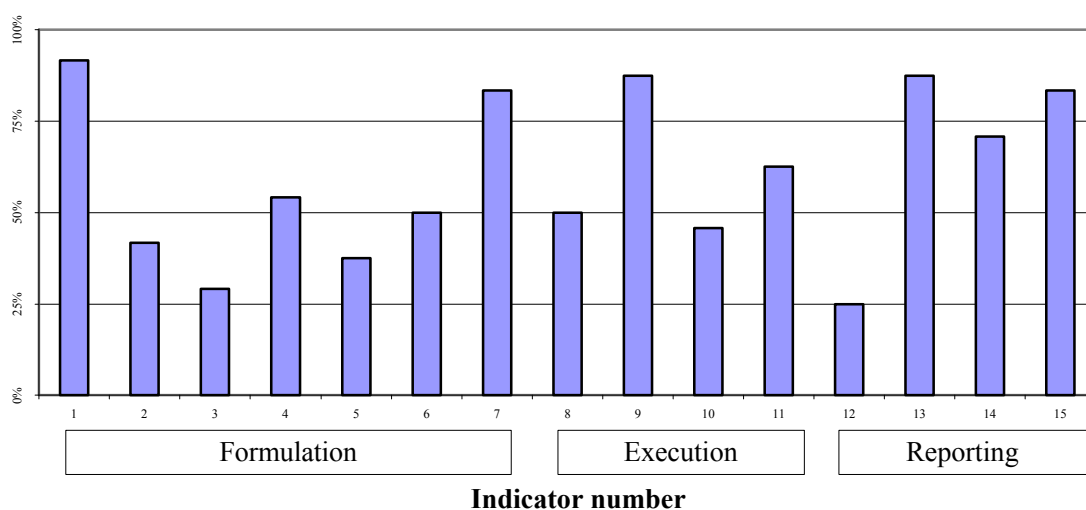
- approximately two-thirds of the desk assessment ratings were unchanged in the final assessment;
- of the changes in ratings, more than half were upward revisions. The bulk of these upward revisions were in budget formulation; and
- downward revisions were spread quite evenly across the three areas. The average assessment improved in execution but worsened in reporting.

17. **Most countries met about half the benchmarks.** The mode was 8 and the median was 7. About three-quarters of countries met between 5 and 8 benchmarks. Countries typically met benchmarks covering all three main areas of the PEM system, with 45 percent of formulation benchmarks met, 39 percent of execution benchmarks met, and 33 percent of

reporting benchmarks met. With some effort and commitment, most HIPC countries can meet at least an additional 2 to 3 benchmarks within the next 18 months. Section III lays out the menu of short-term actions that HIPC countries are pursuing.

18. **The countries scored lowest in six areas.** More than two-thirds of the countries failed to meet the following benchmarks (Figure 2):

Figure 2. Substantial Upgrading Needed to Meet Benchmarks
(Percent of countries not meeting benchmark)



- 92 percent of countries do not provide budget data consistent with the GFS definition of general government (Indicator 1). Of these, about three-fourths provide data that are quite close to this definition;
- 83 percent of countries do not have a medium-term perspective integrated into their budget formulation process (Indicator 7). Of these, about half provide some kind of medium-term perspective on their budget;
- 88 percent of countries have inactive and/or ineffective internal audit (Indicator 9). For 80 percent of these, internal audit exists but has shortcomings;
- 88 percent of countries cannot produce timely, functionally-based expenditure reports from core accounting data (Indicator 13). Of these, about one-third provide some form of functionally-based in-year reporting;
- 71 percent of countries do not close their accounts within two months of the end of the year (Indicator 14). Of these, nearly two-thirds are close to achieving this benchmark; and

- 83 percent of countries do not have final audited accounts presented within 12 months of the end of the year (Indicator 15). For many countries, meeting this benchmark will require substantial time and effort.

B. Availability of Data on Actual Spending

19. **Given the generally weak state of PEM systems, what data are now available concerning trends in poverty-reducing spending?** A few HIPCs (including Bolivia, Niger, Tanzania and Uganda) are tracking poverty-reducing public spending defined in I-PRSPs and PRSPs. Such spending includes, for example, outlays in the health and education sectors, road infrastructure, rural development, and basic sanitation. However, while the assessments showed that these countries generally performed well on budget formulation indicators (with the exception of Niger), significant weaknesses were identified in reporting. As a result, some lags in the provision of these data should be expected. Of these four countries, only Uganda reported actual data on PRSP-defined poverty-reducing spending for 2000/01, and this is consistent with Uganda's relatively strong showing in the finalized assessment.

20. **For a larger number of countries (16 in all) it is possible to establish a broad mapping of budget data to the poverty-reducing spending categories defined in PRSPs or I-PRSPs.**¹² As would be expected, the definitions of poverty-reducing spending vary across countries. Among expenditure components that have been identified as poverty-reducing for this group of HIPCs are outlays on primary education, vocational and technical education, basic health services, water and sanitation, and rural infrastructure.¹³ As can be expected, the definition of poverty-reducing spending in PRSPs goes beyond the usual social sectors (e.g., health and education). For some countries, tracking could be enhanced with a further refinement of the definition of poverty-reducing spending in PRSPs to match the budget and accounting framework. However, over time the preferred option is to implement program classification and increasingly refine the definition of poverty-reducing spending to include all programs considered as effective in reducing poverty.

21. **A larger number of HIPCs report broad trends in social spending.** Of the 24 countries in the sample, 21 countries have data available on budgeted allocations for

¹² Broad mapping typically involves approximating poverty-reducing programs identified in PRSPs with more aggregated budget data. For example, in Burkina Faso, spending on the following is defined as poverty-reducing in the PRSP: basic education, a health-care package, rural health facilities and HIV/AIDS, and rural development (including agriculture, animal resources, water supply, and rural roads). However, the categories for which data are available are total education, total health, capital spending on rural roads, women's welfare, and other social expenditures. Similarly, Mauritania identifies as poverty-reducing: primary, secondary, technical and vocational education; health centers, a health-care package, vaccinations, and reproductive health; and water supply and urban and rural development. Data are available for total education, total health and a category called poverty reduction.

¹³ Expenditures on these poverty-reducing programs in 16 countries are projected to increase by 2.2 percentage points of GDP and 6.8 percentage points of total government spending, on average, over 1999 levels.

education and health care up to 2001/02. However, actual data up to 2000/01 are available for only 14 countries.¹⁴ These data are often not yet at the level of detail to match the definition of poverty-reducing programs that are contained in PRSPs. They provide only a broad-brush picture of the extent to which budgets are allocating more on education and health, and it may not be possible to identify the pro-poor component within such broad categories.

22. **The decentralization of poverty-reducing programs to local governments is becoming more significant and can make tracking more complex.** For most HIPCs, PEM capacity is weaker at sub-national levels. As there is a growing trend toward decentralization in HIPCs,¹⁵ the strengthening of PEM systems at the local level will become increasingly important. For four countries (Bolivia, Ethiopia, Tanzania, and Uganda) poverty-reducing spending executed by subnational governments exceeds 50 percent of the total. Of the 24 HIPCs, half are actively pursuing decentralization strategies. Some countries are addressing this issue in their action plans, and the World Bank is currently providing assistance to roughly one-half of HIPCs in strengthening subnational expenditure management systems.

23. **In sum, the ability to analyze trends in spending on PRSP-defined poverty-reducing programs will inevitably depend on the systems that produce the requisite data.** Staff will have to rely on the authorities to produce the data. Strengthening such data systems will allow countries to monitor actual progress toward achievement of poverty reduction objectives. The timeliness of these and other fiscal data is expected to improve over time as countries continue to implement their action plans to strengthen budget formulation, execution, and reporting.

V. ACTIONS ENVISAGED BY COUNTRIES

24. **HIPCs' action plans include a series of measures aimed at short- and medium-term improvements to their PEM systems.** In some instances, HIPCs are reordering their priorities and re-phasing reforms in order to strengthen the capacity of the PEM systems to track poverty-reducing spending. Action plans include ongoing and planned measures and cover the entire range of the PEM system. Several measures are already incorporated in

¹⁴ The 14 countries are Bolivia, Burkina Faso, Cameroon, Ethiopia, The Gambia, Ghana, Guyana, Honduras, Madagascar, Mali, Niger, Senegal, Tanzania and Uganda. For these countries, education and health care expenditures have increased by 0.4 and 0.2 percentage points of GDP, and 1.5 and 1.2 percentage points of total government spending, respectively, since 1999.

¹⁵ The method and implications of decentralization differ from case to case. For example in Tanzania, sub-national spending on poverty-reducing programs comprises, to a large degree, outlays on wages and salaries that are paid directly from the central government budget. Also, the purchases of goods and services are done centrally, making it easier to account for sub-national spending. However, devolution is ongoing and this situation could change in the future. In Bolivia, in contrast, all HIPC assistance to finance poverty-reducing spending will flow through local authorities.

existing Bank- and Fund-supported programs (see below). These action plans are intended to supplement existing Bank and Fund PEM-related programs and instruments, rather than replace them or establish a separate monitoring system. The action plans should be mainstreamed into existing Bank and Fund programs for follow-up.

25. As reported in the last Board paper, 16 of the 22 HIPCs that reached decision points in 2000 had triggers for strengthening PEM systems for achieving their completion points. The two HIPCs that reached the decision point in 2001 have such triggers as well.

A. Short-Term Measures to Strengthen Public Expenditure Management

26. In general, short-term actions cover a wide array of PEM areas and are consistent with needed medium-term improvements in PEM systems. Measures deemed to be of a medium-term nature in some countries are being implemented as short-term actions in others, as countries are at different stages in the reform of their PEM systems. Key short-term actions (see Table 1) include:

- broadening the coverage of government expenditures to include, in particular, donor-financed expenditures;
- upgrading classification systems;
- introducing functionally-based in-year budget reporting; and
- piloting integrated financial management information systems (IFMIS).¹⁶

27. Most countries are establishing “bridging mechanisms” to facilitate immediate tracking of poverty-reducing spending. A commonly used mechanism has been the tagging of certain budget lines that meet or approximate the definition of poverty-reducing spending in PRSPs (the so-called “virtual” poverty fund).¹⁷ This approach has drawn principally from the experience of Uganda’s Poverty Action Fund. Eleven countries have established or are in the process of establishing such mechanisms. For other HIPCs, there is no need to set up “virtual” funds, since they either already have in place a system of program classification or

¹⁶ IFMISs computerize the functional processes of fiscal management, thereby providing more timely information for improved decision-making. IFMIS implementation projects frequently include components for improved classification and coding systems, training and skills development, record-keeping, and expenditure process reengineering. Properly implemented and fully utilized, IFMISs can strengthen commitment controls and routine reconciliation of banking and fiscal accounts, as well as more timely and accurate reporting.

¹⁷ Some countries, such as Cameroon, The Gambia, Madagascar, Mali, Mauritania, Niger, and Zambia, have started by tracking the use of HIPC assistance rather than all poverty-reducing expenditures. As discussed previously, this is not sufficient to ensure that such funds are additive to current poverty-reducing spending, and these countries are moving beyond tracking of HIPC assistance only.

Table 1. Actions Envisaged in the Short Term

Major weakness	Action	Countries
Inadequate coverage of government transactions	<ul style="list-style-type: none"> • Steps to gather additional expenditure information (particularly donor-funded spending) through, for example, surveys. • Incorporation of off-budget transactions into the budget. 	<p>Burkina Faso, the Gambia, Ghana, Guinea, Honduras, Malawi, Mali, Mauritania, Nicaragua, Tanzania, and Uganda.</p> <p>Chad, Guyana, Mauritania, and Mozambique.</p>
Inadequate program classification	<ul style="list-style-type: none"> • Implementation of program classification. • Introduction of ‘virtual fund’ based on tagged line items. 	<p>Cameroon, Guinea, Guyana, Niger, Mauritania, and Zambia.</p> <p>Chad, Ghana, Guinea, Guyana, Honduras, Mali, Mauritania, Mozambique, Nicaragua, Tanzania, and Zambia.</p>
Inadequate in-year budget reporting	Introduction of functionally based in-year budget reports.	Benin, Chad, Nicaragua, and Tanzania.
Poorly integrated information systems	Pilot introduction of IFMISs and related developments.	Benin, Bolivia, Burkina Faso, Chad, the Gambia, Ghana, Guyana, Madagascar, Malawi, Nicaragua, Uganda, and Zambia.

Source: AAP Country Reports.

are well on the way to setting up such systems. For some countries, the setting up of “virtual” funds had involved making changes to their existing budget and accounting systems prior to the introduction of new computerized systems. In Zambia, for example, a table is being used to map from administrative and economic classifications onto a program classification so as to track relevant poverty-reducing spending. In a similar vein, other countries are introducing new reporting templates to track spending on tagged budget lines (e.g., Mauritania, Mozambique and Tanzania). Also, in Honduras, the budget documents contain additional information on all poverty-reducing spending in 2002.

28. Other examples of bridging mechanisms include:

- controlling the use of cash releases for poverty-reducing spending rather than providing global allocations to ministries. This allows for the tracking of resources earmarked for poverty-reducing spending (e.g. Ghana and Malawi); and

- renewed efforts to capture more donor project information, thereby improving the coverage of what is being reported (e.g., Burkina Faso and Uganda).

29. **These mechanisms will help HIPCs gather and report the best readily available information on poverty-reducing spending.** Many countries are already providing data on budget allocations for poverty reduction, sometimes in a separate budget document. At the same time, the implementation of improved classification systems is being brought forward in the action plans to strengthen data availability and reliability. Improvement in classification systems is a fundamental reform that will benefit the entire PEM system. Other bridging measures, such as controls over cash releases for poverty-reducing programs, are transitory, pending overall improvements in PEM systems.

B. Medium- to Longer-Term Strategies

30. **Substantive changes to PEM systems are envisaged in the medium to long term.** These changes are focused on several key areas:

- legal and regulatory frameworks;
- budget formulation and monitoring processes;
- information systems for improved control and reporting; and
- human resource capacities.

31. **In some countries, the roles and responsibilities of different institutions are not adequately defined from a legal standpoint.** For instance, the definition of the scope of the budget is inadequate. Some countries are reviewing the legislative and regulatory framework underlying the budget process, with the aim of introducing new budget laws (e.g., Malawi and Mozambique). Such reviews will also aim to tackle the issue of increased comprehensiveness in coverage, as well as improving the specification of roles and responsibilities of the various government organizations.

32. **Strengthening medium-term expenditure frameworks and budget classification systems will improve budget preparation.** This will allow for a reliable and useful medium-term baseline that can be disaggregated into sectoral expenditure ceilings. The assessments showed that only two countries have fully functioning MTEFs. In The Gambia, for example, the introduction of a medium-term expenditure framework (MTEF) for 2002-2005 is planned with World Bank assistance. Mali, Ethiopia, Chad, Zambia, and Nicaragua plan to develop MTEFs by 2003, and Ghana is reactivating its MTEF. Overall, the World Bank is already supporting MTEFs in roughly one-half of HIPCs. To further strengthen the ability to focus on the economic and social objectives of budget expenditures, a number of countries plan to implement improved program, functional and/or economic classifications across their budgets over the medium term (e.g., Burkina Faso, Cameroon, Mauritania, Nicaragua, and Tanzania).

33. **Budget execution and reporting can be improved by full implementation of well-designed integrated financial management systems (IFMISs).** This is the goal, for example, in Benin, Burkina Faso, Cameroon, Chad, The Gambia, Ghana, Guinea, Guyana, Madagascar, Malawi, Mali, Nicaragua, Niger, Uganda, and Zambia. However, even where these systems are currently being piloted, it will take several years for complete implementation. The World Bank has been or is supporting IFMISs in roughly one-half of HIPCs.

34. **Substantive reforms need to be supported by development of greater human resource capability.** A few countries (e.g., Benin, Cameroon, Honduras, Malawi, Mali, São Tomé and Príncipe, and Tanzania) are deepening their internal audit skills and reforming other aspects of internal control systems. Such changes require more trained staff. A key part of the medium- to longer-term strategy is therefore the development of human resources through training and the attraction and retention of high-quality staff in government ministries and agencies.

35. **Civil society is also seeking information on poverty-reducing expenditures.** Such civil society monitoring can support improved accountability and sustainability of government commitment to reforms. Specific initiatives include local civic vigilance committees in Bolivia, citizen oversight boards in Chad, Honduras, and Zambia, and support for national assembly monitoring in Mozambique. The consultative processes associated with the development of PRSPs have provided an appropriate and constructive forum for considering not only the development of the poverty-reducing strategy and the designation of poverty-reducing spending, but also the appropriate reporting of progress in implementing the PRSP. Ultimately, civil society will be the best judge of the effectiveness of the poverty-reducing strategy. As PRSPs are revised and updated, the participatory process should facilitate the input of civil society in refining the poverty-reduction strategy and in monitoring results.

VI. ASSISTANCE PROVIDERS

A. Internationally Supported Programs

36. **More than 25 bilaterals and multilaterals are currently providing assistance to HIPCs in PEM.** Existing bilateral and multilateral assistance programs are substantial and cover most areas identified as needing upgrading. Bilateral assistance typically covers the development of IFMISs (e.g., Ghana, Malawi, Mali, Mauritania, and Tanzania), including training and computerization and the strengthening of expenditure commitment control systems (e.g., Malawi and Tanzania). There are assistance initiatives associated with enhancing skills in external audit (e.g., NORAD in Zambia, USAID in Malawi, and the EU in Mali), in internal audit (e.g., USAID in Benin, DFID in Uganda, and the EU in Tanzania), in treasury and accounting systems (e.g., Coopération Française in Mali and Mauritania) and with decentralization of spending to lower levels of government (e.g., DANIDA in Nicaragua, and Malawi, and SECO in Burkina Faso). Further details on bilateral and multilateral assistance providers in the 24 HIPCs are given in the background paper.

37. **Providers have indicated a commitment to continue to assist HIPCs in strengthening their PEM systems.** This is evident from the extensive programs already underway in countries and the sustained engagement planned. This willingness to provide additional assistance is also demonstrated in various other fora, such as the Strategic Partnership with Africa (SPA). The challenge will be to marshal this assistance to fill the remaining gaps and to reorient, where necessary, the existing assistance to ensure the strengthening of PEM systems to track poverty-reducing spending in the shortest possible time.

38. **Long-term success in PEM reforms requires commitment by HIPCs to stay the course.** There are many providers willing to refocus their efforts to assist HIPCs. At current levels of supply, there is no apparent shortage of assistance in the PEM area.

39. **Tracking of poverty-reducing spending in HIPCs can be enhanced by expanding the coverage of the budget to include donor-financed expenditures.** Initially, the tracking of these expenditures can be improved through better coordination with donors, but in the longer term it will involve channeling all donor funds through the government PEM system.

B. Bank-Supported Programs

40. **In the Africa region, significant expenditure accountability programs are under preparation or implementation in all HIPCs.** In April 2001, the Africa Region undertook an internal review of Bank programs in HIPCs to assess overall program comprehensiveness in expenditure accountability. In most cases, the Region viewed the programs as well-suited to the country's needs, although in roughly one-quarter of cases reviewed, the Region concluded the programs could be intensified. These were also the countries found to be most in need of upgrading in the assessments.

41. **Bank assistance is focused on large-scale institutional capacity building across the full range of PEM system components.** As noted above, the Bank has provided loans in support of projects involving the development of MTEFs and introduction of IFMISs.¹⁸ Bank support is also being given to strengthening internal and external audit capacity, parliamentary and civil society accountability arrangements, and subnational PEM system development. The Bank's Public Expenditure Reviews (PERs) represent a major vehicle for Bank advice concerning structural policies. Country Financial Accountability Assessments, Country Procurement Assessment Reviews, and Institutional and Governance Reviews are other analytical instruments for providing advice (Box 2). PRSCs are an important new

¹⁸ As noted above, the Bank is supporting IFMISs in roughly one-half of HIPCs, and has been a primary provider of assistance in this area generally. The sound development of well-functioning computerized financial management information systems has the potential to address many of the weaknesses identified in current systems. The Bank has been assessing its experience in IFMIS development, and found that experience in Africa to date has been mixed, while in Latin America the experience has been more successful. An important task is dissemination of lessons learned from implementing such systems to improve their impact.

Box 2. World Bank/IMF Ongoing PEM Work

The World Bank has a number of programs and projects in HIPCs that seek to build capacity in PEM systems, whether at the center of government (e.g., ministry of finance), in sectors (e.g., health, transportation), for civil society monitoring, or in subnational governments. These include adjustment and investment (TA) loans (e.g., to reform public policies in the expenditure area, to assist in building an MTEF, to introduce external audit and civil society monitoring, or to finance and oversee the installation of computerized information systems) and Economic and Sector Work (ESW) such as Public Expenditure Reviews (PERs), often with related public expenditure tracking or incidence surveys; Country Financial Accountability Assessments (CFAAs); Country Procurement Assessment Reviews (CPARs); and Institutional and Governance Reviews (IGRs). In the aggregate, approximately \$3 billion of the World Bank's adjustment lending to all client countries in each of FY99, FY00, and FY01 contained conditions relating to public expenditure management reform; and between 1995 and 2001 the Bank supported 24 substantial technical assistance operations, with a total value of US\$398 million in investment loans and credits, that specifically addressed public finance or expenditure management issues. Fifteen PERs, eleven CFAAs, nineteen CPARs and six IGRs were delivered to governments in FY01.^{1/} The public expenditure tracking survey (PETS), a relatively new World Bank analytic instrument, was recently undertaken in five countries (Ghana, Honduras, Rwanda, Tanzania, and Uganda), with two more underway in Chad and Mozambique. Their detailed implementation can be adjusted to give more priority to reforms that will enable tracking of poverty-reducing spending. In particular, the new Poverty Reduction Strategy Credits (PRSCs) can target specific aspects of the PEM process.

IMF technical assistance has been delivered through a combination of missions and resident or short-term (peripatetic) experts. Since FY99, FAD has undertaken 35 missions to HIPCs to provide advice to countries on different aspects of PEM reforms, particularly to address the weaknesses in budget execution. More specifically, the missions have focused on issues of payment arrears, reconciling fiscal data, and budget classification. Currently, the IMF has resident and peripatetic PEM, treasury, and general budget experts in 16 HIPCs, whose terms of reference have been adjusted as necessary to include some of the changes required to ensure satisfactory tracking. By the end of FY02, the IMF would have undertaken eight ROSC missions to HIPCs; four were undertaken in previous years. ROSCs serve as a strategic tool for a general strengthening of public financial management, including PEM systems. In addition, the Fund led missions to 12 HIPCs to assess their capacity to track poverty-reducing spending and participated in numerous similar missions led by the Bank.

The World Bank and the IMF are also building regional efforts directed at strengthening PEM capacity, such as implementation of budget classification standards mandated by the West African Economic and Monetary Union (WAEMU).

^{1/} Source: World Bank Business Warehouse database; see also the March 2001 World Bank Board paper entitled "World Bank Work on Public Expenditure Management and Accountability: Evolution and Current Status" (SecM2001-0262).

vehicle for supporting PEM reforms, with all three PRSCs approved to date including such reforms.¹⁹ Total Bank lending to the 26 HIPC countries included in either the desk or agreed assessments for 2000 and 2001 was US\$5.3 billion, and many PEM reforms were supported through these loans.

42. **The Bank is already reflecting the findings of assessments in its work.** Findings of the PEM assessments are, for example, reflected in new operations in Chad, Niger, Mali, Zambia, Mozambique, and Madagascar. A recent Chad Structural Adjustment Credit proposal included extensive conditions on PEM, tying closely to the findings of the preliminary desk assessment. Operations scheduled for Board presentations are being reviewed for inclusion of agreed actions based on the finalized assessments, and regional management is monitoring the progress. This has also led to increased collaboration with the IMF. The action plans for the 24 HIPC countries are being integrated with other action plans developed through other Bank instruments (including PERs, CFAAs, and CPARs).

C. Fund-Supported Programs

43. **There is also a heavy focus on strengthening PEM systems in PRGF-supported programs.** On average, each of the PRGF-supported programs for HIPC countries have included about six measures (as both expressions of intent and formal conditionalities). Most measures are concentrated in the areas of budget execution and reporting.²⁰ The prominence accorded to PEM measures in PRGF-supported programs is noticeably higher than under the ESAF. On average, the number of PEM measures has increased by about one-third.

44. **Early indications are that a majority of PEM-related conditionalities in Fund programs are being implemented on schedule.** A review of PEM-related measures in PRGF-supported programs since July 2000 in the 24 HIPC countries found that about three-fourths of the program conditionalities were observed within the stipulated time or within six months to a year after the test date. This review also found that the countries with Fund-supported programs that were identified as being in need of substantial upgrading have typically fewer PEM measures compared to those countries that need some upgrading. This is not surprising, since PEM measures incorporated so far have not benefited from such comprehensive assessments of the type carried out for this paper.

¹⁹ PRSCs have been approved for Burkina Faso, Uganda, and Vietnam.

²⁰ Budget formulation measures include, for example, integrating off-budget accounts into the overall budget (Guinea, Mozambique, and Rwanda) and adopting functional or program classifications (Benin and Rwanda). Budget execution measures include, for example, introducing integrated computerized and fiscal and accounting systems (Cameroon, Ghana, Madagascar, Mauritania, Nicaragua, Niger, and Zambia), commitment control systems (Malawi and Uganda) and verification and monitoring of arrears (Mauritania, Nicaragua, Uganda, and Zambia). In the area of reporting, the focus has been on improving the timeliness and dissemination of budget execution and treasury reports (Benin, Malawi, The Gambia, and Zambia) and on strengthening the role of audit institutions (Benin, Cameroon, Niger, Rwanda, Senegal, and Zambia).

45. **Current Fund technical assistance is focused on strengthening macrofiscal management, in line with its core mandate.** Fund technical assistance is typically being provided through short-term missions and resident experts, and mostly covers the upgrading of budget classification systems and the introduction of expenditure commitment control mechanisms and treasury reforms aimed at improving budget execution and reporting. These aspects of PEM have proven essential to implementing budgets in a manner consistent with achieving macroeconomic targets.

D. Assistance Gaps

46. **In relation to the overall assistance needs, relatively few gaps between the assistance being offered and the needed reforms were identified.** Common gaps are in budget classification (e.g., Benin, Guyana, Honduras, Mali, Nicaragua, and Senegal); internal audit and procurement (e.g., Ethiopia, Guyana, Honduras, Malawi, and Mauritania); and external audit (e.g., Benin, Ethiopia, Mali, Niger, and Zambia). One country (Guyana) has identified the need for further assistance for establishing mechanisms for reconciling bank and fiscal accounting data on a routine basis. Other identified needs include the full implementation of IFMISs along with improvements in the preparation of MTEFs. Some action plans identify the need for assistance to strengthen human resources through training.

47. **Consultation with partners in the field has already resulted in some reorientation of current projects and the closing of some potential gaps.** In all cases, action plans are premised on the continued availability of assistance. To the extent that any provider of this assistance withdraws or does not shift activities as agreed to meet the priorities of the action plans, new gaps may emerge.

E. Implications for Bank or Fund Assistance

48. **The full implications for assistance providers, including the Bank and the Fund, will become clearer as action plans are embedded in country PRSPs.** The Bank and the Fund will continue to deepen the dialogue with country authorities to define country assistance programs in light of the agreed assessments and action plans.

49. **Fund technical assistance will continue to be provided through both short-term missions and the assignment of resident experts.** The Fund will continue to focus on ensuring proper classification of poverty programs, on effective budget execution and on short-term improvements to provide timely and accurate accounting and reporting of spending on these programs. Some aspects of the Fund's assistance to countries can be delivered by adjustments to ongoing PEM work. Already, the Fund is providing a significant amount of assistance to HIPC countries in Africa in PEM, and the assessment missions have led to requests for additional assistance in Mali, The Gambia, and Malawi. Fund assistance will also be delivered as part of the follow-up to ROSCs. The Fund's role in providing assistance is expected to be enhanced through its participation in the planned regional technical assistance center (AFRITAC) in Africa. This should allow for a timely response by the Fund to technical assistance requests and for coordination with other donors.

50. **The Bank will continue its provision of assistance to support PEM reform through a variety of instruments.** The Bank will support PEM reform through adjustment and investment lending, grants (including the IDF), as well as ESW and review and advisory instruments. Bank country offices are already a focal point for donor coordination.

51. **The Bank and the European Commission have recently launched a Public Expenditure and Financial Accountability (PEFA) Program, with active participation on the Steering Committee from the Fund and selected bilateral donors.** The PEFA program is financed jointly by the Bank's Development Grant Facility, a Trust Fund from the European Union, and contributions from various bilateral donors. Its goals are to increase overall financing of analytic work, spur greater coordination in undertaking such work within the Bank and among donors and IFIs, and design and disseminate toolkits and performance indicators and benchmarks.

52. **In addition, the Bank is an active participant in the donor harmonization subcommittee of the OECD-DAC.** The IFI Heads of Procurement are working to develop common diagnostic instruments with the objective of reducing the multiple reporting burden on countries. It would benefit HIPCs if a single common reporting system and format could be developed for all donors, though more efforts are required to convince donors of the merits of this approach. If such a system were developed and a transparent dissemination mechanism put in place (for example, posting on public web sites), it would ease the reporting burden on countries and allow resources to be shifted to improving planning and management of resources and impact assessment of projects.

VII. NEXT STEPS

53. **The 24 HIPCs that were assessed should be encouraged to incorporate action plans into PRSPs and other country-owned documents.** As the paper notes, many PEM reforms are already incorporated in Bank- and Fund-supported programs. The comprehensive analysis carried out for this Board paper should help to foster a more systematic approach to PEM reforms in HIPCs, and the results provide a benchmark for assessing progress.

54. **Countries should use the PRSP process to solicit additional donor assistance to facilitate full implementation of the action plans.** This is consistent with the notion that it is the country's responsibility to report on poverty-reducing spending. Using the PRSP process to marshal additional assistance should also provide an incentive for countries to be responsible for their action plans and reform programs.

55. **The Bank and Fund have been assisting and can further assist countries in soliciting donors to provide assistance to cover the residual gaps.** There are two options for Bank/Fund staff. One option is for the Bank and the Fund to act simply as a catalyst for donor assistance through the dissemination of the information contained in this paper. Alternatively, the Bank and the Fund could be more proactive in coordinating donor activity, for example, by making use of the Consultative Group Meetings mechanism. (Bank country teams already actively pursue broad donor support.) Staff propose to deal with donor

coordination issues on a country-by-country basis, reflecting the differing country needs and levels of donor engagement.

56. **Staff will continue to report on progress in implementing PEM reforms as part of the normal review of Bank- and Fund-supported programs.** In some cases (Zambia, Honduras, Nicaragua), the results of the assessments have already been incorporated in Bank ESW, which forms the basis for lending operations. Similarly, the PRGF-supported programs are increasingly drawing on the agreed action plans (e.g. Mali and Malawi).

57. **Staff intend to carry out the next comprehensive review of country PEM capacity for tracking poverty-reducing spending in these HIPCs in 2004.** Based on staff reports prepared in the context of reviews of Bank- and Fund-supported programs, a short consolidated update will be provided in 2003. Bank and Fund staff will also continue to report on data on poverty-reducing spending, as defined in PRSPs and to the extent available.

VIII. RISKS

58. **The assessment and action plan approach outlined in this paper faces several risks, both in the countries and in the donor community.** A first risk is that the finalized assessment and action plans may not be embraced broadly throughout the government, or the capacity to implement technical assistance programs may be very weak, and either problem could lead to partial or ineffective implementation of the actions required to strengthen PEM systems. Should this risk materialize, progress in improving PEM systems will follow a slower path.

59. **A second and related risk is that parts of the development community will have unrealistic expectations about the pace of reform.** Even if the assessments and action plans are broadly embraced and implemented, it must be recognized that institutional reform is a long-term process, and progress may well proceed at varying speeds in different settings and over different time periods.

60. **A further risk is the possibility of over-interpretation or misuse of the assessment results.** Limitations in the assessment instrument and in cross-country comparisons were discussed earlier in the paper. In addition, it should not be assumed that HIPCs (or low-income countries more generally) are the only countries with weaknesses in their PEM systems. The assessment tool was developed for the HIPCs and has not yet been applied in middle-income countries, and it is quite likely that many middle-income countries would also not meet some benchmarks.

61. **Finally, there may be some risk that the assessment results could reduce donor support for system-wide and programmatic approaches to lending.** However, this risk does not appear high at this time. Some donors may feel that general budget support is inappropriate from a fiduciary perspective in circumstances where PEM systems are weak. However, the fungibility of resources makes it problematic for donors to depend on fiduciary safeguards in their individual investment projects as a means to improve governance in countries. Donors recognize that government capacity to manage public expenditure in an

efficient, effective, and accountable manner is an important underpinning of development, and continued focus by the donor community on institution-building is essential for poverty reduction. Since donors' ultimate goal is to improve the governance of public spending and thereby reduce poverty, they need to continue to focus on helping countries strengthen PEM systems for the entire budget, and they need to provide financial assistance in a way that supports and reinforces domestic PEM capacity.