

Review of Public Finance Management Reforms in the EU Mediterranean partners¹

(Draft 2)

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Executive summary

This paper reports on work in progress in reviewing the state of public finance management (PFM) systems and recent reforms in the EU Mediterranean partners. It is mainly based on a desk review of PFM diagnostic tools carried out by international donors and financial institutions, complemented by input provided by the Delegations of the European Commission in the Mediterranean region and other sources. PFM systems are assessed against the background of fiscal reforms in the Mediterranean and of the increasing reliance by international donors, including the European Commission, on direct budget support instruments in cooperation with this region. The paper is both intended for internal use, and specifically to support the definition of co-operation priorities by the European Commission, and to contribute to the work on governance in the Mediterranean region.

The paper reveals that, although to different degrees, all the EU Mediterranean partners are taking steps to improve their budget and fiscal management systems. These improvements generally take place with financial and technical support from international donors, among which the European Commission. The early reformers among the Mediterranean countries have already been successful in putting in place the main basic elements of a sound PFM system. Nevertheless, the majority of Mediterranean countries still display weaknesses in the degree of transparency and comprehensiveness of their budgets, in the rules and practices applied to budget planning, preparation and execution as well as in the level of external fiscal accountability.

For both developmental and fiduciary reasons, these weaknesses need to be taken into account by international donors, particularly when direct financial support is provided to these countries' budgets. PFM issues are already included, albeit to different degrees and in a somewhat piecemeal fashion, among the objectives of co-operation of the European Commission with all Mediterranean countries. The emphasis on PFM reforms is being strengthened under the new European Neighbourhood Policy. Nevertheless, while external conditionality and technical assistance can play a supportive role, improvements of PFM -as any other type of institutional reforms- need to be backed up by sufficient domestic reform commitment in order to be successful.

Introduction

This paper reviews the state of public finance management (PFM) systems and recent reforms under way in the EU Mediterranean partner countries. It follows up and complements previous research on fiscal outcomes and performance in the Mediterranean region, which included an initial assessment of issues of efficiency and effectiveness of public spending³. The paper reports on work in progress and is both intended for internal use, specifically to support the definition of co-operation priorities by the European Commission, and to contribute to work on governance in the Mediterranean region.⁴

This paper reviews and attempts to compare the state of PFM systems and recent reforms in seven of the EU Mediterranean partners: Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia and West Bank & Gaza. Israel has been omitted from the review given the relatively advanced level of its PFM system and the absence of financial assistance from the EC budget. The paper is mainly based on a desk review of available PFM diagnostic tools complemented by input from the Delegations of the European Commission in the Mediterranean region and other sources. For some countries, information on the characteristics and functioning of their PFM systems is scarce, due to lack of international PFM diagnostics and/or limited public information. The country examples used in this article are thus not exhaustive and are presented for illustrative purposes only. Additional work will be carried out to complete and verify missing or unclear information.

The paper is organised as follows: starting with a brief reminder of the main aims and principles of PFM systems (section 1), it moves on to describe their importance from the point of view of international donors, which led to development of a variety of PFM diagnostic tools (section 2). After a description of the use of budget support instruments by the EC (section 3) and a summary of the main diagnostic tools applied in the Mediterranean region (section 4), the findings on the state of the PFM systems are reported with a coverage adapted from the Public Expenditures and Financial Accountability (PEFA) programme (section 5). Section 6 concludes.

1. Fiscal reforms and public finance management in the Mediterranean region

Fiscal reforms have been on the agenda of all Mediterranean countries for several years. Starting from sometimes relatively large fiscal imbalances, by the end of the 1990s most of them had succeeded in bringing fiscal deficits (net of foreign grants) below 5% of GDP⁵. This was the result of fiscal consolidation efforts and in some cases the windfall gains from favourable commodity price developments. Progress with fiscal consolidation continued in most Mediterranean countries since 2000, but in

³ “Fiscal consolidation in MED partner countries and selected structural issues” by Michaela Dodini in “Economic review of EU-Mediterranean partners”, ECFIN Occasional Paper, March 2004.

⁴ E.g. by the OECD.

⁵ With the notable exception of Lebanon and Jordan. However, when foreign grants are included fiscal figures for these countries improve markedly.

some of them fiscal performance net of grants deteriorated due to lower than expected growth and depressed revenues, and in some cases higher expenditures and fiscal complacency.⁶ While there are no immediate concerns of fiscal sustainability (with the possible exception of Lebanon), further consolidation is necessary in most Mediterranean countries to put their public finances on a sound footing. Additional elements of fiscal vulnerability include relatively high levels of public debt in some countries⁷, or the dependence on foreign aid or oil sales as a major source of government revenues⁸.

Table 1: General government fiscal balances excluding grants (% of GDP)

	Algeria ^{1,2}	Egypt ³	Jordan ⁴	Lebanon ¹	Morocco ^{1,5}	Syria ⁶	Tunisia ⁷
1997	2.3	---	-7.3	-27.4	---	---	-4.4
1998	-3.8	---	-9.7	-18.3	---	---	-3.0
1999	-2.0	-0.6	-7.0	-16.2	-4.5	---	-3.9
2000	9.7	-1.8	-8.9	-24.6	-6.4	-1.5	-3.9
2001	3.4	-2.7	-8.0	-18.9	-5.8	2.5	-3.8
2002	0.2	-3.5	-10.1	-15.1	-4.7	-1.6	-3.5
2003	5.1	-3.3	-13.0	-14.6	-5.5	-1.6	-3.5
2004 est.	5.3	---	-13.4	-8.2	-5.9	-2.7	-2.8

Source: calculations based on IMF Article IV consultations. Data for 2004 are estimates or projections.

All data exclude revenues from privatisation.

¹ Central government balance.

² Including the balance of special accounts and net lending to the Treasury

³ The fiscal year runs in Egypt from July to June. Therefore, for example, data for 2002 refers to the period July 2001 to June 2002.

⁴ Covers the central government and budgetary agencies. Includes non-budget account net spending.

⁵ Including other special treasury accounts and Fond Hassan II expenditures.

⁶ Consolidated budget balance including grants and operations of the Price Stabilisation Fund (PSF).

⁷ Including special funds, the fonds de concours and the social security accounts.

In recent years, fiscal reforms in the Mediterranean region have increasingly turned to institutional issues. Against narrowing margins for further reductions of aggregate expenditures and, in most countries, sensitivity to reforms of direct taxation as a means to boost revenues, public authorities in the region have become increasingly aware of the need for sound fiscal institutions and budget processes to preserve and sustain fiscal consolidation, improve the effectiveness of public spending. These developments have usually taken place in the framework of public administration reforms which all Mediterranean countries are carrying out (albeit to a different extent), driven by tighter budgets and higher expectations by the public for a more efficient, transparent and accountable state.

The World Bank indicators of government effectiveness indeed reveal that a number of Mediterranean governments are not very effective in carrying out their role. With the exception of Tunisia, Jordan and Morocco, whose performance is both in the positive range and above the average of their income group, the other countries

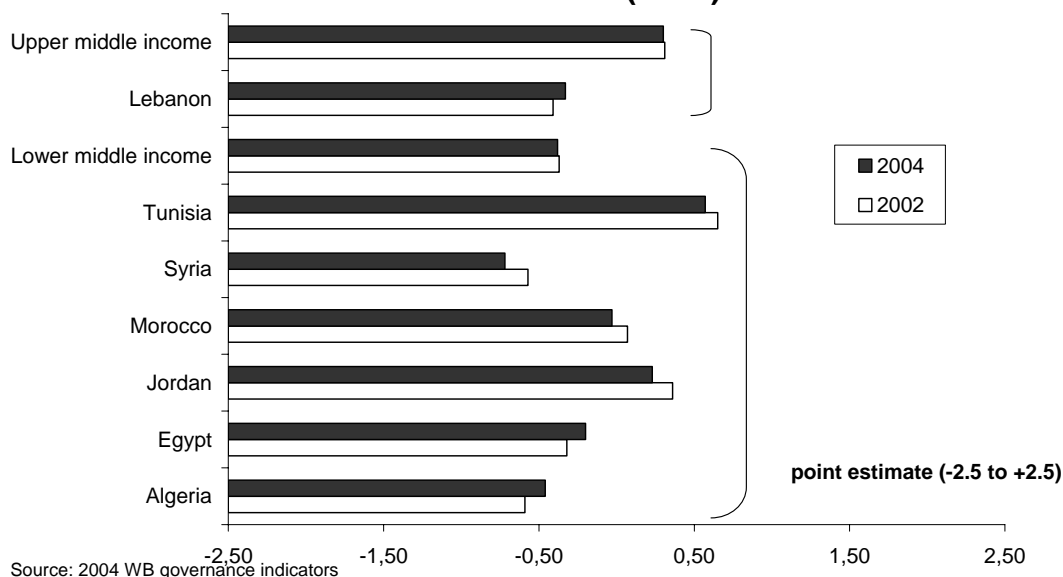
⁶ Notably in countries benefiting from favourable price developments for primary products.

⁷ Egypt and Lebanon had debt stocks above 100% of GDP at the end of 2004.

⁸ Jordan depends heavily on foreign grants as a source of revenues, while Algeria and Syria derive most of their government resources from sales of hydrocarbon products.

perform worse than what would be expected from their level of income. Between 2002 and 2004 some countries even experienced a deterioration of their government's effectiveness.

Chart 1: Government effectiveness in the Mediterranean (2004)



As a complement or an integral part of their fiscal and public administration reforms, the majority of Mediterranean countries have thus moved to improve their public finance management (PFM) systems. Given the breadth and complexity of this field of work, PFM reforms typically require several years to be completed.

Box 1: What is Public Finance Management?

Public finance management is a very broad concept relating to the institutions, processes and arrangements underlying a country's public finances and fiscal policy, including planning, budgeting, accounting, treasury and debt management, reporting, internal control and audit, external audit, legislative oversight and fiscal decentralization. PFM also covers some cross-cutting issues such as budget comprehensiveness, transparency, fiscal discipline and efficient resource allocation to priority needs. A good PFM system, intended as an effective, efficient, transparent, and rules-based PFM system, is an essential tool for a government in the implementation of its policy objectives. Specifically, PFM systems stand at the cross-road of three important objectives: (i) aggregate fiscal discipline, (ii) the efficient use of public funds and their allocation in accordance with strategic priorities and (iii) transparency and accountability in the use of public funds.⁹ Good financial governance can contribute to reducing poverty and achieving the Millennium Development Goals (MDGs), as their attainment is not merely a question of spending more, but also of how to use state resources.

⁹ These three goals are interdependent: fiscal stability creates an environment which encourages the sound allocation of resources and effective performance. In turn, sound performance at the other two levels feeds into fiscal stability. On the other hand, the pursuit of aggregate fiscal discipline should not come at the expense of appropriate resource allocation to strategic priorities or by neglecting the quality of delivery.

Although the specific institutional setting, procedures and arrangement need to be adapted to each country's circumstances, there is broad agreement on the main characteristics of a sound PFM system and on good practices. These include the following:

- Clear rules: a clear set of rules, formal and applied, should underpin the budget process, including a budget law specifying fiscal management responsibilities and published accounting policies and classifications;
- Budget realism: the budget should be realistic and implemented as intended in a predictable manner. The budget outturn should be broadly consistent with the budget;
- Comprehensive, policy based budget: the budget should capture all general government fiscal transactions, including donor finance, and be prepared with regard to government policy. There should be no extra-budgetary revenues and expenditures;
- Medium-term budget orientation: a medium-term budget framework supports policymakers in understanding the realities of what is affordable in the medium-term and to address sectoral priorities strategically;
- Fiscal management: aggregate fiscal position and risks should be monitored and managed;
- Information: adequate fiscal, revenue and expenditure records and information have to be produced, maintained and disseminated for decision making, control, management and reporting purposes;
- Control: arrangements should be in place for the exercise of control and stewardship in the use of public funds. These include a single treasury account into which revenues are received and out of which activities are paid, systems to control payments, commitments and arrears, the use of competitive tendering in public procurement and effective actions to identify and eliminate corruption, continuous reconciliation of fiscal and bank records;
- Accountability and transparency: arrangements for external transparency and scrutiny of public finances should be in place. They include independent audit of government accounts, submission of audited annual accounts to Parliament, appropriate follow up of recommendations made by auditors and holding government agencies accountable in case of mismanagement.

There is also broad consensus about the need to “get the basics right” in PFM reforms: reformers should both focus on the basic principles underpinning reforms –rather than adopt particular techniques- and on tackling the most important issues first while maintaining a pragmatic approach.¹⁰ PFM reforms must also be seen in their broader context. As the budget is part of a broader set of governing and management arrangements, non-budgetary institutional arrangements also need to be supportive in order for PFM reforms to succeed and lead to better budgetary outcomes.

2. Public finance management and international development assistance

Issues of PFM in the Mediterranean have increasingly come to the forefront of the agenda on the donors' side. Recent years have marked a significant shift by donors – including the European Commission (EC)- away from traditional project support towards untargeted general budget support. Although their precise disbursement modalities differ, budget support instruments generally channel relatively large volumes of funds directly to the recipient government's budget, whereby funds are

¹⁰ Getting the basic right includes, for instance, using cash accounting before accounting for accruals, establishing external controls before internal controls, implementing an effective financial auditing before moving to performance auditing, operating a reliable accounting system before installing an integrated financial management system (WB Public expenditure management handbook).

spent using the country's own budget execution systems. Budget support is generally accompanied by policy dialogue and reform conditionality, and often technical assistance and capacity building in these areas. Compared to project-based development assistance, budget support entails the loss of direct control by donors over the use of funds. For both developmental and fiduciary reasons, the growing use of budget support has thus increased the importance of ensuring sound PFM in the beneficiary countries.

Typically in connection with development cooperation programmes, donors have developed various instruments to assess the state of PFM systems in beneficiary countries. The scope and coverage of these instruments vary to reflect different analytical and informational needs, notably whether the analysis is conducted for developmental or fiduciary reasons, or both.

Box 2: Main diagnostic tools for public finance management

Country Financial Accountability Assessment (CFAA)

This World Bank (WB) tool reviews in depth a country's financial accountability framework, financial management systems and practice and identifies priorities for action, which may lead to capacity-building by the WB. Countries' financial management risks are assessed on a four-point scale¹¹. Information obtained is also used by the WB to meet its fiduciary objectives by identifying risks to the use of its loans. The WB may provide budget support to countries in which the level of fiduciary risk is assessed as significant, or even high, provided that there is a strong government commitment to reform and a positive track record.¹²

Public Expenditure Review (PER)

This WB instrument is used to review a country's expenditure policy and practice, including underlying PFM issues. PERs typically review the public-private mix of goods and services provided, evaluate public expenditure priorities and the link between inputs and outcomes and analyse public sector and budgetary institutional arrangements. PERs may also examine issues such as civil service reforms, whether expenditure policies are pro-poor as well as issues related to revenue policy and administration.

Report on observance of standards and codes (ROSC)

The IMF ROSCs summarise the extent to which a country observes certain internationally recognised standards and codes. Fiscal transparency is one of the 12 areas in which ROSCs are regularly conducted¹³, and this module is drafted in accordance to the IMF Code of Good Practices on Fiscal Transparency of 1998¹⁴. ROSCs on data dissemination also usually include some reference to the quality of fiscal data in the countries reviewed.

Other instruments

In addition to those listed above, the WB has developed an array of diagnostic tools addressing specific PFM issues. These include the Country Procurement Assessment Review (CPAR), which examine

¹¹ Low, moderate, significant and high risk.

¹² Of 26 CFAAs completed in 2003, the risk level was assessed as high in 14 countries, significant in 8 countries, moderate in 3 and low in only 1 country.

¹³ Others are accounting; auditing; anti-money laundering and countering the financing of terrorism; banking supervision; corporate governance; data dissemination; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation.

¹⁴ Guidance on the implementation of the Code is provided through a Manual of Fiscal Transparency and a related questionnaire.

public procurement institutions and practices in WB borrower countries, and the Institutional and Governance Review (IGR) which evaluate the quality of accountability, policymaking, and service-delivery institutions. The WB also carries out Public Expenditure Tracking Surveys (PETS) to explore the relation between public expenditures and the final provision of public goods and services. Together with the OECD, it has developed surveys of budget practices.. The WB and the IMF also jointly undertake HIPC Assessments to track HIPC and other poverty reducing spending. In addition to the WB and IMF, other donor agencies have developed diagnostic tools for PFM assessments, including the European Commission's ex ante operational assessments of country financial management¹⁵, the UNDP Country Assessment in Accountability and Transparency (CONTACT).

Public Expenditure and Financial Accountability (PEFA) programme

The European Commission, the WB, DFID and other donors launched in 2001 the Public Expenditure and Financial Accountability (PEFA) programme to support a harmonized approach to PFM assessments and reforms. Recent work under PEFA has led to the development of a common draft list of indicators to monitor the performance of PFM systems across time and countries, by both domestic and international stakeholders. During 2004 this set of indicators has been tested across several countries and a final decision on its use by donors as the main tool for PFM assessment is expected in 2005. The unified PEFA diagnostic would help rationalising the present array of PFM assessments by satisfying the fiduciary requirements of a wide a range of donors. The 28 indicators provisionally selected refer to six main objectives of sound PFM systems: budget turnouts, budget realism and comprehensiveness, fiscal management, information availability and control, accountability and transparency in the use public funds (see Annex 1 for the full list of indicators). PEFA will be initially applied to selected African and Asian countries, while Mediterranean countries should be covered at a later stage.

3. EC budget support in the Mediterranean

The EC is a major provider of development aid to the Mediterranean region and is increasingly relying on budget support operations to channel its assistance. As of late 2004, budget support was provided under the MEDA financial envelope to Egypt, Jordan, Morocco, Tunisia and West Bank & Gaza. For the co-operation programming period 2002-2004, budget support accounted for a relatively large share of EC assistance, ranging from about 30% of total assistance in Tunisia to almost 90% in Jordan. A broad spectrum of sectors is concerned, including education, infrastructure and public sector reforms.

¹⁵ Operational assessments of financial systems and procedures are carried out for fiduciary reasons in countries benefiting from macro-financial assistance from the EC.

Table 2: EC Budget support under MEDA 2002-2004

Algeria		Morocco	
€ 150 m	Total assistance 2002-04	€ 426 m	Total assistance 2002-04
0	Budget support	€ 175 m (41% of total)	Budget support
		€ 96 m	* transport sector
Egypt		€ 79 m	* public administration
€ 351 m	Total assistance 2002-04		
€ 120 m (34% of total)	Budget support	Syria	
*€ 40 m	* trade enhancement	€ 93 m	Total assistance 2002-04
€ 80 m	* social impact of textile reforms	0	Budget support
Jordan		Tunisia	
€ 142 m	Total assistance 2002-04	€ 249 m	Total assistance 2002-04
€ 125 m (88% of total)	Budget support	€ 68 m (27% of total)	Budget support
€ 60 m	* fiscal reforms	€ 20	* ports
€ 35 m	* emergency support (effects of Iraqi conflict)	€ 48	* higher education
€ 30 m	* local development		
Lebanon		West Bank&Gaza	
€ 80 m	Total assistance 2002-04		Total assistance 2002-04
0	Budget support	€ 243	Budget support

Source: calculations by the authors based on EC information

In general, the European Commission encourages the use of budget support as an aid instrument: besides its macroeconomic effect, budget support is considered to be more effective than project aid when implemented within a sound fiscal framework and in support of well defined macroeconomic and sectoral reform strategies. In particular, it is seen as more effective in encouraging ownership by the recipient. Budget support also carries fewer procedures and may be disbursed more quickly than project aid, provided the beneficiary meets the agreed conditions.

While in favour of budget support because of the above-mentioned advantages, the European Commission (EC) also specifies that a number of conditions must be met in order to extend it. These mainly concern the beneficiary country's macroeconomic situation, the assessment of its system of public financial management, and the strategic reform context, whether overall or sectoral. With specific reference to PFM, under EC rules the assessment of the quality/effectiveness of the beneficiary country's public finances and on-going reforms is one of the fundamental pillars for implementing budget support. EC rules explicitly foresee that the identification of a budget support programme should include an assessment of the country's legal and institutional budget framework, the monitoring and reporting methods of financial flows, the internal and external control mechanisms of the budget process, selected key indicators for budget effectiveness/efficiency, democratic control and record in fighting corruption.¹⁶

Box 3: Budget support by the European Commission

The EC has developed two main kinds of budget support instruments to channel its external assistance to Mediterranean and ACP countries¹⁷: the General Budget Support (GBS) and the Sectoral Policy

¹⁶ EC Guide to the programming and implementation of budget support for third countries (April 2003)

¹⁷ As of 2005 only African, Caribbean and Pacific (ACP) and Mediterranean countries are eligible for budget support from the EC budget under the respective Cotonou Convention and MEDA Regulation.

Budget Support (SPBS). Both consist in financial transfers to the national treasury of the beneficiary, but differ in their objectives and emphasis. GBS are extended in support of a country's national development strategy or policy (for example the implementation of an Association Agreement in the Mediterranean region or a Poverty Reduction Strategy Programme -PRSP), and the EC policy dialogue with the authorities and conditions attached to the programme relate to the implementation of such strategy or policy. On the other hand, SPBS are granted to support a specific sectoral programme (for example, an education programme), and often complement other resources directed to it (*additionality*). In this case, the policy dialogue and conditions for disbursement concern the specific sectoral policy and strategy.

4. PFM diagnostics in the EU Mediterranean partners

The Mediterranean region has lagged behind other regions in terms of use of traditional PFM diagnostic tools. This is partly due to the fact that, historically, PFM diagnostics were carried out first in countries benefiting from the IMF Poverty Reduction and Growth Facility (PRGF)¹⁸. Moreover, a number of Mediterranean countries have, until recently, been reluctant to have their fiscal and budgetary systems undergo external scrutiny. Some of them have not agreed to the publication of the results of the PFM diagnostics. Nevertheless, during the last few years there has been a growing attention paid to PFM issues and the use of PFM diagnostic tools by the Mediterranean countries. This is a welcome development, both in itself and given the increasing recourse in the region to budget support instruments by international donors, including the European Commission.

In the Mediterranean, as of early 2005 the WB had completed Country Financial Accountability Assessments (CFAA) for Jordan (2001), Lebanon (2004, not published), Morocco (2003, not published), Tunisia (2004) and West Bank & Gaza (2004). Additional CFAAs were announced in 2004 for Algeria and Egypt but have not (yet) been released. Algeria, Jordan and Morocco have benefited from Public Expenditure Reviews (PER) by the WB and additional PERs have been launched recently in Egypt and Lebanon. A number of Mediterranean countries also completed IMF fiscal ROSCs (Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia). Syria has so far not made recourse to any of the international PFM diagnostic tools.

The eligibility for budget support should be extended with the new financial perspectives for 2007-2013 currently under discussion.

¹⁸ PRGF is the IMF's low-interest lending facility for low-income countries. PRGF-supported programs are framed around comprehensive, country-owned Poverty Reduction Strategy Papers (PRSPs), and have a strong focus on strengthening governance. Of particular importance are measures to improve public resource management, transparency, and accountability.

Box 4: Public Finance Management: diagnostic instruments in Mediterranean countries (as of January 2005) -draft

	WB Public Expenditures Review (PER)	WB Country Financial Accountability Assessment (CFAA)	IMF Report on Observance of Standards and Codes (ROSC) - fiscal transparency	Other diagnostics
Algeria	PER of the social sector (2002) New PER scheduled for 2005	Postponed, scheduled for 2004-05	February 2005 (public)	CPAR (2003)
Egypt	Started late 2004 (limited to education, health, transport and water)	Ongoing	2001 (confidential) ROSC 2003 (tbc)	CPAR (2004), IMF TA on budget classification, TSA, Macro-fiscal unit, etc. (2005) on-going
Jordan	2000, 2004	2001 (public)	April 2005 (confidential?)	Policy loan including PFM (2005) IMF/WB technical assistance Report "Consolidating budget management reforms" (2004) IMF ROSC –data dissemination module (2004, 2002) WB Public Investment Program (1996)
Lebanon	PER (in preparation)	CFAA (2005) done jointly with ROSC	done jointly with CFAA (2005) (public)	WB Public Investment Review (1995)
Morocco	PER 1994, 2002 (draft not made public)	2003	2003 (confidential), new one planned 2005	-WB Public Sector Reforms report (under way) -IMF ROSC –data dissemination module (2003) -WB Public Sector Governance report (2000) -IMF technical assistance report (modernisation du système fiscale et de son administration) 2001
Syria	---	---	---	---
Tunisia	Scheduled (2005)	June 2004	1999 (published), 2001 (published), 2002 (confidential)	WB Public Debt Management report (2003)
West Bank & Gaza		June 2004		

In addition to reviews and diagnostic tools, all Mediterranean (MED) countries benefit from external financial and technical assistance to improving their PFM systems. For example, the WB supports the Algerian Ministry of Finance to modernise the budget system¹⁹ while the EC is providing technical assistance and ITC equipment to upgrade the revenue collection department. In Egypt, improved fiscal transparency is one of the conditions for the disbursement of budget support under the EC Trade Enhancement Programme (TEP-B).²⁰ The WB recently started a pilot project on performance-based budgeting. PFM reforms in Jordan have been supported for a number of years by several international donors including the WB, IMF, GTZ, DFID and USAID. The EC will shortly begin providing technical assistance to the Jordanian

¹⁹ The project aims to enhance the transparency and comprehensiveness of public resource allocation, establish a framework for strategic expenditures, promote efficiency and effectiveness in budget execution as well as feedback mechanisms to ensure controls and fiscal discipline.

²⁰ Specifically, the conditions relate to the publication of comprehensive fiscal data and of the accounts of the National Investment Bank and the Social Insurance Funds.

Audit Bureau. Always in Jordan, PFM reforms were also included among the disbursement of budget support from the EC.²¹ In Lebanon, the IMF Fiscal Affairs Department assisted in the development of public expenditure management reforms. The EC supported the setting up in 1996 of the Institut des Finances, which provides training to the staff of the Ministry of Finance.

In Morocco, the EC supports public administration reforms, in parallel to the WB.²² One of the three components of the EC project concerns budget management²³. In Syria the EC will provide support to the modernisation of the Ministry of Finance²⁴, including PFM issues such as budget classification, accounting and bookkeeping. In WB&G, the EC and other donors support the World Bank's Public Financial Management Reform Trust Fund set up in 2004 and channelling donors' support to the PA's budget upon respect of reform conditionality.²⁵

As described above, PFM reforms are addressed by the European Commission in cooperation with all the Mediterranean partner countries. EC support to PFM reforms has been deployed through technical assistance or the use of PFM-related conditionalities for the disbursement of budget support under the MEDA budget line, and has usually come as a complement to PFM reform activities by the WB, IMF and other donors. However, so far the EC approach to PFM reforms in the Mediterranean region has been rather piecemeal, at least compared to cooperation with other regions of the world.

The emphasis on PFM issues should be strengthened further under the new European Neighbourhood Policy (ENP).²⁶ The ENP Action Plans concluded or being negotiated with most Mediterranean countries all include references to the opportunity to ensure sound PFM systems and accountability of financial circuits. The enhanced emphasis would ideally lead to a more systematic and coherent use of PFM conditionality for the extension of budget support, the design of technical assistance programmes of a larger scale than it is currently the case, and a more active dialogue with other

²¹ The reforms conditions for disbursement under the Structural Adjustment Facility III (€60 million) include the setting up of a Single Treasury Account and improvement of the macroeconomic framework underpinning the budget.

²² The EC project is a budget support intervention with a budget of €79 million to be disbursed in 4 tranches

²³ This component particularly focuses on budget programming and execution, performance-based management methods, budget decentralisation and internal audit. The other 2 components of the project relate to human resources management and containing the wage bill.

²⁴ The project has an allocation of EUR 8 million. It should begin in early 2005 and run during a period of 3 and half years.

²⁵ For 2005, the reform benchmarks will cover issues of internal and external audit, financial control, pension reform, budget formulation, execution and transparency, and containment of the wage bill.

²⁶ The ENP was launched in 2003 as an ambitious framework for relations between the EU and the countries in its vicinity. The countries covered by the policy include the EU neighbours on the southern and eastern Mediterranean shores (the EU Mediterranean partners and Libya) and to the east (the Western New Independent States and the South Caucasus countries). Building on existing agreements between the EU and its neighbours (including the Euro-Mediterranean partnership), the ENP implies a move from traditional trade and cooperation toward closer political, social and economic integration, while stopping short of accession to the EU.

international donors and financial institutions on PFM reforms in the region. Nevertheless, it has to be recognised that while external conditionality and technical assistance can play a supportive role, improvements of PFM –as any other type of institutional reforms- need to be backed up by sufficient domestic reforms commitment in order to be successful.

5. Country reviews

The country reviews presented here are based on information gathered from several available PFM diagnostics carried out in the MED, merged and complemented by information collected by EC Delegations in the Mediterranean region and other sources. For some countries information on the characteristics and functioning of their PFM systems is scarce, due to the lack of international PFM diagnostics or limited public information. The country examples used in this article are thus not exhaustive and are presented for illustrative purposes only. Additional work is foreseen to complete and verify missing or unclear information.

The coverage of each country reviews follows an adapted PEFA format (Annex 2)²⁷, to maximise cross-country consistency and comparability. The choice of PEFA as the reference format reflects the expectation that, in due time, PEFA should become the principal reference for PFM diagnostics, including in the Mediterranean region. The main findings are summarised below.

Summary of findings (draft)

	Budget comprehensiveness	Budget planning and formulation		Budget execution		Accountability	
		Single budget cycle	Medium Term Expenditure Framework	Single Treasury Account	Proper accounting	Public fiscal data and reports	Public external audit reports
Algeria	problematic	?	no	no	problematic	problematic	no
Egypt	problematic	no	no	no	?	problematic	no
Jordan	Mostly yes	no	in progress	in progress	problematic	mostly yes	no
Lebanon	problematic	no	no	no	yes	mostly yes	no
Morocco	problematic (contingent liabilities)	it seems so	in progress	yes	problematic (contingent liabilities)	needs improvement	yes
Syria		no	no	no		problematic	no
Tunisia	mostly yes	it seems so	no	yes	mostly good	mostly good	limited publication
WB&G	problematic (donors financing)	yes	??	yes	needs improvement	mostly good	no

²⁷ The main emphasis of country reviews is on budgetary processes and institutions, while issues of fiscal performance is not dealt with here. Also not covered in this review are issues of effectiveness of internal audit and internal controls and the functioning of public procurement rules.

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5.1. Budget comprehensiveness and transparency

Budget comprehensiveness is limited in most MED countries. Perhaps unsurprisingly, the best performers – Jordan and Tunisia- are among those countries which started diagnostics and reform of their PFM systems relatively early. Limitations to budget comprehensiveness include unreported quasi-fiscal operations of public enterprises and banks²⁸ (e.g. Algeria, Egypt, Syria), exclusion of special accounts (e.g. Algeria²⁹, Lebanon³⁰), inappropriate accounting of contingent liabilities, non-performing loans and claims (e.g. Algeria, Egypt, Morocco³¹), of treasury or Central Bank borrowings by some public sector institutions (e.g. Lebanon³²) and of losses of state-owned companies (e.g. Syria). In some cases, financing from foreign donors is excluded from the budget (e.g. WB&G) which makes it difficult to properly assess available resources. On the other hand, progress in improving the comprehensiveness of budget documents was made in Jordan (notably with the full incorporation of the NSEP³³ in the 2005 budget).

Transparency of the budget and other fiscal information is often limited. In many MED countries, fiscal data and aggregates are only compiled at the central government level, with no detailed information on activities of local governments, public corporations and social security funds (e.g. Algeria, Jordan, Lebanon, Tunisia³⁴). This prevents an assessment of the government’s overall budgetary position and fiscal stance. In some MED countries, transparency is hampered by the dispersion of fiscal data across several budget accounts (e.g. Algeria, Morocco³⁵,

²⁸ These are often associated with indirect subsidies, notably on the sale of energy products, or direct credit to loss-making state owned companies.

²⁹ Algeria’s special accounts include the Revenue Regulation Fund, i.e. the country’s oil stabilisation fund, set up in 2000 and expected to be worth USD 8.85 billion in 2004. The receipts, expenditures and balances of Algeria’s special accounts are not recorded in the annual budget laws, and thus not subject to parliamentary approval.

³⁰ The operations of the Lebanese Council for Development and Reconstruction (CDR) –worth about 1/10 of the budget- are not consolidated in the general budget and there are apparently no plans to merge the two budgets.

³¹ The Moroccan budget does not explicitly recognise contingent liabilities nor includes an estimation of their budget value and potential cost. These are mainly associated with state guarantees, the indebtedness of SOEs, weak performance of public owned banks and other institutions and the functioning of the welfare system.

³² Like Electricité du Liban and the Higher Relief Council. Total financial support to EdL from the government and the Banque du Liban was estimated by the IMF at about 3% of GDP in 2003.

³³ National Social and Economic Plan 2004-2006. Its predecessor SETP used to be reported under a separate chapter in the budget and its execution was not integrated in the normal budget execution process.

³⁴ Although Tunisia provides the IMF with an annual consolidated presentation of the budget accounts, the budget law does not include the budget of the local authorities and social security system.

³⁵ Morocco’s budget includes several budget accounts including about 100 SEGMA (services de l’état gérés de manière autonome), about 130 special treasury accounts including the Hassan II account for privatisation revenues and the compte du Fonds spécial routier, as well as the annexed budget covering revenues and expenditures of state services of commercial and industrial nature.

Tunisia³⁶, WB&G). Often, no budget breakdown is provided on the activities carried out by such special accounts, making it difficult to assess the effective and efficient use of the funds and the policy objectives they pursue.

Budget classification is broadly compatible with international standards in some Mediterranean countries including Jordan, Lebanon and Morocco. In Egypt, although since 2001 fiscal data is compiled in a way compatible with IMF GFS criteria, these data are only used with international donors while domestically the government and the Parliament continue to use their traditional budget presentations, leading to confusion and complicating international comparisons. Budget classification in Syria does not comply with international standards. Progress was recorded in 2004, when the budget was presented for the first time in a way that discloses the deficit.³⁷ In Tunisia, notwithstanding a recent modernisation, budget nomenclature still needs to be improved to conform to GFS standards. Weaknesses in **fiscal data** are reported in Algeria, Egypt, Lebanon and Syria. On the other hand Jordan has made significant improvements in government finance statistics, also thanks to the establishment of a statistical division and the adoption of a financial management reform project.

Public access to fiscal documents is mixed. Relatively comprehensive information on the budget and fiscal performance is publicly available in Lebanon, Morocco and WB&G although there remain room for improvement. On the other hand, only limited fiscal information is made available to the public in some other Mediterranean countries (e.g. Algeria, Egypt³⁸, Syria, Tunisia³⁹) often in a very aggregated form (e.g. Egypt) and with long delays (e.g. Algeria, Egypt, Syria).

5.2. Budget planning and formulation

Several MED countries display weaknesses with respect to the budget planning and formulation but improvements are under way in several of them, usually with assistance from international financial institutions and donors.

The lack of a **medium-term expenditure framework** (MTEF) is a major weakness in many MED countries including Algeria⁴⁰, Egypt, Lebanon, Syria, Tunisia. The MTEF is an important budgetary tool that allows planning over a number of years and thus takes into account the medium-term financial implications of policy decisions and issues of sustainability. In Jordan preparations for the introduction of a MTEF with

³⁶ In Tunisia there exist about 30 special treasury funds.

³⁷ External financing and state borrowing were removed from the revenues.

³⁸ In Egypt, the general public has no access to budget documents, even after budget approved by the People's Assembly. Documents are available on a "need to know" basis.

³⁹ In Tunisia, apart from the final budget accounting law (loi de réglemant) published in the official gazette, there is no legal obligation to publish fiscal data. Aggregated monthly data are generated in a timely manner but disseminated only for the internal needs.

⁴⁰ Although three-years expenditure projections are considered in the budget law, these only serve as a rough guide and are not based on the detailed analysis of expenditure programmes. Expenditure allocation is based largely on renewal of appropriations from previous budgets. The WB is supporting the elaboration of a multi-year and programmatic budget.

support from the GTZ are well advanced⁴¹. In Morocco, the preparation of a MTEF on a three years rolling basis is being supported by the WB/EC public administration programme.

Many MED countries also suffer from inadequate preparation of the **macroeconomic framework** for budget preparation (including Algeria, Egypt⁴², Lebanon, Syria and Tunisia⁴³). A reliable macroeconomic framework is important to obtain revenue and expenditure projections that will feed into the budget, consolidate the analysis of fiscal data with policies and inject macro-fiscal objectives into budget planning and preparation. On the other hand, improvements are reported in the preparation of the medium-term macroeconomic framework in Jordan, Morocco and WB&G⁴⁴. **Additional weaknesses** in budget preparation include the lack of a stable and reliable budget framework law (e.g. Algeria, Lebanon⁴⁵), several different bodies in charge of budget preparation (e.g. in Egypt⁴⁶, Jordan⁴⁷, Syria⁴⁸) often resulting in weak links between investments and current expenditures, low consideration of issues of medium and long-term fiscal sustainability.

Some Mediterranean countries also face problems in **prioritising expenditures** and negotiating budget allocations across sectoral ministries (e.g. Algeria, Egypt⁴⁹). On the other hand, since the preparation of the 2005 budget Jordan has succeeded in framing budget negotiations by issuing ceilings for each line ministry at the beginning of the budget process. Similarly, in Morocco the budget circular sets expenditure ceilings, which facilitates discussions with line ministries and ensures that the overall expenditure ceiling is not exceeded. A budget circular with indicative ceilings to line ministers is also employed by the Palestinian Authority.

⁴¹ The budget circular for 2005-07 already followed it *de facto*.

⁴² With IMF assistance Egypt is currently implementing a Macro-Fiscal Unit.

⁴³ In Syria and Tunisia the budget is based on the macroeconomic framework of the five-year plans. Although this allows for coherence between the budget, the macroeconomic framework and the government's economic policy, the five-year plans do not provide the medium-term budget framework for assessing the sustainability of public finances.

⁴⁴ In WB&G the 2004 budget document offers three macroeconomic scenarios, discusses exchange rate and monetary assumptions and provides information on public debt. Revenue estimation is particularly difficult, given uncertainties related to border closures, donor financing and transfers of customs and VAT revenues by Israel.

⁴⁵ The Algerian and Lebanese budget laws are not "organic", and may be amended by the budget laws to which they apply.

⁴⁶ In Egypt, the current and capital investment budgets are prepared respectively by the Ministries of Finance and Planning.

⁴⁷ In Jordan, the main responsibility for budget preparation is with the General Budget Department (GBD), a semi autonomous agency of the Ministry of Finance. However the GBD has no responsibility over macro-fiscal and macroeconomic planning, which are covered respectively by the MoF and the MoP. The MoP is also involved in budget preparation of some capital investment projects.

⁴⁸ In Syria, the current budget is prepared by the MoF whilst the investment budget is under the responsibility of the State Planning Commission (SPC) and the Directorate of Public Enterprises for capital investments by state owned companies. Nevertheless, the Government is apparently transferring the investment budget responsibility to the Ministry of Finance.

⁴⁹ In Egypt, the Budget Circular does not set any ceiling within which line ministries should make their budget proposal. Proposals are based on past history and sectoral allocations are often the result of compromises rather than on effectiveness considerations. Some pilot projects are currently underway to improve the result orientation of the budget process.

A number of MED countries lack effective **fiscal rules** to frame fiscal consolidation and ensure their sustainability (e.g. Algeria⁵⁰, Egypt⁵¹, Lebanon, Morocco). On the other hand, Jordan's budget process takes place within the framework of Jordan's medium-term fiscal consolidation strategy aimed at meeting the requirements of the Public Debt Law of 2001.⁵² In WB&G, according to the 2003 and 2004 budget laws the Palestinian Authority cannot borrow from the Palestinian Monetary Authority⁵³ or any other public institutions. Another problem of some budgets in the Mediterranean region is their **low performance orientation**, associated with an excessive emphasis on financial inputs rather than on policy objectives pursued and on results achieved. Improvements are nevertheless under way in many countries: pilot projects on performance-based- budgeting have been carried out in a number of MED countries including Egypt, Jordan, Lebanon, Morocco, Tunisia, WB&G.

In all MED countries the **Parliament** has the power to oversee and approve budget preparation. However, in some cases this power is constrained by insufficient expertise by Members of Parliament and Parliamentary Committees in evaluating budget proposals (e.g. Algeria, Morocco, WB&G), low quality of the budgetary documents presented by the government to the Parliament (e.g. Algeria⁵⁴, Egypt⁵⁵, Lebanon, Syria, WB&G⁵⁶) and short delays for discussion and approval (e.g. WB&G). Most MED countries apply strict rules concerning **changes to the original budget** in the course of the fiscal year. However, problems remain in some of countries including Egypt⁵⁷, Lebanon⁵⁸, Jordan⁵⁹, Syria⁶⁰.

⁵⁰ The only rule in Algeria is a ceiling on advances by the Central Bank at 10% of the government's current revenues in the preceding fiscal years, and for not more than 240 days per year.

⁵¹ The new banking laws limits monetary financing of the budget. It sets a cap on the rate of growth of debt that may be financed by the Central Bank of Egypt (CBE) but does not set a fixed ceiling on the amount of government borrowing from the CBE.

⁵² This provides for a reduction of total and external government debt to respectively less than 80% and 60% of GDP by 2006. Monetisation of government deficits is forbidden under the public debt management law n°26 (2001).

⁵³ Nor under its legislation is the PMA permitted to lend to the PA.

⁵⁴ In Algeria the government does not observe the obligation to submit to the Parliament, along with the draft annual budget law, the draft budget "review law" for fiscal year N-3.

⁵⁵ In Egypt the level of aggregation of budget documents presented to Parliament makes it difficult to determine the intended use of resources.

⁵⁶ In WB&G the budget is largely a detailed listing of inputs, with no explicit focus on performance or priorities.

⁵⁷ In Egypt there is little correspondence of the final budget with the initial one approved by the Parliament.

⁵⁸ In Lebanon there are frequent changes to the original budget during execution associated with the opening of supplementary credits through the issue of new laws.

⁵⁹ In Jordan the WB/IMF (2004) reports of the government submitting budget amendments to parliament *after* increased expenditures have already occurred.

⁶⁰ In Syria budget revisions during the year are not reported to the General Budget Directorate, but only lead to the updating of records at the Central Treasury. This breaches of the segregation of duties since the Central Treasury is also responsible for executing transactions and accounting for expenditures and budget balance.

5.3. Budget execution

Single treasury accounts (STA) are in place in Morocco, Tunisia and WB&G, preventing the formation of parallel financial circuits and facilitating cash management. However in WB&G the functioning of the STA is constrained by the fact that some foreign donors are still unable or unwilling to use it to channel their assistance.⁶¹ The setting up of a STA is currently under way in Jordan where, progressively, the accounts of various agencies have been rationalised and their balances transferred to the STA. Lebanon in principle has a STA but this is fragmented thus hampering consolidation and preventing efficient cash management.⁶² Algeria, Egypt, and Syria have not implemented STAs, and do not appear to have immediate plans in this respect.

A number of MED countries are reported to experience difficulties in the **execution and control of expenditures**. These are often associated with the fragmentation of responsibilities for budget execution (e.g. responsibilities for the execution of the current and the investment budget are split between different government agencies in Algeria, Egypt and Jordan). Difficulties include a poor record in controlling costs, problems in effective service delivery (e.g. Algeria and Egypt), problems in monitoring, accounting and updating debt records and insufficient control on the emergence of contingent liabilities (including in Jordan, Lebanon⁶³ and Morocco⁶⁴). The Lebanese Ministry of Finance is currently implementing a number of reforms including the automation of budget execution. In Morocco and Tunisia expenditure controls are reported to be generally appropriate, with expenditures broadly remaining within the limits of the budget law. However, in Morocco there remain some difficulties to effectively control expenditures on wages and salaries⁶⁵. Tunisia faces some weaknesses in the transparency and ex post control of the budget of local authorities.⁶⁶ In WB&G the Ministry of Finance exercises a good control over budget

⁶¹ Given recent significant PFM reforms some donors have chosen to route their assistance through the Central Treasury Account. This account has sub-accounts through which donors can fund their projects. However some donors remain unable or unwilling to use the CTA.

⁶² Although the public accounts law foresees that all public finances should be channelled through a public treasury account in the Banque de Liban, public administration, municipalities, and other public entities are allowed to open private accounts in Banque de Liban.

⁶³ the IMF has stressed the need to control the growth in contingent liabilities, foremost the losses of Electricité du Liban and the social security system. It suggested that open-ended transfers should be replaced by a time-bound restructuring programme.

⁶⁴ Large contingent liabilities are reported as a major problem in Morocco. The power of line ministries and the MoF to control the emergence of risks and contingent liabilities are minimal and should be reinforced. The WB has called for including contingent liabilities fully in the budget process and from the start, i.e. in budget preparation. The WB also suggested issuing specific rules and regulation to avoid the creation of off budget liabilities, and strengthening the assessment and management of the risks related to projects. The issue of new commitments by the government should be consistent with the macroeconomic framework and the sustainable level of debt.

⁶⁵ These are the biggest spending item in the Moroccan budget. Although the 5 years plan sets clear objectives for overall expenditures on salaries and no new employment can be created beyond what is authorised by the loi des finances, these rules have been undermined by the frequent recourse to exceptional measures.

⁶⁶ With support from the EC/WB the Moroccan authorities are setting up an integrated system of expenditures focusing on process automation and effective decentralisation.

expenditures, and in particular the control over the public sector payroll has improved significantly⁶⁷. Another weakness is the lack of a formal system of commitment control, as budget allocations are an authority to make payments

Some MED countries are taking measures to improve their system of **financial planning and cash flow forecasting**. These reforms are often connected with progress in implementing single treasury accounts, as effective cash flow management and monitoring is seriously hampered in the absence of a STA. In Morocco cash flow planning, management and monitoring are reported to be generally effective. In WB&G the introduction of the STA has facilitated cash management and eliminated previous non-transparent and discretionary spending from various off-budget sources.⁶⁸

Debt management by Mediterranean governments is of mixed performance. In Morocco and Tunisia procedures for government borrowing and debt management are reported to be broadly sound.⁶⁹ Given the high level of public debt and the cost of servicing it, the Lebanese government has attached great importance to modernizing its debt management functions, and the IMF reports of significant improvements made in debt management.⁷⁰ On the other hand, debt management in Egypt is relatively basic. Most of public debt issuance is held by the Central Bank of Egypt and commercial banks. In Syria comprehensive data on debt is not publicly available and there is no functioning treasury bills market.

5.4. Accounting, data reconciliation and reporting

Mediterranean countries use different types of **accounting** systems, which suffer from limitations in some cases. Algeria uses a modified cash-based double entry system⁷¹. In Egypt accounting for current expenditures is undertaken on a cash basis, implying that arrears appear only implicitly and with a delay, while the investment budget is

⁶⁷ The MoF has taken charge of the central payroll system and is now able to monitor new recruitment and pay all public sector salaries, and thereby to contain hiring. In the 2004 budget, the previous large discretionary transfer appropriation for the President's office has been virtually eliminated, with these funds instead transferred to relevant service ministries.

⁶⁸ Given political instability and revenue unpredictability, however, cash forecasting and management remains rudimentary.

⁶⁹ Nevertheless in Tunisia there remain issues of transparency and reporting on the stock. This is associated with the fact that procedures for debt reporting are not institutionalised, particularly when financial conventions are concluded by government bodies (such as the Ministry of Foreign Affairs and the Ministry of Development and Co-operation).

⁷⁰ The MoF participates in a WB – IMF Program on Central Government Debt Management and Domestic Debt Market Development which has led to the development of a reform programme. Although the debt level remains high, improvements were already made in the composition and the risk profile of the public debt since the implementation of the Paris II financial package and with the overall improvement in market conditions.

⁷¹ Whereby certain items awaiting payment or collection at the end of the year can also be taken into account. Uncertainty about the length of this supplementary period complicates the preparation of financial statements and hampers transparency. A major reform is reportedly underway to introduce a government charter of account leading to the implementation of accrual accounting.

reported on an accrual basis.⁷² In Jordan accounting is on a cash basis with double entry bookkeeping but in many respects falling short of international practice.⁷³ In Lebanon a new accounting system has been recently introduced based on accrual accounting and conform to the IMF's GFS manual. In Morocco accounting is relatively reliable and precise, and is being further modernised but still not suitable for correctly assessing contingent liabilities.⁷⁴ The Syrian government uses single-entry cash basis accounting system, which may lead to loss of control of liabilities, and financial statements are not consolidated with those of state owned companies. Accounting in Tunisia is on a single entry cash-basis system. It is automated, well structured and institutionalised, with appropriate safeguards. Reforms of the accounting system with the view of introducing the double entry procedures have been long on the agenda (since the 1970s). In WB&G accounting is on the double entry principle and partly centralized in MoF (covering the single treasury account) and partly decentralized to line ministries and agencies, where individual accounting systems have been established at line ministries and agencies covering the monthly transfers from the single treasury account.⁷⁵

Fiscal ex post reporting is relatively advanced in a number of Mediterranean countries including in Jordan, Lebanon⁷⁶, Morocco⁷⁷ and Tunisia⁷⁸ but remains problematic in some others. For instance in Algeria the budget “review law” (Loi de règlement) which reports on the execution of the budget law and on the budget fiscal surplus or deficit, has last been submitted to Parliament in 1985 (covering the 1982 accounts). Moreover, the fiscal accounting documents are not circulated outside the Algerian Ministry of Finance. In Egypt, ex post expenditure data is made available in a much aggregated form and with big delays. Contingent liabilities, foregone revenues and arrears are not monitored on a systematic basis. In Syria very limited information is made publicly available on fiscal out-turns. In WB&G there have been significant improvements in fiscal reporting and in 2004 the PA produced a first-ever set of

⁷² Nevertheless, in Egypt accounting data are compiled in a way that is comparable with IMF and international standards.

⁷³ In Jordan there is no accounting system for the government and a whole and the MoF has no access to the data of ministries and departments. Government agencies undertake their own accounting and reporting using a mix of systems (manual and IT). In addition, the investment projects managed by the MoP are included in the accounts only at the end of the year.

⁷⁴ While some progress was made a number of budget risks are not analysed and reported. These includes the debts of extraordinary budget funds, social security, non guaranteed debt of SOEs and local authorities and the guarantees by the special treasury accounts.

⁷⁵ The WB has recommended that the MoF should provide guidance to line ministries so as to harmonise their accounting systems with the central system.

⁷⁶ Regular reports available on the MoF website include yearly, quarterly and monthly statistical fiscal reports, as well as Paris II Progress Reports. However the restricted coverage of the budget limits the overall validity of these statements.

⁷⁷ However a weakness of the transparency of budgetary execution in Morocco relates to the lack of publication of the acts of expenditure movements (allowing for movements among budget allocations provided that the overall expenditures ceiling is not exceeded) and of the correcting budget law (allowing to adjust expenditures and revenues in the course of the budget year to reflect unforeseen developments) and the lengthy procedure for validating the budget review law.

⁷⁸ However the annual accounts presented in the budget review law are submitted to Parliament with long delays -2 years after the end of the accounting period.

consolidated financial statements the first audited financial statements for Palestinian Investment Fund. However remaining weaknesses include the lack of aggregate financial statements providing information on the overall financial position of the Palestinian Authority.

All Mediterranean countries have put in place **audit systems for external accountability**, but in most of them their functioning is below international standards. Problems include weak capacity of the external audit institution (e.g. in Algeria, Jordan⁷⁹, WB&G⁸⁰), limited or no publication of the audit results (e.g. Algeria⁸¹, Egypt⁸², Jordan⁸³, Lebanon, Tunisia⁸⁴), excessive focus on accounting irregularities (e.g. Egypt⁸⁵, Jordan, WB&G), incomplete guarantees of independence (e.g. Jordan⁸⁶, Lebanon, WB&G⁸⁷), delays in reporting to Parliament (e.g. Lebanon⁸⁸, Syria⁸⁹) or lack of obligation to report to the Parliament (e.g. WB&G⁹⁰) and involvement in non-audit activities (Jordan⁹¹). In Morocco and Tunisia external audit is carried out

⁷⁹ Although within its mandate the Audit Bureau does a good job, it does not have the capacity to perform certain types of audits such as the thorough analysis and reconciliation of the final budget accounts and the certification of their accuracy and reliability.

⁸⁰ The Palestinian General Control Institute (GCI) has weak technical capacity and the quality of its work is low. It focuses on relatively minor compliance issues rather than on issues of systems, materiality and risk.

⁸¹ In Algeria although the law foresees that the National Audit Court should address its annual report to the President of the Republic with a copy to Parliament and wholly or partly published in the Official Gazette, only the reports of 1996 and 1997 have been published.

⁸² In Egypt the reports by the Central Accounting Office (CAO) are narrowly disseminated.

⁸³ In Jordan the annual report of the Audit Bureau is submitted to Parliament, with copy to the Prime Minister and the Minister of Finance, but it is not issued to the general public.

⁸⁴ Only some 600 copies of the audit reports are circulated and only some abstracts are published on the official journal.

⁸⁵ The Egypt Central Accounting Office has, in April 2004, very outspokenly criticized the country's fiscal management (2001/2002 out-turns) for discrepancies between budgeted and actual outlays. The new Minister of Finance appears keen to launch an audit of the National Investment Bank some time in 2005.

⁸⁶ Although some progress is being made the WB/IMF have called for further amendments of the law to strengthen the financial independence of the AB by issuing a separate procedure for determining its budget.

⁸⁷ The President has the authority to exempt any undertaking from audit by the CGI.

⁸⁸ Delays in producing the final financial accounts have prevented the Court of Auditors from presenting its report to the government and the Parliament.

⁸⁹ Syria's final fiscal accounts are controlled by a Central Unit for Financial Control before being forwarded to Parliament for discussion and voted as a law by a presidential decree (the "law of final accounts"). However due to delays in preparation, the audited fiscal accounts are not available to Parliament in time for the preparation of the following year's budget. It is notable that in June 2004 the Parliament approved the final accounts law for closing the accounts of 2002 asking the government to review its method of budget preparation.

⁹⁰ The Palestinian General Control Institute (GCI) reports formally to the President, but neither reports to nor is responsive to the Palestinian Legislative Council. GCI reports are not used by MOF, the line ministries and agencies concerned nor by the PLC or international donor. The GCI nevertheless has some desirable features such as adequate budgetary independence and the power to obtain information.

⁹¹ In Jordan the Audit Bureau gets involved in non-audit activities (such as controlling procurement and financial management in line ministries) which prevents it from focusing on the audit function and exercising it independently. The EC will provide technical assistance to the Jordanian Audit Bureau through twinning (i.e. detachment of an official from the EU MS to the Jordanian administration).

satisfactorily by the Court of Auditors and in accordance with the INTOSAI guidelines, except in Tunisia for the limited public circulation of its annual audit report. Both in Morocco and Tunisia a weakness in accountability relates to the long delays in presenting to Parliament the “loi de règlement” on the execution of the budget law, which limit the ability of Parliament to carry out timely ex post examinations of expenditures and use fiscal information when discussing the future budget. In WB&G in late 2004 a new External Audit law was awaiting the signature of the President, for the establishment of a Council of Administrative and Financial Control to replace the GCI. This would report to the PLC as well as the President and cover the budget and all PA entities. A positive development in WB&G was the issue since 2004 of annual audited financial statements of the Palestine Investment Fund⁹².

6. Conclusions

This paper reports on work in progress in reviewing the state of public finance management systems (PFM) and recent reforms in the EU Mediterranean partners. Additional research will be carried out to complete and verify missing or unclear information for some countries. Although preliminary, this review shows that, although to very different degrees, all the EU Mediterranean partner countries’ authorities are giving attention to improving the state of their public finance management systems. Against narrowing margins for expanding government resources on the one hand, and on the other, citizens’ demands for a more efficient and accountable state, sound PFM systems can help strengthen Mediterranean countries public finances, raise the efficiency in the use of public monies and government accountability. PFM reform efforts in the Mediterranean are generally backed by technical and financial support from international financial institutions and foreign donors, including the European Commission.

This paper however also reveals that there remain significant weakness in the design and functioning of PFM systems in most Mediterranean countries. The majority of Mediterranean countries still display weaknesses in the degree of transparency and comprehensiveness of their budgets, in the rules and practices applied to budget planning, preparation and execution as well as in the level of external fiscal accountability and control. The reluctance of some countries to agree to the publication of the PFM diagnostics carried out by international donors appears indicative of the state of their PFM systems and the need to strongly pursue reforms.

For both developmental and fiduciary reasons, these weaknesses need to be taken into account by international donors, particularly in relation with the provision of direct financial support to these countries’ budgets. With special reference to financial and technical cooperation from the EC budget, PFM issues are already included, albeit to

⁹² The PIF was established to bring under MOF oversight all PA equity holdings, including virtually all state-owned enterprises. On the other hand, the requirement that SOEs produce annual audited financial statements is not being observed in all cases. The WB recommends that audited financial statements required from SOEs should be prepared.

different degrees and in a somehow piecemeal fashion, among the objectives of EC co-operation with all Mediterranean countries. The emphasis on PFM reforms is being strengthened under the new European Neighbourhood Policy. Ideally, this would lead to a more systematic and coherent use of specific PFM conditionalities for the extension of budget support, the design of technical assistance programmes of a larger scale than it is currently the case, and a more active dialogue with other international donors and financial institutions on PFM reforms in the region. Nevertheless, while external conditionality and technical assistance can play a supportive role, improvements of PFM –as any other type of institutional reforms- need to be backed up by sufficient domestic reforms commitment in order to be successful.

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Annex 1

Draft set of PEFA PFM performance indicators

A. PFM OUT-TURNS
1. Aggregate fiscal deficit compared to the original approved budget. 2. Composition of budget expenditure out-turn compared to the original approved budget. 3. Aggregate revenue out-turn compared to the original approved budget. 4. Stock of expenditure arrears; accumulation of new arrears over past year.
B. KEY CROSS-CUTTING FEATURES : COMPREHENSIVENESS AND TRANSPARENCY
5. Comprehensiveness of aggregate fiscal risk oversight. 6. Extent to which budget reports include all significant expenditures on government activities, including those funded by donors. 7. Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation
8. Administrative, economic, functional and programmatic classification of the budget. 9. Identification of poverty related expenditure in the budget.
10. Publication and public accessibility of key fiscal information and audit reports.
C. BUDGET CYCLE
C(i) Medium term planning and budget formulation
11. Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting. 12. Orderliness and participation in the budget formulation process. 13. Coordination of the budgeting of recurrent and investment expenditures. 14. Legislative scrutiny of the annual budget law.
C(ii) Budget execution
15. Effectiveness of cash flow planning, management and monitoring 16. Procedures in operation for the management and recording of debt and guarantees. 17. Extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with original/revised budgets. 18. Evidence available that budgeted resources reach spending units in a timely manner. 19. Effectiveness of internal controls. 20. Effectiveness of internal audit. 21. Effectiveness of payroll controls. 22. Clarity and enforceability of procurement rules, and the extent to which they promote competition, transparency and economy.
C(iii) Accounting and reporting
23. Timeliness and regularity of data reconciliation. 24. Timeliness, quality and dissemination of in-year budget execution reports. 25. Timeliness of the presentation of audited financial statements to the legislature.
C(iv) External accountability, audit and scrutiny
26. The scope and nature of external audit reports. 27. Follow up of audit reports by the executive or audited entity. 28. Legislative scrutiny of external audit reports.
D. INDICATORS OF DONORS PRACTICES
Donor 1. Completeness of donor information provided on aid flows, and comparison of actual donor flows with donor forecasts. Donor 2. Proportion of aid that is managed using national procedures.

Source: PEFA

Annex 2

Adapted PEFA indicators for MED country reviews

BUDGET CYCLE

Comprehensiveness and transparency

Comprehensiveness of the budget

Extent to which budget reports include all significant expenditures on government activities, including those funded by donors

Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation

Administrative, economic, functional and programmatic classification of the budget

Publication and public accessibility to the wider community of key fiscal information and audit reports

Budget planning and formulation

Description of the budget legal and institutional framework, budget procedures

Orderliness and participation in the budget formulation process

Results-orientation of the budget

Existence of a technically sound, up to date, economic framework

Extent of multi-year perspective (e.g. use of a medium-term expenditure framework)

Coordination of the budgeting of recurrent and investment expenditures (consideration of the medium-term implications of new investments)

Frequency and legitimacy of changes in the budget during implementation in response to political and economic circumstances

Existence and use of fiscal rules and hard budget constraints backed by appropriate authority

Legislative scrutiny of the annual budget law

Budget execution

Existence of a single treasury account

Effectiveness of cash flow planning, management and monitoring

Emergence of large contingent liabilities

Extent of deferred budgeting (expenditures are pushed to subsequent years and arrears build up)

Existence of sound procedures for government borrowing and debt management, and the management and recording of debt and guarantees

Accounting and reporting, external accountability, audit and scrutiny

Preparation of complete, accurate and timely accounts of actual expenditure including of in-year budget execution

Timeliness and regularity of data reconciliation

Scope and nature of external audit reports, compliance with international standards

Follow up of audit reports by the executive or audited entity

Legislative scrutiny of external audit reports