STATE BUILDING IN CONFLICT AFFECTED & FRAGILE STATES:

A COMPARATIVE STUDY

Public Finance and National Accountability in Timor-Leste and Afghanistan

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1 The views expressed in this comparative study are those of the authors, who were directly involved in the work described in the case studies albeit in different roles. The authors acknowledge this makes them participants in and not simply observers of these events. Vincent Ashcroft worked in the Ministry of Finance (MoF) in Timor-Leste in 2002-2003 and then was later the Head of the Australian Government’s aid program in Timor-Leste from 2011-2014. Andrew Laing also worked in the Timor-Leste MoF from 2000-2003 and then was the Lead Economist for the World Bank until 2004. Andrew has been a senior adviser to the MoF on implementation of its strategic plan since 2011. Both have also been working with the Government of Afghanistan on their Fiscal Reform program since 2015. Clare Lockhart was adviser to the UN and the Afghan Government from 2001-2005 and is the Director of the Institute of State Effectiveness, which supports the Government of Afghanistan across a range of reform areas including fiscal reforms. ISE maintains that the evidence presented supports the conclusions in these case studies.
The g7+ is a group of conflict-affected countries that collectively advocates for country-led pathways towards peace and resilience through reconciliation, a culture of tolerance, and shared experiences. The g7+ Foundation documents the experiences of the g7+ countries to benefit other countries in their pursuit of peace and resilience.

The Institute for State Effectiveness supports leaders, reformers, international organizations, and civil society with the systematic tools and knowledge needed to enhance state effectiveness and the citizen-state compact.

The g7+ Foundation supported the Institute for State Effectiveness to research and prepare these case studies on public financial management in Timor-Leste and Afghanistan. They are the first in a planned series to highlight innovative state-building practices in fragile states.

— Vincent Ashcroft, Andrew Laing, and Clare Lockhart
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Executive Summary

In conflict-affected or fragile states there is often a significant gap between what the state is able to deliver and what the citizens of that state, as well as international partners, expect the state to deliver. This problem stems in part from international partners focusing heavily on what should be delivered and not enough on how best to deliver it in that particular context. To examine this idea further, the g7+ Foundation has commissioned two initial case studies to try and bridge the gap in understanding and to enable governments to see what has and has not worked in comparable countries. These case studies are intended to give governments and their international partners a clearer understanding of how best to achieve meaningful reform in such countries.

This paper, using the two case studies of Timor-Leste and Afghanistan, looks at the experience of state building in the area of public financial management (PFM). The case studies demonstrate how the evolution of the Ministry of Finance (MoF) in both countries has led ministers to similar conclusions about the real challenges they face and about what works in building sustainable and robust national systems of accountability. The experience over the last decade or more is that state building as an explicit goal has largely been side-lined in practice by both governments and donors. The goal of using the national budget as the primary tool of development policy has fallen out of favor in many development circles.

Establishing systems for PFM in conflict-affected or post-conflict fragile states is challenging, to say the very least. There might be on-going conflict, but even if not, the shadows of conflict – mistrust, trauma, and chaos – are almost certainly present. The result of bypassing country systems and the annual budget process is usually large-scale fragmentation. Both a “projectization” of the national development effort and an unintentional undermining of state legitimacy in the eyes of the citizenry occur. Ignoring the importance of building legitimacy of the state means that newly elected governments are often saddled with a fragmented budget that is already locked into the donor project cycle and priorities, which are often not responsive to the government’s national priorities.
**TIMOR-LESTE**

The Timor-Leste case study follows the development of the MoF through three distinct periods after the restoration of independence in 2002. First, was a period of initial work to put in place systems to manage the national budget. Second, a longer period of reform work responded to a sharp increase in the size and scope of the national budget due to oil and gas revenues. Third, the period under the current government focuses on the capacity of the national staff to manage the challenges of the future.

The case study shows that Timor-Leste has made consistent progress in difficult circumstances. By 2014, just seven years after a period of unrest and widespread violence in 2007, the MoF had dramatically scaled up the budget, showed steady progress against international indicators on reform and development of its systems, restructured its organization twice, developed a 20-year strategic plan, and adopted a program of team-based rolling plans to implement a long-term strategic plan under a performance management system. It had moved from being aid dependent to being largely self-reliant with a direct budget support arrangement with its two key donors.

As a result of reforms, by 2016 the MoF had managed to reduce its reliance on external advisers from over 180 to only 35, with all critical functions performed by local staff or local contractors. During this same period the economy showed strong growth of more than 10% for many years and experienced a rapid reduction in poverty – one of the fastest in the world. Most critically, this has been the longest period of peace in the country’s history and there has been no repeat of the earlier episodes of violence. The country saw the withdrawal of international troops and police and successful presidential and parliamentary elections in 2012. In fact, the legacy of the last ten years has been that Timor-Leste, through its leadership roles in the g7+ and the New Deal for Engagement with Fragile States, has been able to export its experience in post-conflict stabilization and development by being a key interlocutor in other parts of the world.

**AFGHANISTAN**

The Afghanistan case study similarly follows the Afghan MoF through the initial transitional period from 2002 to 2004, and from 2004 up to the election of the current government in 2014. This case study shows a similar pattern to that of Timor-Leste. Despite the government's initial work in laying the foundations of the budget, extensive fragmentation due to the large number of donor-driven development projects caused a myriad of problems. The first budget of the transitional administration was able to start discussions between the political leaders about how much would be allocated to development objectives and each administrative agency based on policy priorities. Given the circumstances, establishing the national budget as a policy tool and not just a means to distribute rents to warring parties was a substantive achievement requiring innovation and pragmatism in equal measure.

The period from 2005 to 2014 saw some improvements in the development of core public finance systems, but also highlighted the difficulties in shifting some practices once they become entrenched. Afghanistan’s budget systems improved over time – quickly at first, but then at a slower pace. While international benchmarks like the World Bank’s Public Expenditure and Financial Accountability (PEFA) framework tended to overestimate progress in a number of key areas, progress once achieved did not reverse despite significant security challenges.

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4 In the lead-up to the elections in 2012 there were some isolated incidents of violence, but in contrast to previous periods, they did not cause broader instability and the remaining international troops in the country were not called on.

5 The New Deal came out of the International Dialogue on Peacebuilding and Statebuilding and was endorsed by 44 countries at the 4th High Level Forum on Aid Effectiveness in 2011. The principles laid out in the New Deal aim to establish more context-sensitive and country-led terms for international engagement in conflict-affected states and rests on mutual accountability from domestic and international stakeholders.
A new government was elected in August 2014 and a former Minister for Finance, Dr. Ashraf Ghani, became President. One of his first policy decisions was to commission an assessment of the public finance and national accountability systems. It was the first time the Afghan government had commissioned an assessment by the government and for the government. The President wanted advice on how to make the budget an effective tool to support the new government’s national priorities, while making the government and donors more accountable to the public for managing public finances. Using this assessment as a baseline for the challenges ahead, the government established a program of 5-year rolling plans meant to address the challenges raised in the assessment. These plans would be team-based and subject to a performance management system. The system ranks team performance against a set of criteria aimed at measuring each team’s progress against their goals.

The first annual assessment of progress against the Rolling 5-Year Fiscal Improvement Plan was conducted between November and December 2016. This follows the completion of the first mid-year assessment of performance that was presented by the Minister of Finance at the International Conference on Afghanistan in Brussels in October this year. The annual assessment shows signs that the reform trajectory is beginning to rise again, with significant steps taken on the policy front by the Afghan government, such as the establishment of the High Economic Council, which is supported by the Directorate-General of Macro-Fiscal Policy and Performance.

Further signs of progress include: a synthesized and streamlined set of National Priority Programs being designed, with some already well advanced; the first steps taken to establish forward estimates and reduce the problem of endemic over-budgeting (however, reform of the budget process remains the biggest risk to the reform program); a big investment to upgrade the Afghanistan Financial Management Information System (AFMIS), as well as investments in the backbone of the MoF – HR, IT, and accounting; and The National Procurement Authority’s outstanding progress in cleaning up procurement and setting new world class standards that will be gradually rolled back out to line ministries based on performance.

Finally, despite continuing aid dependency, the government is engaging donors to support national priorities and use country systems, and has encountered some progress on this front. For instance, budget support programs are now in place with the US and EU.

CONCLUSIONS

The importance of linking the political process to development financing and legitimacy

In both case studies, the international community played a very large and generally positive part in establishing a political settlement, which was a precondition for peace and for reconstruction, with a follow-on political process stretched over two and a half years. However, in both cases, the political settlement did not adequately address the issues of development financing and legitimacy of the state in the post-conflict setting.

In Timor-Leste, the UN established an administration and set about the very important process of working towards a new constitution and a long-term system for governing. But initially the Timorese were less in control of the process and the national budget, even after independence was restored, was not the most important driver of development with the vast majority of development funds held in trust funds or delivered by projects. This led to severe fragmentation of the development effort and low levels of accountability for aid expenditures by donors that took a number of years to address.

Afghanistan suffered from some of the same issues, although through the management of the Afghanistan Reconstruction Trust Fund (ARTF) and the presence of an Afghan-led Interim and Transitional Authority, national programs were established and partly funded. What was clear though was that the early administrations in Afghanistan were in competition with the UN and humanitarian agencies for funds and for legitimacy. It also meant that, as with Timor-Leste, the development effort was severely fragmented. More importantly, by not using the national budget as the primary tool of development early on, there was a plateauing of reform efforts in managing public finances over the next decade, even as aid flows continued to rise.
The importance of “how” development is done, not just “what” is being done

Despite the inherent challenges, both case studies show a similar path and some notable successes in both countries. They also highlight that self-reliance and sustainability can only be gained through the long and patient process of building local capacity and institutions. Conversely, the case studies highlight that an overemphasis on fiduciary risk (particularly fraud and corruption) at the cost of development outcomes, especially if used as a pretext to avoid going through government systems, will not succeed in delivering the very improvements in governance the international community sees as a priority.

Both cases illustrate that patient donor support for local capacity and institution building is key. In Timor-Leste, the heaviest period of donor influence in the MoF also correlates to the worst period for developing systems of accountability. As oil and gas revenues began to accumulate and the national budget increased dramatically, the government responded with big investments in systems and capacity. Far from the budget becoming a tool of corruption, it became a tool of transparency, far more so than many of the donor agencies operating in Timor-Leste.

In Afghanistan, analysis also shows a promising start, with some good work done by the transitional administration to get the foundations of the budget in place. This was actually helped by the way the ARTF was structured to support some fledgling national programs funded through the national budget. However, this good start plateaued in the period from 2008-2014, with little incentive provided by donors for the government to continue to reform. Aid flows increased often despite development outcomes. More focus on national priorities and local capacity with an emphasis on self-reliance and legitimacy of the government in the eyes of the people should have driven donors towards more use of the national budget.

Better development outcomes do not require higher fiduciary risks for donors

In both countries, development partners and governments have tended to prioritize reducing fiduciary risk over reducing the risks of poor development outcomes. The case studies show through a range of indicators that development risk, by which we mean the risk that development outcomes are not achieved, has generally been given a lower priority than fiduciary risk. This focus on minimizing fiduciary risk drives the project-oriented and fragmented approach to development that has been a feature of fragile states. Projects focus on “safeguarding” donor funds and “end of program outcomes” rather than progress towards national goals like self-reliance and the continuous improvement of the institutions of the state. There is also the misapprehension that there is a trade-off between the two; that, in order to achieve better development outcomes, donors have to increase their fiduciary risk. The evidence does not support this. In fact, the opposite is more common. By increasing focus on development risk, including by using national systems and building self-reliance, donors are actually in a position to ask for higher levels of accountability and to achieve lower fiduciary risk. Leaving aside donor priorities, governments themselves tend to increase the level of transparency and accountability when budgets increase, as was demonstrated in Timor-Leste during the period of expansion following the increase in oil and gas revenues.

Similarly, in the early stages of Afghanistan’s reconstruction, reform outcomes were moving at a fast pace, but as time went on and national systems were not being used in favor of processes that were designed to protect donors from fiduciary risk, the reform trajectory plateaued. These are related issues. The operational budget in Afghanistan comes under a great deal of scrutiny and is the part of the budget that the government has the most discretion over. Execution rates are routinely above 95%, indicating the budgets are realistic and systems for executing the budget work relatively well.

On the other hand, the development budget in Afghanistan is split between the discretionary part and the non-discretionary part. It is in a different currency to the operational budget, with multiple rules for different projects. Most of the discretionary budget is under the ARTF, and so follows World Bank rules, but there are still around 180 special accounts managed by the Treasury Directorate General for various projects that, while “on budget”, all have their own set of parameters. Budget execution rates for the development budget are routinely low, around 50% or lower. This indicates that budgets are too high and systems are not working well.
This sort of budget framework does the opposite of the budget scale up from 2008 in Timor-Leste, which drove reform. It entrenches poor processes and ensures that reform efforts stall. Donors, by putting money into what they see as a ‘safer’ channel have increased the chances of a poorer development outcome. And importantly, they have not lowered their fiduciary risk, as the systems in the development budget for accounting for funds and monitoring outcomes are in fact more fragmented and weaker than for the operational budget.

This is further highlighted by the fact that in Timor-Leste during their budget scale up, both development risk and fiduciary risk fell at the same time. This result tells donors and governments that using national systems is not only better for development outcomes, it is likely to be less risky.

That is not to say there are no risks. National systems that are under development need to be given time to develop. Donors need to work at the pace of the government. This may mean that initially less aid but better delivered and better targeted is likely to produce better outcomes. Where money is not channelled through the national systems directly, it must come under the policy framework of the government.

The g7+ group of countries have long understood these issues. Analysis of development projects, programs, country strategies, and frameworks is almost always done from the perspective of the development partner or donor. Reports tend to focus on what is important to those who are paying the bills. The New Deal for Conflict-Affected and Fragile States that was signed by most donor countries in 2011 set out a new narrative for development in these difficult contexts. Its twin principles of TRUST and FOCUS called on donors and developing countries to work together to focus on the priorities and capabilities of each country, not just concern themselves with the barriers and hurdles to development. And both sides pledged to work through country systems in a spirit of trust where accountability is shared and relationships are open and transparent. There also needs to be a genuine understanding of the true challenges faced by these countries. In both Afghanistan and Timor-Leste there are teams that could not be working any harder or with more diligence, and the pace of change, with its triumphs and setbacks, should not diminish their efforts because a project cycle demands short-term outcomes.

In the difficult context of an immediate post-conflict intervention, the long-term sustainability of the country may be some years away, but how a country begins the process of reconstruction can have a big impact on whether it ends up where it wants to go and how long it takes to get there. More effort needs to be made to support the legitimacy of the state in delivering the core functions that matter to ordinary people, and more emphasis needs to be given at every stage to the long-term goal of sustainability. State building is the only certain way to ensure peace, and it is peace that allows for development. Judging by the experience in both Afghanistan and Timor-Leste, international efforts would be more effective if they focused on helping countries build the legitimacy of the state and its capacity to manage and deliver services, rather than on disparate projects that in most cases do not deliver peace and stability. Securing the peace dividend that comes from an end to the cycle of conflict is a legitimate development outcome itself, and only comes with a gradual shift towards self-reliance.
ACRONYMS

- **AACA**: Afghan Assistance Coordination Authority
- **ACD**: Afghanistan Customs Department
- **AFMIS**: Afghanistan Financial Management Information System
- **ANDS**: Afghanistan National Development Strategy
- **ANPDF**: Afghanistan National Peace and Development Framework
- **ARD**: Afghanistan Revenue Department
- **ARTF**: Afghan Reconstruction Trust Fund
- **ASYCUDA**: Automated System for Customs Data
- **CBR**: Capacity Building for Results
- **CCFM**: Consultative Council on Financial Management (Timor-Leste)
- **CDCU**: Capacity Development Coordinating Unit
- **DAC**: Development Assistance Committee
- **DAD**: Development Assistance Database
- **DBS**: Direct Budget Support program
- **DFID**: Department for International Development (UK)
- **EITI**: Extractives Industries Transparency Initiative
- **ESI**: Estimated Sustainable Income
- **EU**: European Union
- **FMIS**: Financial Management Information System
- **FPIP**: Fiscal Performance Improvement Plan
- **FPU**: Fiscal Policy Unit
- **GDP**: Gross Domestic Product
- **GOTL** (Figure 4): Government of Timor-Leste
- **HCDF**: Human Capital Development Fund
- **IMF**: International Monetary Fund
- **ITAP**: Interagency Appeal for the Afghan People
- **MFPD**: Macro-Fiscal Performance Directorate
- **MoF**: Ministry of Finance
- **NGO**: Non-Governmental Organization
- **NPA**: National Procurement Authority
- **OBI**: Operation Budget Index
- **OECD**: Organization for Economic Cooperation and Development
- **PEFA**: Public Expenditure and Financial Accountability
- **PEFM**: Public Expenditure and Financial Management
- **PFM**: Public Financial Management
- **PFMCBC**: Public Finance Management Capacity Building Center
- **PMT**: Performance Management Team
- **SDP**: Strategic Development Plan
- **SIGAR**: Special Inspector General for Afghanistan Reconstruction
- **SIGTAS**: Standard Integrated Government Tax Administration System
- **SMAF**: Self-Reliance through Mutual Accountability Framework
- **TA**: Technical Assistance
- **TACU**: Technical Assistance Coordination Unit
- **TAPA**: Transitional Assistance Program for Afghanistan
- **TFET**: Trust Fund for East-Timor
- **UN**: United Nations
- **UNDP**: United Nations Development Program
- **UNTAET**: United Nations Transitional Administration in East Timor
- **UPMA**: Unit for Planning, Monitoring and Evaluation (Timor-Leste)
- **USAID**: United States Agency for International Development
- **VAT**: Value-Added Tax
Introduction

In conflict-affected or fragile states, there is often a significant gap between what the state is able to deliver and the expectations of the people and international partners about what they think should be delivered. This problem stems in part from international partners focusing heavily on what they think should be delivered and not enough on how best to deliver it within the context of conflict-affected or fragile states. To examine this idea further, the g7+ Foundation has commissioned these initial two case studies to try and bridge the gap in understanding and to enable governments to perhaps see what has and has not worked in comparable countries, as well as to give international partners a clearer understanding of how best to achieve meaningful reform in such countries.

Many books have been written on the role of the state, but few present really meaningful attempts to come up with a framework for building (or rebuilding) the state in a country in conflict or recently post-conflict.

In Fixing Failed States (2007), Ashraf Ghani and Clare Lockhart defined the sovereignty gap as: “The disjunction between the de jure assumptions that all states are sovereign regardless of their performance in practice.” They propose that there exists a set of core functions that a state should perform for its citizens and define the sovereignty gap as the difference between what a state should do and what it actually does. One of these core functions is public finance and national accountability systems. The assumption is that a government must be competent in the management of public finances if a country is going to build a stable foundation for development. Few development practitioners disagree with this proposition and over recent decades, “good governance” has become a key focus area for international development assistance. In conflict-affected countries or those coming out of conflict, this is a huge investment but one that is often ignored due to scarcity of resources and the preference of donors to work on projects with a more immediate impact.

This paper, using two case studies — Timor-Leste and Afghanistan — looks at the experience of state building in the area of public financial management (PFM) and how the evolution of the Ministry of Finance (MoF) in both countries has led them to similar conclusions about the challenges they face and what works in building sustainable and robust national systems of accountability. Experience over the last decade or more shows that using the national budget as the primary tool of development policy has some major advantages if done well. However, when external support is not provided through the national budget, it is harder to assess if investments are maximizing benefits or if there is duplication or overlap. Effectiveness and efficiency then become harder to achieve because decision makers are not given the full picture.

Building the legitimacy of the state, especially after a conflict, is one of the most important goals for any government. The chances of recurring or ongoing conflict are much higher when the state is not seen as benefiting the people. Lastly, donors want to see real ownership of policy making by national governments in developing countries.
but this can only be achieved when local authorities are both responsible for their decisions and accountable to their stakeholders for the outcomes.

*In truth, when countries are highly aid-dependent, donors can ask for whatever checks and balances in the national budget they want* and thereby can choose the level of fiduciary risk they are willing to bear while still using national systems. For their part, national governments are more likely to accept lower levels of aid and more accountability if they have more flexibility and control over resources. In the language of the New Deal, countries and development partners need to work at the pace of the country and within the capacity of the national staff. In practice, this rarely happens.

Establishing systems for PFM in countries coming out of conflict is challenging, to say the very least. There might be ongoing conflict, but even if not, the shadows of conflict – mistrust, trauma, and chaos – are almost certainly present. Once peace is established, or in some cases when there are enough international troops on the ground to allow state building and peace building to begin, the international development machine often arrives in huge numbers. Local authorities are often sidelined or co-opted into an externally driven stabilization and reconstruction effort. Initial results often appear to be good, coming off a low base, basic services are re-established and projects are designed and deployed in every sector. This success is often illusory with little meaningful investment in the foundations of the state, particularly in the capacity of the people to gradually take on the core functions of the state.

In the highly emotive period immediately post-conflict, the focus is on the short-term inputs, such as restoring basic services, rather than the longer-term goals of self-reliance and sustainability. Governments are faced with a pressing need to immediately deliver services, whilst at the same time the international community is focused on transparency and accountability of the aid they are providing.

The result is usually massive fragmentation and “projectization” of the national development effort and an unintentional undermining of state legitimacy in the eyes of the citizenry. Ignoring the importance of building some legitimacy of the state ensures that newly elected governments are saddled with a fragmented budget locked into the donor project cycle, which often is not responsive to the national priorities of the government. When the aid machine inevitably moves on to the next crisis, and the projects start to wind down, the state is often still weak and unable to meet the demands of its citizens with domestic resources, leaving many of the original drivers of conflict – corruption, mismanagement, and poverty – still in place. This has been the experience in many countries over the last decade or more, and provides the context for this paper.

“Ministers need to recognize when advisers and other forms of technical assistance are fragmenting their control over their institutions. They need to see the inter-linkages between various parts of the Ministry. They need to know how to use the latest technology to make public finance easier to manage, especially in the context of limited capacity. There are just so many lessons to learn but never enough time to learn them. Ministers of Finance will never be in control unless they know all these things: how each piece of the puzzle is connected to each other, and how data is important.”

*Emilia Pires, Minister of Finance, Timor-Leste, 2007-2014.*

What is revealed in these case studies is that there are ways to address the problems of fragmentation and projectization. Afghanistan and Timor-Leste have embraced fiscal reform in new and innovative ways, and have used team-based performance management to help achieve results by getting the right institutional culture in place. The history of development in Timor-Leste and Afghanistan has many examples of technical assistance projects cherry-picking themes for reform and teams for support. Both Ministries have worked towards changing the how development happens to “teams not themes” and “every team and every team member matters” (teams refer to the departments and units within the MoF).
Case Study: Timor-Leste

BACKGROUND

Timor-Leste faced an immense challenge in terms of state building and peace building in the wake of Indonesia’s withdrawal in 1999. After 24 years of occupation that was defined by violence and subjugation, Timor-Leste by some estimates lost 90% of its infrastructure. This widespread destruction was the most visible problem, but a much more fundamental challenge was the absence of any real capacity to deliver the core functions of the state. Timor-Leste found itself with such a profound sovereignty gap that it submitted to a United Nations Transitional Administration (UNTAET). From 1999 until 2002 the people of Timor-Leste effectively had a United Nations (UN) government whose job was to provide the basic core functions of the state and prepare for the time when independence could be restored.

While the intervention of the international community without doubt facilitated Timor-Leste’s return to independence, it would also lay the foundations for how the state would be constructed, and the pace at which the transition from a post-conflict and fragile economy to lower middle income country would occur. With widespread trauma and extreme poverty prevailing across the country, the early focus of the UN administration was in securing peace and in restoring some basic services. Huge resources were brought to bear on a small and very fragile country. In hindsight, it could be argued that there was not enough emphasis put on the capacity of Timorese to be part of the reconstruction and state building effort, and insufficient effort made to build national systems. The immediate focus was on international systems, not local capacity, and in retrospect this was perhaps not the best way forward.

Given the violence and disruption of the last years of the occupation, Timor-Leste in 1999 was experiencing a significant human capacity gap. On the one hand, the UN faced a profound need from the citizenry, but on the other, it perceived the local population as having little capacity to lead the early state building efforts. The result was a “projectized” approach that immediately fragmented the reconstruction effort and did not allow for the new government in 2002 to build its own capacity to deliver the core functions of the state. In effect, the sovereignty gap was largely still present.
Perhaps the aspect of state building that most strongly typifies both the challenges and the resilience and determination to improve outcomes is that of public financial management and building of national accountability systems. Despite Timor-Leste’s challenging beginning there have been many successes and significant progress. This case study analyzes three distinct phases of the state building process from the perspective of the MoF and charts the evolution of the budget and other systems to manage public finances. It begins with the struggle to establish the basic systems, moves to laying the foundations of core institutions, and proceeds to how Timor-Leste is fostering a culture of performance and building capacity from within to drive the MoF towards true sustainability.


The first national budget of the newly independent state of Timor-Leste in 2002 was USD $72 million. This contrasted quite dramatically with the Trust Fund for East-Timor (TFET) administered by the World Bank, which had a balance of around $270 million. This meant that the total available funds were $342 million, but only $72 million could be managed and directed by the government. While there were future prospects of significant oil and gas revenue to support the national budget, in 2002 Timor-Leste was, in essence, depending entirely on the international community to fund its budget.

In the early phase of building the national public finance systems, some very significant investments were made in establishing the basic functions but reliance on external assistance and advisers was virtually universal.

Big achievements were made early on after the restoration of independence. The budget office initiated a process of seeking budget submissions, established standard costing methodologies based on economic and functional classifications, and assisted the newly constituted Council of Ministers to set up a budget review process. Treasury established basic functions to manage and commit funds for procurement, make payments, and account for expenditure. Given the very low base, this was a heroic effort from both the new government and the donors. It is often overlooked that these achievements were made in the most difficult of contexts. There was little access to the internet, as the UN had largely dismantled the network they had used when they were acting as a transitional government. The few computers that were available were not networked and information management was very difficult. The first budget after restoration of independence was done on Excel spreadsheets and budget submissions by line ministries were provided on floppy disc. Timor-Leste is a tropical country with high temperatures and high humidity. But with only $72 million for the national budget, a proposal for air conditioning in the main government offices in the center of Dili was turned down. Most of the civil servants and the international advisers did not speak the same languages, making day-to-day communications a constant struggle.

Investment in the revenue departments – both tax and customs – was significantly lower than for the expenditure side of the budget. This partly reflected the low level of tax flowing from the economy after the conflict and partly reflected the priorities of donors who needed to construct systems of accountability for their aid flows. This imbalance persists to this day with external assistance and government investment in revenue systems well below that of the budget expenditure. The current government has launched a fiscal reform initiative with a focus on domestic sources of revenue to address both underinvestment and falling petroleum revenue.

The most pervasive problem during this initial phase of establishing the national public finance systems was that of fragmentation. The national budget was $72 million and systems had been established to plan for, execute, and account for expenditure, which as noted above was a significant achievement. However, most of the development investments being made were either made from the TFET, by various UN organizations or by other donors. There were hundreds of individual projects, which all had different systems for planning, executing, and monitoring. This may have been inevitable given the circumstances, but it meant that the newly elected government had little or no control over the vast majority of development investments, and

7 All figures are in US dollars (USD) unless specified otherwise.
could not assess what investments were being made, nor whether they had been effective. Quite simply there was no way to know what progress was being made. This fragmentation meant that there was little space for the newly elected government to gain legitimacy from its citizens through investment in services. This fragmentation would remain a significant feature of Timor-Leste’s experience over the following decade.

The fragmentation of the development effort and the escalating number of projects also meant that efforts to build the capacity of civil servants were fragmented as well. There was some effort to train staff in national systems, particularly in the budget office and in the Treasury, but officials were also confronted with the need to learn how to manage UN systems, World Bank systems, and a host of bilateral country systems. It is worth bearing in mind that Timorese civil servants experienced significant hardship during the Indonesian occupation and in most cases low levels of formal education. The low levels of basic literacy and numeracy of the civil service was never systematically addressed in the early days after the restoration of independence. It was not until 2007 when a first assessment of staff numeracy levels in the MoF was done that it became apparent that most professional staff had the equivalent of Grade three numeracy skills (the level of 10-year-old primary school students in OECD countries). The significant donor resources had meant that capacity substitution was the norm and efforts at meaningful capacity building of local staff were ad-hoc at best and largely unsuccessful.

This is not to say that the capacity of Timorese civil servants, particularly in the MoF, did not improve over the next decade or more. Rather, it is a testament to the resilience and determination of the people of Timor-Leste that they have achieved so much despite such a historically inconsistent focus on personal and professional development in the civil service.

The lack of a coherent and sustained focus on capacity building for civil servants was partly due to the national government and donors focusing more on what needed to be delivered, and less on how things should be delivered. The budget was entirely funded by the donors, which created a mismatch between donor expectations about reporting and local capacity. Civil servants were often excluded from regular reporting on the national budget by default, with reports produced independently by contractors employed by the very same donors.

Fragmentation of the budget, and particularly the huge number of projects, was not the only aid-induced problem. At the time of the restoration of independence, the absorptive capacity of the government was low. Systems were weak, human capacity constraints were high, and fragmented systems created a complex array of often competing modalities for development for government authorities. In the face of this relatively low absorptive capacity, flows of international assistance were high. From the period 2002 to 2009, flows of official development assistance grew steadily from $150 million in 2002 to over $250 million in 2008, but fell as a percentage of government expenditure (reducing from over 250% in 2002 to under 50% by 2009). In other words, development assistance grew at a slower rate than government expenditure, which was essentially driven by government withdrawals from the growing petroleum fund.
There is a case to be made that in this period in Timor-Leste, international development assistance was too influential — thereby reducing the legitimacy of the State. This is because the forced use of donor systems and processes meant that the government had very limited ability to influence how those funds were used. The funds would have to follow donor priorities and some kind of adjustment would be made to government priorities to accommodate the wishes of donors.

The use of direct and/or sector budget support could have allowed the government to manage and direct the funds according to their own processes and priorities, provided they were anchored by a budget process that followed basic good practice and was transparent. These types of mechanisms can work better than projects that are ‘off-budget’ and do not follow government processes. They can also increase the predictability of aid flows and increase the ability of the government to make strategic investments in national priorities based on need.

While typically, the issue of predictability of aid flows is about ensuring sufficient resources are available, in this case the problem was too much aid flowing into too many projects which had no oversight and control by the government. Some early efforts were made in the Planning Office (which was part of the MoF) to create a Development Assistance Database (DAD) to try to ameliorate these risks, but it would be many years before this became an effective part of the public finance system. For a few years from 2001, the MoF ran two such databases. One was used to construct a fully consolidated budget, including against government functions. The other was used to track and report on donor commitments and disbursements — in accordance with donor systems, along the lines of the OECD DAC standards. With little or no systematic way to collect or analyze performance information over this period, it is safe to assume that much of the aid provided was either poorly targeted, poorly delivered, or spent on international advisers with little impact on the people and communities most in need of such aid. In Timor-Leste during this period, the incidence of poverty increased to over 47%.
Large amounts of aid provided through a myriad of projects had one other important impact: it shifted the incentives for civil servants as they began to view donors and their projects as their main stakeholder for which they were accountable to, instead of their government. This made it hard to establish a culture of institution building.

A culture of interdependency between donors and civil servants had emerged. Senior officials needed external assistance to do their work and so projects were routinely approved and then extended regardless of their effectiveness. Donor projects routinely imposed rules and systems pushing capacity building of civil servants on national systems further away from the focus. It was not until 2007 – when a new government was elected and revenue from the petroleum fund allowed a partial break from aid dependency – that the MoF was able to seriously map out a long-term institutional plan.

Despite these challenges, much was achieved in the first five years after the restoration of independence. Most of it is qualitative, as formal assessments – including using the Public Expenditure and Financial Accountability (PEFA) framework – were only conducted from 2007 onwards. As noted, the first foundations of the budget system were put in place, with good principles; the Treasury system was established and basic financial accountability was put in place through the annual budget process. Government procedures around the Council of Ministers were established and Parliament scrutinized the executive government.

The government early on made a critical decision not to borrow from the international financial institutions against future oil and gas revenues. The government instead took the time to establish the legal basis for the petroleum fund with the assistance of the Norwegian government. This proved to be a truly inspired decision, as it would lay the foundation for future progress towards self-reliance. The legal framework would mean that the revenue from oil and gas royalties would be invested in a separate fund, the earnings from which would then be used to fund the national budget. A formula for an Estimated Sustainable Income (ESI) was devised that would allow the government to draw down on the fund while maintaining the balance of the fund in perpetuity. The ESI is about 3% of the total projected future value of the petroleum fund. Any drawdowns over and above the ESI require approval by the parliament.

This framework stood Timor-Leste in good stead and has resulted in an accumulation of over $16 billion in the fund by 2015 (Source: State Budget 2015) and substantial investments by the government in crucial areas of development. Given the devastation of 1999, it is one of the most substantial achievements in Timor-Leste that in 2011-12 the country became compliant with standards set by the Extractives Industries Transparency Initiative (EITI). This means Timor-Leste joined a select club of countries that have met the internationally recognized benchmarks for transparency of how revenues from extractive industries are collected and spent. The decisions made in the period after independence played a key role in reaching this important milestone. They also provided the opportunity for the government to begin its long journey towards self-reliance.

2007-2014: LAYING THE FOUNDATIONS OF AN INSTITUTION

Despite the heavy investment by the donor community (by some estimates over $3 billion dollars) the country continued to face periods of social instability. The failure of governments to deliver core services on a timely basis, due partly to a loss of control over the resources provided to them by the international community, culminated in a severe social crisis in 2006 and an eventual change in government.

The election of a new government in 2007, after a period of conflict and uncertainty, also coincided with a significant increase in oil and gas revenues and a commensurate increase in the ESI. In 2005, the ESI was $103 million but the government made no withdrawal from the petroleum fund. By 2010, the ESI had grown to $502 million but the government decided to withdraw an additional $309 million over and above the ESI to finance the national budget. While many people considered the withdrawal of funds over and above the ESI as unsustainable, it also provided an unprecedented opportunity for investment in development priorities, particularly infrastructure. Importantly, the decisions were

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8 Though a HIPC assessment was undertaken informally in 2003 and World Bank CPIA assessments were routine until the time Timor-Leste graduated from IDA.
made through the budget process and by the required two-thirds majority of the parliament.

The MoF needed to rise to the challenge of the scale up, and help guide the government through a potentially bumpy period. The political situation of the previous years had been extremely volatile and building genuine legitimacy of the state in the eyes of the people was of prime importance. The economic and social dividends of the restoration of independence were yet to materialize for most people. The internal displacement of around 150,000 people as well as the deployment of foreign troops and police to help provide stability emphasized the challenges ahead for the new government.

Large investments in both physical and social capital were going to be crucial. Decisions like introducing a basic social welfare system to cover pensioners, single mothers, the disabled, and war veterans without doubt contributed to restoring calm, and opened up room for a better dialogue on the future of national development. As petroleum revenue peaked just before the global financial crisis in 2008 and then fell back to lower but still substantial levels, the government was already embarking on a strategy of front-loading investments to drive development. This strategy would later be set out in detail in the Strategic Development Plan 2011-2030. Withdrawals from the Petroleum Fund over and above ESI were $104 million in 2009, $309 million in 2010, $321 million in 2011 and $830 million in 2012. The budget would in fact triple between 2009 and 2012 as the government attempted to fast track the diversification of its economy in order to move away from economic dependence on both donors and the petrochemical industry.

As a result, MoF was facing a large increase in the size of the budget, a volatile political situation, and a big drop in aid dependency, which would fundamentally reshape the government’s relations with their international development partners. There was also the critical additional factor that the frontloading of investment by the government was being funded from excess withdrawals from the Petroleum Fund. The MoF’s ability to advise the Prime Minister on the balance between much needed development investments and the need to be prudent in maintaining the sustainability of the Petroleum Fund was going to be a crucial determinant of long-term sustainability in Timor-Leste.

This challenging context had to be faced with many of the constraints of the previous five years still prevalent. The budget was fragmented between large numbers of projects, as were systems for monitoring public finances, with visiting international monitoring missions virtually a permanent feature of life in the government. Skills and human capacity gaps were still very high, with the basic numeracy and literacy of professional staff still not systematically addressed.

In 2007 there was a basic assessment conducted to establish the level of numeracy in the MoF, which was at the time regarded as one of the most highly skilled ministries. As mentioned, this assessment found that the average level of numeracy within the ministry was equivalent to Grade three (equivalent to 10 year old primary school students in OECD countries). Faced with this significant capacity challenge, the ministry put in place a combination of responses including designing simpler business processes that more closely matched the competencies of the staff tasked with managing them, automating processes using IT solutions and removing unnecessary and more complicated steps. This approach acknowledged that professional development for staff would take time and provided the necessary space for a sustained effort to “upskill” staff by focusing on the basic skills they needed for their day-to-day jobs.

Little external capacity existed at the time to take on this task of training civil servants, and so the MoF essentially created a school within the ministry and began to train staff in basic skills focused on simplified business processes. Over time, this was gradually outsourced and a Human Capital Development Fund was used to fund the on-going training needs of the staff.

Management and leadership improved considerably over the next few years with a number of senior managers in the MoF having been there from the time of the UN administration through the first term of government after restoration of independence. Similarly, in the MoF, the long-term commitment of the Australian government and the World Bank as partners had meant that the MoF had access to consistent and reasonable quality technical assistance (TA).

However, systems were also perilously weak, both technical (IT-based) and management systems. The government had begun to use the FreeBalance platform to manage the
budget but the IT infrastructure backbone was weak, given poor infrastructure and low capacity to maintain it, and the Financial Management Information System (FMIS) was not fully integrated across the government until 2010. Staff capacity to manage the FMIS was also low, requiring heavy support from FreeBalance to both operate and administer the system. This posed a significant risk given the scale up in the budget. On a more mundane but equally as important level, the MoF did not have networked computers, having largely inherited PCs from donors, and there was no consistency in software. One of the first large-scale procurements the new Minister ordered was the purchase of 500 new computers to make sure all staff had the basic tools required to do their jobs.

The government had inherited a lot of poorly constructed and dysfunctional legacy systems that were often inaccurate and not interfaced with each other. The Financial Management Information System (FMIS) was extremely limited and could not be rolled out to other ministries and into remote locations in the districts. For example there had been no bank reconciliation in three years, it was nearly impossible to check financial accounts going back in time, and a different set of charts of account emerged between budgeting and execution, which made it difficult if not impossible to compare actuals to budgets with any certainty. An external audit by Deloitte showed that at that time over 54% of transactions were being processed with no vendor identified. The FMIS was simply not fit for purpose and would pose a serious problem as the budget increased.

Even relatively simple functions like processing purchase orders was being done by expensive “international advisers”, of which there were still over 180 in the MoF in 2008. Despite the large numbers of advisers, other than in the budget directorate, none really focused on building the capacity of the local staff, partly because they were executing a centrally managed budget driven by external priorities.

The solution was a complete overhaul that would take a number of years to complete but in the end ensured the FMIS for the budget was now of a standard that might be expected in a bigger and richer country. It included a redesign and upgrade of the entire FMIS, to add in appropriate functionality and to cope with the increased resources. All modules were upgraded using web-based technology – quite a challenge given the broader ICT issues in Timor-Leste at the time. All internal workflows had to be redesigned to both fit with the simpler and streamlined business processes that were needed so local staff could manage them, and to improve the robustness of financial management. One of the most difficult legacy issues and one faced by many post-conflict countries was the poor quality and fragmentation of data partly caused by weak control of the chart of accounts. The MoF took two years to centralize and clean historical data.

In order to improve budget credibility and address the issue of not being able to compare budgets to actual expenditure, the chart of accounts had to be harmonized. Once that was done, MoF began work to develop some best practice reporting tools to enable others’ access to their improved data. This included an online transparency portal giving real time information on revenue and expenditure by creating a new and more accurate centralized database of financial data. These were huge strides forward in both the integrity of the underlying data and also in the transparency and accuracy of the budget.

The upgrade to FMIS also meant a massive program of integrating various systems. This is another common problem in many developing countries. Various parts of the systems are reasonable in and of themselves but the fact they do not talk to each other and have no automated interface leaves gaps for mistakes and even corruption. If the budget, procurement, and contracts systems aren’t linked for example, then there is room for processes to break down. Timor-Leste as part of the FMIS upgrade integrated up to 13 modules including payroll, budgets, procurement, contracts, and assets.

Without the on-going reliance on external assistance and international technical assistance, MoF embarked on a large investment in training within MoF and for line ministries. A training center was established in the central office at the MoF and all relevant staffers were put through training on the basics of public finance and the business processes associated with FMIS. This enabled a transition from advisers to local staff to manage basic processing,

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as well as the devolvement of some functions such as procurement out to line ministries where it properly belongs.

A more functional and automated FMIS also allowed the MoF to create bank accounts for over 25,000 civil servants and start making electronic transfers into them for salary, entitlements, and allowances. This was done primarily by expanding a local micro-credit institution into a national bank that could serve the needs of the government. This reform would ensure that payments were only made to individuals on the system, with an account that had verified their identity.

This entire process, while transformative in terms of moving to ownership by national civil servants of core budget functions, took some years to complete. In the meantime, senior MoF managers still relied on external advisers, but to a lesser extent over time. The main source of assistance to the MoF was through a multi-donor trust fund administered by the World Bank, which was, in effect, a project with its own reasonably narrow goals. The project started out using World Bank systems for recruitment, procurement, and monitoring and evaluation mostly due to the near absence of these systems and procedures in the MoF at the time. As the MoF evolved, and due to the reforms beginning in 2008, these systems and processes have slowly become aligned to the government's own systems. Gradually most of the designs and procedures that were being applied on the project found their way into the work of the Corporate Services General Directorate.

This process was not always smooth with the existence of a Project Implementation Unit for most of the life of the trust fund, which arguably slowed down the transition from project to national systems. Despite this, the trust fund served the MoF well and would remain a central pillar of the reform process in the MoF until it was replaced in 2014. One pivotal reason for its longevity was the fact the advisers under the trust fund were accountable to the MoF, and not to the donors. This was a big change from the previous Australian government funded program where advisers were not directly under the supervision of the MoF, and the Minister did not have the power to direct them to areas where their technical services were most needed.

Despite the challenges, by any reasonable measure, the government’s – in particular the MoF’s – performance on PFM was very good, given the circumstances. Between 2007 and 2014 under the stewardship of the Finance Minister, Emilia Pires, the MoF made a raft of changes to the way it operated. The Minister began a program of restructuring the MoF that continues to the present. The year 2008 saw the first of a series of structural reforms to the MoF to establish an administrative and organizational structure to manage the challenges ahead. Prior to this there had been a number of years of disempowerment amongst the MoF leadership group and no effective executive office oversight of key budget functions.

To address this gap in leadership and to create a sense of empowerment and teamwork between the Minister, the Vice Minister, and the senior managers in the MoF, a new forum was created. The leadership group began to meet in 2009 as a regular forum that became known as the Coordinating Council for Financial Management, or CCFM. Until this time there had been a range of management forums, but CCFM has remained a constant feature of the MoF. It is a place for discussion of reforms, for monitoring performance, and for airing ideas. The establishment of this council was followed by a new Organic Law for the MoF and a ministerial decree defining the structure and roles of the ministry. The first step was to establish four general directorates and then later expand them into six, increasing the use of merit-based selection over time. For the first time, instead of the default position of filling gaps with international advisers, the MoF appointed national coordinators (Timorese) to highly technical posts on government contracts to fill existing capacity gaps.

The way this was done was very different to past efforts and signalled clearly a shift to self-reliance and teamwork. The CCFM was a consultative forum for agreeing on management outcomes, where merit-based selection and home-grown expertise was first used. The use of such methods paved the way for a future change in culture.
Two additional key areas also needed to be addressed. First, the MoF did not have a high quality independent external auditor to provide an independent check and balance on the reforms and in particular to improve the credibility and transparency of the budget. This was addressed with the appointment via a competitive tender of Deloitte as the MoF external auditor, which went above and beyond the limited audit scope performed by Ernst & Young prior to the tender.

Second, there was not sufficient ownership within the MoF of donor projects. Individual managers engaged with their advisers but there was still not enough coordination. The solution was to set up a team to coordinate all MoF projects and to bring the World Bank team into CCFM meetings as the donor representative. This began the process of the long transition from projects to sector budget support and was typical of the iterative, problem solving management approach being employed.

The shift away from advisers was under way but they were still needed in a number of key positions. Some of them were guilty of corruption, the largest profile case being that of Nigerian-born adviser Bobby Boye, who managed to elude the oversight of donors and steal significant sums of money before he was caught. Others may not have broken the laws but pushed the limits of what was in their contracts, a problem that was particularly acute in the area of taxation. These cases highlighted the problems with oversight and performance management of advisers, by both the government and their donor partners. In direct response to corruption and performance issues, the MoF has since revised their recruitment process to make it much stricter, and has significantly reduced the number of international advisers from over 180 in 2007 to around 35 in 2017.
MoF also established a program to build an archive to make sure that data is not lost and is available when needed. This was a large and complicated process, which required professional advice and resulted in a fully operational archive center with three full-time staff. Thousands of poorly stored paper documents have now been catalogued, recorded, and stored for future use. As a result, the culture of information management is gradually changing and becoming routine.

Despite Timor-Leste’s challenging context, international benchmarks for the period from 2007 to 2012 back up the reform narrative. An independent Development and Fiduciary Risk Assessment carried out by the government in 2012,\(^8\) showed that between 2007 and 2010 the quality of public finance and national accountability systems improved, with overall fiduciary risk decreasing from high levels of risk to moderate.

\(^8\) This assessment was in large part done to establish a baseline for negotiations with donors over future targeted sector budget support for the MoF Strategic Plan.
While the independent Development and Fiduciary Risk Assessment of Timor-Leste's public finance found that overall development risk remained high, this simply underscores the point that development gains in fragile and conflict-affected states take time. However, in Timor-Leste the trend maintained a steady path of improvement (see Figure 4). Similarly, the assessment found that the direction was consistently positive. Public Expenditure and Financial Accountability (PEFA) assessments in 2007 and 2010 respectively, reported on real progress that had been made in the development of systems and identified some clear strengths (see Figure 5). The MoF during this period made material gains in budget credibility by improving their budget papers with much more information provided to the public, by improving reporting and accounting practices and by increasing the predictability of and control over budget resources. Despite a very challenging context, PEFA shows a credible improvement in average grades from a D+ to a C between the two assessments.12

12 Afghanistan and Timor-Leste are leading g7+ countries in terms of performance against PEFA. They both rate high on the g7+ league table of PEFA performance at a simple average of “C+”. However, while Timor-Leste’s progress has been relatively even, Afghanistan began quickly and then slowed down in its reform trajectory. Timor-Leste was also much more cost effective for donors with much lower aid investments for similar PEFA outcomes. For more details see the separate technical paper “Country Comparisons of Fiscal Performance Improvement” prepared by ISE to accompany these case studies.
By far the most important achievement during Timor-Leste’s reform efforts throughout the 2007-2010 timeframe was that it marked the longest period in Timor-Leste’s history without internal conflict. According to the World Bank, poverty also fell by over 16% during this period. What this demonstrates is that with the right resources, and with significant national ownership, it is possible to end the cyclical nature of internal conflict in fragile states.

The major policy development of this period was without question the development and publishing of the National Strategic Development Plan for 2011-2030. The Prime Minister with the assistance of the MoF and other agencies toured the country for most of 2010 before finalizing a comprehensive development plan. From the perspective of developing public finance and national accountability systems, the Strategic Development Plan (SDP), while un-costed, provided a detailed basis for future planning.

The Minister for Finance initiated a process for the MoF to develop its own strategic plan covering the same period of 20 years. This was a very significant step forward in building the MoF as an institution. The MoF contracted the assistance of a former head of the New Zealand Ministry of Finance and Treasury to help formulate the strategic plan. This was extremely important. The MoF led the process, but with so much practical experience, the adviser was able to guide the MoF in making sure their plan was fit for purpose. It was anchored very much in the MoF’s capacity to manage the challenges the government and the economy faced. In the end, it recommended a series of activities over the coming years that would lay the foundation of a sequenced reform plan and build a strong institution.

![FIGURE 5 2007 AND 2010 PEFA SCORES: SOURCE OF CHANGE (A BEST D WORST)](Source: Development and Fiduciary Risk Assessment 2012)
The establishment of the MoF Strategic Plan was then followed up by a process to take the long-term plan and turn it into a system of rolling 5-year action plans linked to key performance indicators. This process did a number of innovative things at once. First it recognized that planning is not static and that it is important to monitor progress and update plans to reflect outcomes. In this case, the decision was made to have an annual performance management system where progress would be assessed against the plans in the middle of the fiscal year, then an annual performance assessment would be used to update plans and publish a new rolling 5-year plan the next year. Rather than merely putting in place a planning tool, the implementation of the performance management system linked the planning cycle to the budget cycle and meant that the annual performance assessment could begin to replace other processes. In other words it was the beginning of a process to significantly lower fragmentation of the planning process.

The 5-year rolling plans were derived from the overall strategic plan, but the MoF adopted a team-based system rather than one based on themes (i.e. procurement, customs, and revenue). This was in recognition that outputs and outcomes are important, but the key goal was to measure the continuous improvement of their teams, their people, and their capacity. Another key change was the adoption of an impact and risk assessment framework for each of the major reform actions. Each team sat down and assessed each major action for its impact (importance) and against the overall risk of failure to achieve goals and complete activities successfully. The MoF also linked the actions to key performance indicators allowing a performance assessment on progress against the plans in three dimensions: timeliness, quality, and effectiveness.

This new process introduced many new ideas to the MoF and required considerable facilitation. The Australian government provided some technical assistance to facilitate teams doing their plans and to validate the performance outcomes, but at all times the process was driven by the MoF leadership. The plans reflected for the first time a truly Timorese government plan for a significant reform program based entirely on the government’s priorities. Annual performance assessments in 2013 and 2014 published by the Timorese government showed very strong improvements in a number of areas, but most strikingly in
MoF’s corporate services national directorates, highlighting the emphasis being placed on better business processes and on institution building.

The MoF engaged the Australian government in a discussion to link future support for the reform program under the MoF Strategic Plan. In other words, the MoF wanted to shift support from the multi-donor trust fund administered by the World Bank to targeted sector budget support. The Australian government, in line with its commitments to the New Deal, agreed to negotiate a program. In order to facilitate this negotiation, the government commissioned a Development and Fiduciary Risk Assessment to create a baseline and to assess the challenges.

The assessment identified a number of preconditions that would need to be met by the MoF before the Australian government would be able to move to sector budget support. These preconditions were part of the initial 5-year plans and over the course of 2013, the MoF systematically began to address these conditions. This meant that by the start of 2014, the MoF was ready to sign an agreement for direct budget support with the Australian government to support their 5-year plans.

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**FIGURE 7**

**RANKING OF MoF TEAMS ON BIGGEST IMPROVEMENT FROM 2013-2014**

Source: MoF Annual Performance Assessment 2014

**MOST IMPROVED FROM 2013 (RANK BY PERFORMANCE SCORE)**

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The Direct Budget Support (DBS) program would have some new features that again helped to reduce fragmentation. First, the DBS program allowed the closure of the multi-donor trust fund that had been around for many years. The MoF would now have just one avenue for dealing with its two major donors – the Australian government and the European Union. Second, the DBS would follow the 5-year plans and use the MoF’s performance management system for monitoring progress and would trigger the disbursement of additional funds. Thirdly, support would be direct and part of the national budget. The DBS program would split payments into fixed and variable components, effectively sharing the risks between the government and the donor. The fixed component would not be earmarked and could be used by the MoF for anything identified under the 5-year plans for that year. It would be paid on the completion of the annual performance assessment with satisfactory performance scores on average across all plans. The flexible component was to be negotiated based on mutual priorities under the 5-year plans for additional progress over and above the fixed component. This flexible part was to be paid on performance outcomes against mutually agreed priorities on a sliding scale. Effectively, the fixed component represented the donor’s risk, and the flexible component represented the government’s risk.

Performance would be self-assessed by teams and then validated by an independent team with one person from the MoF and one from each donor providing support under the DBS program. The EU joined the program in 2014.

From the uncertainty of 2007, by 2014 the MoF had massively scaled up the budget, showed steady progress by international indicators of reform and development of its systems, had restructured its organization twice, developed a 20-year strategic plan, and adopted a program of team-based rolling plans to implement the strategic plan under a performance management system. It moved from being aid dependent to largely self-reliant through a direct budget support arrangement with its two key donors.

The next phase of reforms would now focus on building a performance culture and investing in the capacity of its staff.

2014-2016: INVESTING IN CAPACITY AND BUILDING A PERFORMANCE CULTURE

After a period of relative stability, Timor-Leste in 2015 saw the retirement of the Prime Minister, Xanana Gusmao, and the long-term Finance Minister, Emilia Pires. A new Prime Minister, Rui Maria Araujo, was sworn in and he appointed a new finance minister. The new finance minister represented continuity in many ways. Santina Cardoso was the former Vice Minister of Finance and had been a senior manager in the MoF for a decade. As Director-General of Corporate Services, the new minister had been one of the driving forces behind the reforms to the budget and the MoF.

Under the new minister, the drive for further reforms would not lose any momentum. The MoF has now embarked on two additional major reforms, a program of fiscal reforms, targeting long-term sustainability through increased revenue from domestic, non-oil sources, and performance management reforms, targeting the basic competencies of the professional staff of the MoF.

PROGRESS ON TEAM-BASED PERFORMANCE MANAGEMENT AND THE 5-YEAR PLANS

Before discussing these new reforms, it is also important to briefly examine the progress of the team-based performance management system and progress against the MoF Strategic Plan. After a promising start in 2013 and 2014, the momentum on the 5-year plans and the team-based performance management system slowed. Following the 2014 annual assessment, a new 5-year rolling plan was produced in early 2015 with updated key performance indicators. However, the performance cycle that had been established over the previous two years was not completed. A mid-year assessment of progress was completed in April 2015 but not finalized until August 2015, due to disagreements about scope, content, and outcomes. No formal annual assessment of progress against the plans was completed or published at the end of the year, however, a partial assessment was produced by the Australian government. Nevertheless, the outcomes were not agreed on between the partners – Australia and the MoF. This breakdown in the system can be partly attributed to the change in government (and ministers) in early 2015, but it can
also be partly attributed to the change in focus of MoF towards performance management reforms targeted at individual staff, and in some measure, to a change in approach by the MoF’s major donor, the Australian government.

In mid-2015, the Timorese government approved a new decree law on Planning Budgeting, Monitoring and Evaluation (Law No.22/2015), which set out a new direction for the budget. The decree law established a new focus on program-based budgets with a top down approach to setting priorities based on shares of the budget. The law also established a new team within the Prime Minister’s office to oversee the implementation of the new law. The Unit for Planning Monitoring and Evaluation (known as UPMA) was staffed by international and local advisers and with driving forward this new reform agenda.

The new agenda led by the Prime Minister represented an opportunity for a whole-of-government approach to public finance reforms, but in practice may have served to fragment the policy environment; the move towards program budgeting has changed the policy agenda significantly without a clear, sequenced pathway to implement the changes. Further the new agenda follows a well-travelled path of consultant-driven reforms using a central authority to impose a framework rather than working on national systems to develop them. The creation of UPMA could have created a useful mechanism for coordination, but instead it shifted much of the responsibility for managing the reform agenda away from the MoF and into an institution run by consultants rather than officials. While initiated by the Prime Minister, donors have also played a role in the change of policy direction, and may have contributed to the fragmentation of development assistance in the area of public finance and national accountability systems.

MoF have adjusted to the change in policy direction to support the program budget reforms but have struggled to maintain the momentum around their institutional reform program. With no formal performance assessments finalized for 2015, both parties in mid-2016 dissolved the DBS program.

Since support for the broader public finance reforms set out by the government in the decree law number 25/2015 is important, the dissolution of the DBS program is a significant step back by both the Timorese government and donors, as it represents a return to a “projectized” and fragmented approach. Such an approach is not in line with the principles of the New Deal and risks repeating the mistakes of the past.

After the DBS setback, the MoF is trying to get back on track. It has now revised its 5-year plans and is trying to resume the cycle with an abbreviated annual assessment to be published in early 2017. The MoF is doing this without the incentive of budget support and in many cases with little prospect of filling the gaps in technical assistance. The assessment is yet to be published, but initial findings show that despite the difficult context, MoF has continued to make incremental progress against its strategic goals.

**Fiscal Reforms**

Fiscal reforms are crucial to understanding how governments attribute their budgets and how practices and programs can be adjusted to make resources available for critical new development priorities. The first major reform of the new 6th Constitutional Government of Timor-Leste is the Fiscal Reform initiative. Like initiatives before it, the fiscal reforms are a government led and initiated program. In recognition of falling petroleum revenue and limited sources of long-term growth in non-oil domestic revenue, the government took a proposal to the national parliament to begin addressing the sustainability of public finances. This has been a big political issue since the government began making excess withdrawals from the Petroleum Fund in 2008.

The government proposed establishing a Fiscal Reform Commission to oversee the program and the proposal was approved in late 2015. This Commission is approaching the task with a comprehensive view, examining the institutional, legal, systems, and human resource issues in revenue and has a long-term agenda with a 10-year vision for the reforms.

The work is multi-faceted. Work has already commenced with studies looking at the policy framework for non-tax revenue (fees and charges), including for electricity and water. These are key issues for poverty as well as fiscal sustainability, so careful analysis needs to be done before
changes are made. The Commission has acknowledged that this area of fees and charges is less about money as more about providing services and sustainable systems that are cost effective for the government.

The Commission’s main body of work is directed at tax and customs reform. As already noted, tax and customs are areas of relative under-investment. Their first priority is to examine the tax base and identify potential increases in, as well as new sources of, future revenue. Studies into tax incentives and the sustainability and effectiveness of the investment law are already under way. A review of tax policy has been initiated to identify the gaps in the tax system, and a draft framework for introduction of a Value-Added Tax (VAT) has begun, with a target of introducing the new tax by 2019.

Changes in tax policy will be backed up with more investment in government capacity to administer the tax system. Customs will also see more investment, and will prioritize the integration of policy and coordination. This work is being done internally, with the Fiscal Reform Commission using its own resources from the national budget. The allocation of resources from the budget is a clear indicator of the strong political will and commitment behind the reforms.

These fiscal reforms will also require significant investment in public sector reform and a focus on critical institutions like the revenue and customs departments. The capacity of staff is still quite low and a long-term commitment to training is necessary. Sequencing will also be very important. The Commission is pulling together plans for restructuring institutions under the revised organic law for the MoF, a long-term training strategy that combines formal study with the job training, as well as a legislative agenda and a workforce planning strategy that includes merit based recruitment. This is an ambitious long-term undertaking that will be a key determinant of Timor-Leste’s future.

**PERFORMANCE MANAGEMENT REFORMS**

The final and most ambitious piece in the reform puzzle is human capital development. In most developing countries, it is generally accepted that capacity of civil servants will be low and somewhat of an intractable problem. As discussed in this case study, Timor-Leste has been no exception to this rule and has suffered from a lack of focus on human capital development, by both the government and donors. The assessment of MoF staff in 2007 and the establishment of the Human Capital Development Fund (HCDF) in 2011, were first steps by governments intent on addressing this major constraint to self-reliance. The HCDF is a whole-of-government initiative, with the MoF as one of the most active users of their resources. Internally funded scholarships for long-term and short-term study have now far exceeded those provided by international partners and the establishment of the MoF training center has seen a much larger emphasis put on training in recent years.

In 2015, the MoF began a process to systematically assess the capacity of their staff, including for basic literacy and numeracy. The MoF has designed competencies for a range of fields, and tested their staff. This phase of assessment has been followed in 2016 by the introduction of merit-based selection for all positions, including in senior management. These reforms are truly groundbreaking for a country like Timor-Leste.

The government began with a third restructure of their finance ministry through the establishment of a new organic law. The law established a reform team to lead an analysis of the current human resource capacity and develop a process for HR capacity building. The MoF looked at the current qualifications of its staff and set some goals for what the long-term needs would be. As shown in Figure 8, there is a significant gap between the existing qualifications of staff and the ideal.
The next step involved establishing basic competencies for the various fields of expertise in the delivery of the budget and the management of public finances. This was a much more rigorous approach than is typically seen in developing countries. Most approaches focus on individual job descriptions for each position. The MoF instead wanted to establish what the generic requirements are for certain functions and map them for different levels of responsibility. This had never been done in the MoF and was well beyond what was required by the Civil Service Commission. The MoF drafted the core competencies for four core areas using internal resources in the Public Finance Management Capacity Building Center (PFMCBC) – a center established to design and implement a professional development system – and technical advisers in various departments.

Once the competencies had been established the next step was to design standard tests. The idea was radical, as it was to test all professional staff in the MoF and as many staff as possible from line ministries working in public finance roles in both generic competencies like literacy and numeracy and also core competencies related to their work. Tests were conducted in 2015 and 2016 for over 1000 civil servants under exam conditions.

Results are not publicly available, but staff members have been informed of their results and the MoF has used them to finalize the most recent round of appointments. According to the results, capacity of professional staff both in the MoF and in line ministries is still quite low. Of over 1000 officials tested in numeracy, only 14 scored above 80%, with around 230 (around 20%) scoring above 60%. The test results revealed that a significant proportion of MoF staff could not manage basic mathematical tasks and some had poor reading and writing skills. In some competencies, such as in revenue and ICT, less than 5% got a mark of above 60%.

![Staff Qualifications – Existing Versus Ideal](chart.png)

**FIGURE 8** STAFF QUALIFICATIONS – EXISTING VERSUS IDEAL
Source: MoF 2016
On the other hand, results on leadership and management testing showed most managers performed well, especially in the MoF. For the first time in Timor-Leste, the MoF had established a true capacity baseline for one of the most fundamental core functions of the state.
The next steps are to institute a long-term and comprehensive training program based on the established competencies and in line with identified needs. The purpose of the testing was not to punish, shame, or exclude staff. It was to establish a baseline to assess training and professional development needs.

The difficulty of these reforms should not be underestimated. There is a reason that most developing and particularly conflict-affected and fragile states don’t take on human resource constraints. Merit-based selection of staff based on competencies might be sensible but they challenge the entrenched and strong vested interests of those who have benefited from patronage and politically based civil service systems. As a result, there have been reports of intimidation and threats to staff who have been offered promotions based on their performance. Some staff members have even declined promotions due to fear of the repercussions. These reforms take courage and staunch political will, and they are worthy of support.

The professional development plans developed by teams within the MoF are set out below in Figure 10, and are well in advance. The task now is to bring strategic planning under the rolling 5-year plans, together with workforce planning, under the performance management reforms. The MoF recognizes that bringing all of their staff up to the competencies will take time. Rather than fill positions with people who are not qualified, the teams have put in place arrangements where suitably qualified national technical assistance staff (contracted non-civil servants) will fill positions temporarily, while international technical assistance will remain in place to support the operations of the ministry for some time to come. In a final demonstration of how far the MoF has come, the government is now putting some weight behind efforts to coordinate technical assistance, via a newly established Technical Assistance Coordination Unit (TACU).

The Capacity Development Coordinating Unit (CDCU) was originally under the Prime Minister’s Office during the early years after the restoration of independence, but had little capacity and there was little political will to make it work. Then under the IV Constitutional Government the MoF was given the mandate to set up a Technical Assistance Coordination Office but it too was never fleshed out as a program. Now under the VI Constitutional Government it has been given a push from the Council of Ministers for it to be implemented, starting with the MoF who will set up its own unit, TACU, to establish policies and procedures. It will then be rolled out government-wide to ensure that the performance of technical assistance is coordinated across ministries and agencies. This also has never been done before.
As a result of all of these changes MoF managed to reduce its reliance on external advisers from over 180 to currently around 35, with all critical functions performed by local staff or local contractors. During this same period, the economy showed very strong growth of 10% or greater for many years and a rapid reduction in poverty – one of the fastest in the world (approximately 2.4% per year). By diversifying the petroleum fund, an additional $3 billion dollars accrued to Timor-Leste over and above what would have otherwise been the case. Poverty fell between 2007 and 2014 at one of the fastest rates in the world from 47.2 % to 30.3% (using the international poverty line of $1.33 per day).

FIGURE 10 PROPOSED SYSTEM FOR INTEGRATING WORK FORCE PLANNING WITH STRATEGIC PLANNING

Source: MoF 2016

WORKING TOGETHER TO DELIVER SERVICES (PMR CONCEPT)

Timor-Leste has undergone the longest period of peace in the country’s history and there has been no repeat of the earlier episodes of violence leading to instability and internal displacement of people. Timor-Leste has managed the withdrawal of international troops and police with no long-term problems and held successful presidential and parliamentary elections in 2012.

The legacy of this period has been that Timor-Leste, through its role in the g7+ and the New Deal, has been able to export its experiences in post-conflict stabilization and development by being a key interlocutor in other parts of the world, including in Africa.
Case Study: Afghanistan

BACKGROUND

The second case study, Afghanistan, has a very different set of circumstances to Timor-Leste, but also bears some similarities. Afghanistan is a country still in conflict and heavily reliant on international support. For the purposes of this discussion, the common features between the two case studies are the long occupation by a foreign power (in Afghanistan’s case the Soviet Union) and a history of conflict despite the restoration of independence. Many authors have written about the modern history of Afghanistan in greater detail. Therefore, this paper will not endeavor to give a detailed account of the country’s complex and challenging environment.

Afghanistan is illustrative of the need for new approaches when analyzing why budgets are key to development in fragile and conflict-affected states. There are two crucial features in Afghanistan that distinguish it from the first case study in this paper. First, without significant domestic sources of revenue, Afghanistan remains one of the most aid dependent countries in the world even 14 years after the ousting of the Taliban regime. Second, opposing parties have been unable to reach political reconciliation and the conflict remains a significant threat to the future.

With the election of President Ghani in 2014, improving governance and making the national budget the primary tool for policy making and nation building became key goals. In Fixing Failed States, Ghani writes:

“Sound management of public finances is the vehicle through which states can realize public goals. Efficient collection of resources among contending priorities turn ideas and aspirations into concrete outcomes. The record of state activities lies most clearly in its budget, which is both the medium and the message.”

The challenge faced by Afghanistan in living up to this goal can hardly be overstated. By 2001 Afghanistan had experienced nearly 25 years of occupation, civil war, and rule by a religious fundamentalist regime. Afghanistan faced a reconstruction effort of enormous proportions. The task was not only to put in place crucial core functions of the state, but also to build legitimacy with a people used to

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14 See “Reforming Fiscal and Economic Management in Afghanistan” (Carnahan, Manning, Bonijer and Guimbert, 2004) and “Peace and the Public Purse — Chapter 6: The Budget as the Linchpin of the State: Lessons from Afghanistan” (Ghani, Lockhart, Nehan and Massoud, 2014).
corruption, rule by warlords, and ethnic divisions. A huge proportion of the population had been displaced, and many had been educated in neighboring Pakistan or other countries. Women in particular had borne the brunt of the oppressive policies of the Taliban. Bringing the country together in a single national purpose of reconstruction and reconciliation would be challenging.

The challenge was made even more so given the near total collapse of the economy. In 2002 the International Monetary Fund (IMF) estimated GDP per capita in Afghanistan to be just $196. While Afghans had their own government from the outset, their reliance on international support was almost total. Their leaders were a combination of well-educated elites returning from exile together with the jihadi leaders who had stayed inside the country as part of the coalition of resistance to the Soviet occupation. They had an initial window of peace and security following the overthrow of the Taliban. Much progress was made in this period, but budget fragmentation, a proliferation of projects, and huge numbers of foreign advisers would make sustainable reform a long-term challenge.

2001-2004: TRANSITIONAL GOVERNMENT

As in Timor-Leste, the first government in Afghanistan after the ousting of the Taliban was an interim one followed by a transitional administration. The interim administration was in place from December 2001 until June 2002, and was subsequently replaced by a transitional administration from July 2002 until December 2004. The interim and transitional administrations would pave the way for a new constitution and a permanent government from the end of 2004. This period would present huge challenges for the transition team, who found themselves dealing with the legacies of occupation, civil war, and a highly unorthodox regime. Politics and security would play as much a role in the formulation of the budget as economics and development planning. Old habits had to be un-learned and new processes installed with pragmatism and patience. By the end of 2004, the basic framework of the budget was established, a new Public Expenditure and Financial Management law was in place, and a duly constituted government and parliament would take over the stewardship of the budget. The achievements made throughout this initial period, and in particular the lessons learned, were significant.

Much has been written on this time and this case study won't attempt to go over old ground, but this section draws heavily on the work of some of those who were there and wrote up their experiences in: “Reforming Fiscal and Economic Management in Afghanistan” (Carnahan, Manning, Bontjer and Guimbert, 2004) and “Peace and the Public Purse – Chapter 6 The Budget as the Linchpin of the State: Lessons from Afghanistan” (Ghani, Lockhart, Nehan and Massoud, 2014).

The most significant feature of the early experience in Afghanistan in late 2001 and early 2002 was the absence of any structured budget process. Under the previous Taliban regime, the bulk of the budget was put into discretionary funds under the control of a few powerful ministries and money was doled out to frontline units, provinces, and municipalities based on requests. There was no structured macro-fiscal framework, no costing of policy and no medium-term budget or expenditure framework.

On top of that, several of the ministries that were created in the transitional administration were new, and so there was no baseline of previous years’ expenditure and little or no institutional capacity or experience. Quite simply these were brand new institutions engaging with the center of government over the allocation of scarce public resources for the first time.

Human capacity in general was also low, although there were a number of experienced and well qualified senior managers and ministers, including some expatriates returning after many years out of the country. The computerization that had taken place all over the world in the previous two decades had not happened in Afghanistan. When the transitional administration took office, there were no computers in the MoF.

As in Timor-Leste and other places, very severe fragmentation of policy formulation, budget execution, and reporting was also prevalent. Some of this was driven by historical practice, as in the case of revenue. Under the Taliban, revenue was collected by local authorities and then used by them to meet local needs for basic services. The policy had been that a certain level of budget was set and that provinces would settle up with Kabul at the end of the
year. It was neither practical nor sensible, given the security and infrastructure constraints inherent in having large cash transfers between regions and the capital. While in theory this looked to be a viable alternative system, in practice, it reinforced the power and influence of regional power brokers and severely inhibited the central government’s ability to redistribute revenue based on need. In 2002, virtually all revenue came from just five provinces.

Despite this skewed revenue base, underlying systems and laws were in place. There was a network of 34 Mustofi and Mustofiat (district finance officers and offices), and reports from the time confirm that procedures, systems, HR, and payroll were evident. They were not computerized, but they existed and could be expanded to address the low level of domestic revenue facing the government.15

In the early years of the transitional government, the old policy was replaced with a centralized revenue system that used a standard approach, where all revenue is remitted to a consolidated fund and appropriations for authorized expenditure is provided to spending units. In practice, the government had to negotiate the remittance of revenue from regional authorities. Despite these challenges, revenue rose dramatically in the first three years of the transitional administration, then remained low as a proportion of estimated operating expenditure (40%) and as a proportion of GDP (4%). Donor funding made up for this significant shortfall.

Donor fragmentation also played a role in the way the budget was formulated. The significant humanitarian needs and the pressing need to restore basic infrastructure meant that the budget was immediately fragmented into a number of parts. To go with domestic revenue, donors provided funds to what was referred to as the ordinary or operating budget. Funding through this channel included bureaucratic recurrent costs, salaries, basic goods, and services needs as well as some non-salary costs for investment in minor capital and maintenance. The envelope for donor funding to the national budget was initially set at around $20 million, a tiny fraction of the amount asked to fund humanitarian agencies. The vast majority of the money provided for the reconstruction effort was instead funnelled through what became known as the development budget.

Despite the problem of fragmented budgetary systems, the first budget of the transitional administration was able to make some progress by starting the discussion between the political leaders about how much would go to each objective and to each administrative agency. That in the circumstances was a huge achievement requiring innovation and pragmatism in equal measure. There was no statement of actual expenditure from previous years, few people in senior positions with any real experience in putting together a budget, and a difficult political situation. The first Council of Ministers was essentially a coalition of people, many of whom had been combatants who had fought each other. In Chapter 1 of Reforming Economic and Fiscal Management in Afghanistan, Carnahan describes the tension over the first defense budget, where the decision was made to allocate $100 million with little or no detail. This political economy approach of allowing a “loose” budget for defense helped to keep important political factions within the government at the beginning, allowing the MoF to build on the budget process in future years.

Aid fragmentation was also a significant challenge. It was very difficult for the transitional administration to track, let alone monitor, donors’ off-budget expenditures. The UN agencies had launched their own collection of projects in the Consolidated Interagency Appeal for the Afghan People (ITAP), an appeal worth $1.8 billion, which was followed by another appeal, the Transitional Assistance Program for Afghanistan (TAPA), worth another $900 million. These bids included hundreds of projects to build schools, irrigation ditches, and clinics entirely outside the national budget process – indeed the UN initially refused to share information on these projects with the government. In a very real sense, the UN and the government were competitors for the hearts and minds of the people through development investments and demonstrable progress.

The first year’s development budget has been described as little more than a list of projects driven entirely by the priorities of the donors, with the exception of the then nascent “National Programs”. It was clear that moving from a supply-driven approach to a more demand-driven one was going to take some time. This was not surprising given the inexperience of the transitional government and the difficult time constraints. Ministries were still working out their staffing

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structures and adjusting to a centralized budget process, and therefore were not able to articulate priorities that would drive the development budget. There was also a failure to invest in training Afghans on how to administer development investments. The project-based culture that ensued placed an emphasis on building infrastructure such as primary schools, but very little attention was given to training the cadre of people needed for the national ministries to manage these type of facilities and public services.

The effort by both the government and some of the international partners to establish a small number of National Programs was an exception to the fragmented approach taken by the broader reconstruction effort.

These started with six national priorities set by the President and Cabinet. Each of these national priorities was translated into programs through a reconstruction agency with a team comprised of Afghan and international consultants and specialists in developing large-scale country-managed programs.

These included:

- The National Emergency Employment Program, which created hundreds of thousands of man days of labor across every province by sub-contracting NGO and contractor partners;
- The National Solidarity Program, which allocated block grants to rural communities across the country for basic tertiary infrastructure like roads and water;
- The National Transportation and Infrastructure Program, which laid out a master plan for a ring-road, a plan for developing a northern power line, and to build and repair major dams; and
- The National Health Program, which set up a framework whereby the European Union, USAID, and World Bank pooled funds to implement the program, while the government set policy and delivery standards and contracted delivery of a basic package of health care across the country.

These national programs were incubated in the Afghan Assistance Coordination Authority (AACA), working hand in hand with government ministries, and were to be managed by Afghan ministers or senior deputies. Talented and experienced Afghan managers were identified and recruited to manage these programs and recruit teams. Usually, programs like these work because there were talented ministers or leaders already in place. But in this case, it was actually the other way around. The program design actually set out to recruit good managers as a precondition for beginning the program. This is another example of the importance of how something is done, not simply what is being done. In tough environments such as Afghanistan, finding the right people and empowering them is often more likely to succeed than a great design by itself that gives less attention to the local context.

These programs were funded in two ways. The first was by initially allocating a grant (in this case through the World Bank) that provided funding to start these large-scale programs. Second, the programs were expanded through the national budget, underwritten by the Afghanistan Reconstruction Trust Fund (ARTF). This large trust fund was designed by Afghan leaders with significant input from the Finance Minister and his team, together with the World Bank. It was then set up to fund Afghan priorities through the budget. The ARTF, which remains in place today, has been one of the most important tools for the government over more than a decade. To allow funds to be committed to the budget while systems were still being put in place, the ARTF employed additional layers of auditing and a dedicated team to provide procurement and accounting capabilities that the government “bought in”. These were from Crown Agents and Price Waterhouse Coopers, respectively. The British Government, through the Department for International Development (DFID), moved quickly through an emergency window to provide the advance funding to get these teams in place while the ARTF establishment process underwent World Bank approval.

Another very early action in 2001-2002 was taken to get a handle on the tashkeel (civil service structure) and payroll of the country. A team of accountants were mobilized to go through the tashkeel of the government and establish a payroll system to ensure the core civil servants of the country were

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paid. As the ARTF was not yet up and running, and there was no money in the Treasury, a trust fund was quickly mobilized to cover the accountant team and the payroll costs through the Afghanistan Interim Trust Fund, under the aegis of the United Nations Development Programme (UNDP). The mobilization of the trust fund was crucial in establishing the legitimacy of the central government and the bureaucracy supporting it.

There are a number of important points to note from this discussion on the first budget. There was clearly strong leadership, particularly in the MoF, and efforts were being made to put in place both the policy and systems to manage development investments. Some of these programs, like the National Solidarity Program, went on for over a decade with a lot of success, while some of the infrastructure projects such as the roads and dams are only being completed now – 14 years later. There was also quite high human capital within parts of the leadership group, and the programs that looked for and found good local leadership did well. At the same time, it was clear that the UN and the humanitarian response was in some sense in competition with the fledgling administration. Billions of dollars were spent through projects, and fragmentation of the development effort certainly contributed to the slow progress on some of the national programs.

The second budget established by the transitional authority began the process of entrenching a more structured budget process. Budget preparation was less frantic and was managed through a series of meetings between the MoF and line ministry staff to discuss their needs, followed by meetings with the ministers. The proposed system was to establish a “base budget” to reflect the cost of delivering current policy. However, in this environment, it was more often than not a reflection of the available resources, with only some consideration of absorptive capacity. In effect, these became competing ways of understanding the base budget approach. Since available funds from donors were greater than the government had the capacity to spend in ministries and frontline spending units, it might have been better to allocate funds based on capacity rather than the perceived needs. In the end the pressure from donors to budget for higher development investments meant that improvements in budget preparations each year were not matched by improvements in budget execution. This legacy of over-budgeting remains a problem in Afghanistan to this day.

A legacy of budget planning versus budget execution issues was partly attributed to the Transitional Government and the need to educate the Cabinet on budgets and budget processes. Good leadership at a cabinet level and an understanding of the role of the finance minister in maintaining the sustainability of public finances are necessary conditions for managing the budget and maintaining accountability for public investments. The on-going tendency to rely on political economy accommodations is illustrated by the decision to drop the idea of drafting budgets for ministries based on the cost of existing policy (what they were in fact able to deliver), and instead provide generous budgets to many of the smaller ministries so that the larger and more important ministries with the biggest budgetary needs would then be prompted toward a robust debate on resource allocation. This is quite understandable, but it would later make it more difficult to revert back to the more sustainable approach of costing existing policy, establishing a baseline budget for a ministry (preferably over a medium-term timeframe) and then considering new policy proposals each year in the annual budget process.

The process of setting unrealistic “ceilings” where ministries get to set their priorities driven by unrealistically high levels of aid makes the budget less flexible. Without such flexibility, it is harder for the government to reallocate funds from lower priority or lower performing investments to higher priority, higher performing ones. Lack of flexibility can also distort the priorities away from the established national programs towards other areas, depending on what donors are willing to fund. Finally, it also provides an incentive for ministries to “lock-in” funds to their sector by signing agreements with donors. These agreements set “ceilings” based on whatever funding they can raise, instead of budgets based on what ministries can or have spent in the previous year. The distortion to the process created by these arbitrary ceilings locks in over-budgeting. It also takes away from the government an essential tool for budget formulation within the annual budget process: ministries having a base level of funding for their existing policy commitments, but also the ability to compete with each other for the scarce fiscal space available for new activities.
Nevertheless, after three years of the Transitional Administration, the MoF had established key systems, including a budget process, a financial management system, a treasury single account (at least in theory, the practice would take some time to be fully bedded in), and a centralized revenue system based on the old methods of revenue collections (which was dealing with a fragmented and project heavy donor environment). The Public Expenditure and Financial Management (PEFM) Law was in place and the first national development framework was established to help push money towards defined national priorities.

There were two other reforms during this initial period that are notable for their impact on the future of the budget. The first was the change of the currency, whereby the Afghan government led a complete changeover of its old currency to a new currency, using the hawala dealers as the exchange mechanism. Countries coming out of conflict are often faced with significant external risks and careful management of the national currency is a key economic task. By taking advantage of the inflow of foreign exchange, the government would be able to put in place a flexible but relatively stable system for managing the currency.

The second reform was the telecoms licensing process, whereby the government established a transparent and fair tender process for issuing Global Standard for Mobile Communication (GSM) licenses. The process resulted in four mobile operators setting up GSM services across the country. The telecom sector today is the single biggest source of company tax revenue for the government, and mobile services have served as a key enabler for the economy.

2005-2014: BUILDING FOUNDATIONS

While the government during the 2002-2004 timeframe had demonstrated a clear commitment to reform and began to implement the necessary changes, much work remained. Despite the truly heroic work of the transitional government and the MOF in establishing a budget framework, the baseline for Afghanistan in 2005 on the core function of public finances and national accountability systems remained low. A PEFA assessment conducted in 2005 showed an average score of D+ with particular problems in budget credibility, external scrutiny, and audit. This is not surprising given the challenges described above: a fragmented budget with systemic over-budgeting, and a large number of projects all being driven by disparate systems of reporting mandated by whichever donor was funding a given project. The period from 2005 to 2014 would show some improvements in development of core public finance systems, but also highlights the difficulties in shifting some practices once they have become entrenched.

Afghanistan’s budget systems throughout this time were marked by an initial period of quick improvement starting in 2005, followed by a persistent slowing down of progress from 2008 onward – quickly at first but then the speed of success slowed. Figure 14 shows rapid improvements in PEFA scores between 2005 and 2008 in all areas except budget credibility. This move from a D to a C+ is testament to the solid foundations put in place by the transitional government and to the commitment by the first Karzai government and its development partners to putting in place basic systems. In one sense, it is easier to achieve higher levels of improvement coming off a low base than it is to move from reasonable levels of performance to high.

This, in part, might explain why the same figures show that from 2008 to 2013, essentially improvements measured by the PEFA framework begin to plateau. The second round of reforms are much harder to achieve and rigidities and fragmentation become greater obstacles to moving forward.

The PEFA scores show a significant improvement in budget credibility by 2013, which is not supported by more recent analysis, but in most other areas scores are the same, and in policy based budgeting there is even a small decline in performance. This reflects that over time the budget needed to become less of a record of donor projects and more a tool for national policy. This also corresponds to the period in Timor-Leste where they became less aid dependent as a result of petroleum revenue and began to move more
towards simplified processes managed by local civil servants. While Afghanistan and Timor-Leste show similar outcomes in PEFA scores for the same period, the trend in Timor-Leste was continued improvement while in Afghanistan, gains stalled after a rapid period of improvement.

The overall speed of reform in the early period seems to indicate a more general commitment to reform by leaders and officials within the MoF as well as Afghanistan’s development partners. After some initial good work, efforts at moving to increased self-reliance were not as prevalent as they should have been. Nevertheless, the fact that the early performance improvements were maintained despite a significant deterioration in the security environment should been seen as a positive.

Reductions in measurable fiduciary risks were also rapid between 2005 and 2008. The government’s success in reducing fiduciary risk slowed down between 2008 and 2013, but didn’t stop. Figure 11 reveals that fiduciary risks fell from substantial in 2004 to moderate in 2013. In lay man’s terms this means that the risk of funds in the budget being misused, wasted, or stolen fell from substantial to moderate. In other words, the budget became more robust and better managed from the perspective of accounting and reporting. This reflects the substantial investment in the systems over the period, with AFMIS rolled out to all provinces and financial statements routinely produced and published. This is especially true for the operating budget, where budget execution rates have historically been over 95%, and controls improved substantially. While annual reports are not produced routinely, financial statements for the operating budget could now be compared to the published budget. The same cannot be said for the development budget, where the performance of projects varies considerably and the way they are monitored, evaluated, and reported on is not done consistently.
Reforms throughout this period achieved reasonable progress, but this by no means meant that systems were not open to corruption. AFMIS was and remains not much more than a general ledger. As such, related systems were not connected, such as procurement and payments, HR, payroll and payments, budget, and treasury. All of these areas required manual updating of data. The treasury single account was also essentially exactly what its name implies. Finally, the lack of sub-accounts means that tracking and reconciling payments by spending unit or ministry is only possible by manual means. As a result, corruption has been able to flourish despite significant improvements in the capacity of the MoF and the management of these systems. MoF became better at using imperfect systems, but the limitations of those systems created the space for large-scale corruption.

The budget process itself became more about redistributing donor funds through the development budget to appease vested interests, rather than a tool for funding national priorities. The development budget was subject to direct parliamentary intervention where parliamentarians would visit ministries and demand projects be given to their districts and to contractors they were associated with. This remains a problem today.

The development budget remains fragmented — split between discretionary spending, which the government has some say over, and non-discretionary spending, which is essentially projects administered by the government on behalf of the donors. Both were in different currencies and subject to rules stipulated by donors. Off-budget projects were recorded in the Development Assistance Database.
(DAD) but only for information. A separate DAD was used by the MoF’s budget department for budget preparation. The databases were very different and could not be reconciled. The government failed to conduct a systematic analysis of budgets, execution, and performance, and left it to individual donors to assess their own projects. As security worsened, these projects became more expensive and much more risky to implement.

**Corruption was also given a fertile environment to grow.**

Monitoring became harder, as there was no direct link between procurement and payments, little disclosure on who the proponents of contracts were, and significant political pressure from the parliament to direct resources to certain districts and through certain parties. The likelihood of both development risks and fiduciary risks became greater. Reporting by the US Special Inspector General for Afghanistan Reconstruction (SIGAR) shows a long list of projects that were dubious in concept and unused after construction. As security has deteriorated following the withdrawal of international troops, it is harder to reach many areas, and monitoring investments is becoming harder to lock down.

**In other words, the fragmentation of the development budget served to increase the level of fiduciary risks,** as it was very difficult to reconcile the operating and development budgets. An example to illustrate the point: there was a misperception that the operating budget included all the operating costs for the government, but this was simply not true. There were (and still are) significant resources for things like fuel, office goods, and minor capital items like computers and photocopiers that are considered operating costs in the development budget, and in some projects not included in the national budget. This means that someone could request a computer under the operating budget, then under the discretionary development budget, and also from a donor operating an off-budget facility. Each would process the request separately, through different systems and would have no way of checking if there were multiple requests. The person could end up with three computers and no one would know. Alternatively, the system would also be unable to track whether only one computer was bought but then charged to three different accounts. That is why to this day, if you lift up almost any piece of office equipment in the MoF, you will see a branded sticker from the donor who paid for it.

**Figure 12 also shows that after accounting for both fiduciary and development risk factors in addition to PEFA scores, development risk profiles were relatively higher than fiduciary risk profiles for the period.** What this means is that the risk of getting poor development outcomes from public investment was higher than the risk of money being misused, wasted, or stolen. The trend was positive, with development risk reduction relatively greater between 2005 and 2008, compared to fiduciary risk reduction.

Development risks, however, remained substantial, but were reduced from 2005. In other words, risks to development outcomes and fiduciary risks both reduced over the period, but development risks remained substantial while fiduciary risks were moderate.

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19 By fiduciary risks we mean the risk that funds are misused, stolen, or wasted. Development risk is the risk of not achieving meaningful and sustainable improvement in development outcomes.
Under the new PEFA-plus risk factoring approach, systemic fiduciary risk reduction was very rapid between 2005 and 2008 and then slowed down but continued between 2008 and 2013. The highest risks were associated with weaknesses in systems for non-tax revenue, anticorruption, procurement, banking supervision and taxation (see Figure 13). What this illustrates is that the types of fiduciary risk that most donors focus on—the expenditure side of the budget—has reduced, but the systems that are most prone to manipulation and have the strongest vested interests in maintaining weak controls have been the hardest to reform.20

20 In the very early years between 2002 and 2005 Timor-Leste was around three times more cost effective in achieving PEFA results compared to Afghanistan. For the middle period, Timor-Leste was over five times more cost effective for the same outcomes and for the more recent period, Timor was almost fifty times more cost-effective than Afghanistan. For more details see the separate technical paper “Country Comparisons of Fiscal Performance Improvement” prepared by ISE to accompany these case studies.
Revenue systems in Afghanistan have seen relative underinvestment when compared to expenditure. For example, AFMIS was expanded to every province during this period, while SIGTAS and ASYCUDA (revenue and customs systems) cover only a few areas outside Kabul.

Similar results were found for development risks, though these risks were calculated to be relatively and significantly higher than fiduciary risks (see Figure 13 and Figure 14). Again, what this means is that the focus has been more on accounting for expenditure rather than what that expenditure has been applied to. The previously described features of ceilings by administrative unit (Health, Education, Infrastructure) has meant that the government has been unable to reallocate funds to areas that are being underutilized or areas where they can be better applied. This happens on both the government side and the donor side.

On the government side, the adoption of program-based budgets in 2009 did not lead to any significant improvement in targeting of expenditure because a number of foundational reforms that should be sequenced prior to linking resources to “programs” were never properly implemented. The move toward costing existing policy to set up baselines for ministries was not done. Robust and consistent costing of new policy was also not done. This meant that even though the budget was set in a medium-term framework in theory, it was neither anchored to forward estimates of expenditure, nor did actual expenditure impact future budgets. Projects could routinely “underspend” with no possibility of money being reallocated. In fact, the practice of automatically carrying over unspent funds to the next year meant that chronic over-budgeting at the project level was over time exacerbated.
A project, for example, that has a budget of $100 million a year and spends $50 million in a given year will see the estimate for it in the following year go up to $150 million, regardless of the ability of the executing agency to spend that money. To make matters worse, the carry-overs are not of actual appropriations but merely of commitments. Donor projects do not fund the budget for the estimated amount of the budget allocation, just the actual amount of money spent.

In the example of the $100 million a year project that spends $50 million, there is actually no $50 million to carry over. This automatic carry-over practice which continues to today is in fact contrary to the way the relevant law is written, but is symptomatic of the way the budget has been routinely formulated as a tool to distribute donor largesse, rather than an instrument of policy. The contest or competition for the scarce fiscal space that is available was not (and is still not) happening. Ministries would essentially put up their wish lists each year, comfortable in the knowledge that they would receive a ceiling where they could choose their own priorities.

Instead of stronger scrutiny of project preparation, particularly on the development budget, the MoF has, for a decade, used allotments or commitment controls as a quasi-contract management tool instead. These allotments are meant to be a cash management tool to ensure that expenditure is not made when the government does not have the cash to cover its commitments. Instead, the allotments have been used as a tool to leverage information out of line ministries after a contract is signed and being implemented. The practice is possibly contributing indirectly to poor year-on-year budget execution performance, as agencies have incentives to increase budgets to avoid contracting and cash controls. It also certainly causes significant delays (two months) in spending by line ministries at the start of the fiscal year, which has subsequent effects.

Donors have also contributed to this problem, with their unrealistic projections. A cursory analysis of the ARTF shows that almost every project during this period needed to increase its disbursement by many multiples if it was to close on time. Meaning, despite slow actual disbursements, both the World Bank and the Afghan government continued to project unrealistic numbers for the budget, year after year, with no objections from the donors on the ground or their headquarters. Nor did any of the donors raise the issue of the automatic carry-over of unspent funds, despite a heavy presence of international advisers in the Afghan government’s budget department for many years. This combination of carry-overs and allotments has contributed significantly to the poor budget execution numbers that the donors do care about.
Despite efforts in 2010 in the run up to the Kabul Conference and the development of the Afghanistan National Development Strategy (ANDS) to reduce the number of projects and to move to a more sector orientated system, the opposite occurred and project proliferation increased. The ANDS had a huge scope and set the basis for a large number of existing projects to continue, as well as for the introduction of new projects with unrealistic project preparation. It became next to impossible to shift resources around and the budget process became little more than a way to pay salaries and record the operations of projects. National Priorities were so broad that donors could choose almost any set of interventions and claim they had fully aligned with the government’s agenda. Steps were taken in Tokyo in 2012 to create some mutual accountability goals, but they again focused on budget execution as the primary indicator of performance for the budget without addressing the core problems inherent in budget planning and project preparation.

These persistent over-budgeting problems are an indicator that there might be a potential to move towards more flexibility in the way aid is channelled into the budget with lower fiduciary risk, but also the potential for much better development outcomes. This is often misinterpreted as a trade-off, that higher development gains require more fiduciary risk, but as this analysis shows, both risks fell during this period. The more important issue is to focus reforms based on the relative strengths and weaknesses of the systems. This long period of relative stability in the government meant that the capacity of Afghanistan’s system was relatively high for a country at its level of development (Figure 15), while Figure 16 summarizes some of the remaining weaknesses that contribute to on-going exposures to avoidable fiduciary risks.
Timely submission of audit reports. Good scrutiny of the budget by the legislature. Executive responsive to legislature on audit matters

External Scrutiny and Audit

All expenditures reported, good consolidation of accounts and active monitoring of provincial fiscal behavior

Comprehensiveness & Transparency

Budget calendar adhered to and dept analysis undertaken regularly

Policy based Budgeting

An ability to meet targets with operational control and relatively low stock of arrears

Budget Credibility

Predictability & Control

Certain tax systems working well (info to taxpayers, registration, and tax banking.) Active cash management. Good payroll systems. Procurement legislation and systems too standard. Active commitment control.

Accounting, Recording & Reporting

Timely reconciliation of accounts. Good in-year reporting and complete and timely financial statements.
What these strengths and weaknesses show is that the budget process is well established. The calendar is adhered to, and that in year reporting and accounting is pretty good, especially for the operating budget. In short, the capacity of the government to manage money through its systems is quite good and the ability of the legislature and other stakeholders like donors to scrutinize the budget is reasonable, but there are problems with the way the budget is formulated and presented. The problems or weaknesses are with fragmentation, so it is hard to compare actuals to budgets because of the development budget, medium-term controls and forecasts are relatively weak due to the complexity of forecasting across the different budgets and the uncertainty of aid flows over the medium-term. Audit and oversight are not working as they should, partly due to capacity, but in large part due to the fragmented monitoring and evaluation approaches of individual donors. What this points to is the need to work towards a consolidated national budget with investment in systems to strengthen planning, execution, and reporting through one annual process.

This became very apparent in late 2014 and early 2015 when a fiscal crisis emerged. The consequences of the three transitions: security/military, political, and economic
created a drop in economic activity that led to a significant fall in domestic revenue. The government, in partnership with the World Bank, had been contributing to the development budget but shortfalls in both domestic revenue and donor actual disbursements meant that the government faced a significant operating shortfall. With little flexibility to move funds around, the government agreed to implement austerity measures, which undoubtedly contributed to the on-going economic downturn. At the very time that the economy needed more investment, the government was forced to do less. This did have economic consequences and may well have had political ones, with cuts to the budget doing nothing for the legitimacy of the newly elected government. In such an environment, this can have consequences for peace and internal stability.

2014-2016: A NEW ERA OF REFORM

In August 2014 a new government was elected and the former Minister for Finance, Ashraf Ghani, became President. One of his first policy decisions with regards to the budget process was to commission an assessment of the public finance and national accountability systems. This would be the first time the Government of Afghanistan had commissioned an assessment by the government and for the government.

The President asked for an assessment that focused on how to strengthen the budget process to reduce fragmentation and to ensure the budget is more flexible and responsive as a tool for national development policy. The President wanted advice on how to make the budget an effective tool to support the new government’s national priorities, while making the government more accountable to the public and the donors for managing public finances.

The MoF, while quite strong in technical capacity and supported by donors, was without a minister. The long serving minister had just left and had not yet been replaced. Long serving and experienced deputy ministers and directors-general were in place, so there was some leadership, but the political economy of the National Unity Government would contribute to some lack of clarity on a long-term strategic plan for the future. The guiding strategy over the previous few years had been the PFM Roadmap put in place in 2010, which was now coming to an end. Work on a replacement roadmap was just starting, which potentially made the timing of the assessment good if the Ministry could coalesce around a reform strategy.

The full assessment can be accessed at www.mof.gov.af but the broad outcomes can be summarized as:

1. The budget remained hugely fragmented and needed to be consolidated under a clear and focused development strategy. The long-term goal has to be a single national budget, merging the current operational and development budgets and making the annual budget process the key tool to execute government policy.

2. The budget system was in reasonable shape for a conflict-affected country at Afghanistan’s level of development, but reforms had plateaued over the last five years. The next reform plan must link budget reforms to international benchmarks and sequence actions to achieve acceptable progress over the next five years.

3. Perceived underspends in the development budget were largely caused by poor project planning and preparation that mean budgets were routinely overestimated, not under spent. Efforts to strengthen the role of the government and the MoF in particular in the approval of project costings must be prioritized.

4. The relationship with donors needed to evolve. Donors had been quite flexible and very supportive of Afghanistan, but the tendency to have projects, even on budget, had led to severe fragmentation of the budget. Donors needed to shift to higher ownership of reforms by the government and finance sectors, rather than imposing projects using budget support, output, or incentive based tools. Most importantly, they needed to hold the government to account rather than set up separate or parallel monitoring processes.

5. There would be no quick fix; consolidating the budget, increasing tax revenue, strengthening the budget process, and following a long-term development strategy would require consistent leadership over decades, not just years.
The President and the newly appointed Finance Minister embraced the recommendations and determined that a reform program based on the assessment was required. They decided to put in place a program of team-based performance management for a rolling 5-year, sequenced, fiscal performance improvement plan. In simple terms, the government would focus on establishing 5-year rolling plans based on addressing the challenges raised in the assessment. These plans would be team-based (directorate level) and be subject to a performance management system that ranks team performance against a set of criteria based on progress against their goals. This performance management system would also form the basis of discussions with donors to move towards targeted sector (PFM) budget support linked to performance outcomes.

This mirrors the path taken by Timor-Leste just a few years before, and articulates the government’s self-reliance policy as focused on developing the capacity of the MoF and other civil servants to manage the budget.

The Minister established a Performance Management Team (PMT) within the newly upgraded Macro-Fiscal Performance Directorate-General to facilitate the process. The role of this PMT includes facilitating the establishment of the inaugural 5-year plans, facilitating both a mid-year and an annual self-assessment of progress against the plans, arranging for independent validation of the self-assessments and lastly, based on outcomes, rolling over the 5-year plans and publishing an updated plan in the early part of the next fiscal year.

The first challenge was to engage the teams on the assessment. The core problem with the assessment was that, while it had high-level political support from the President and the Minister, there was little ownership of the findings within the broader MoF. The assessment had recommended a process of follow up that would have ideally included a series of discussions about the findings at the level of director-general and deputy minister with a view to getting a broad consensus on the challenges ahead. This largely didn’t happen and this less than perfect consultation made progress slower than it might have been. The PMT in the end went team by team and engaged them on the challenges in their specific area. Initially the goal was to move fairly quickly towards establishing team-based plans. However, unlike in Timor-Leste where there was a long-term strategic plan that had been thoroughly road tested in the MoF, Afghanistan has no such agreement to the way forward.

Getting people to take time out from their busy schedules to discuss reforms was not easy. In addition, team level understanding of international benchmarks and frameworks like PEFA, the Operation Budget Index (OBI), and Doing Business Indicators was relatively low. Despite some pressure to show progress on the reform plan, it was obvious that the MoF and other partner agencies would have to move at a pace that would result in ownership over this process. A number of key programs of support were coming to an end and donors were thinking about replacement programs. There was a real risk that without a reform plan, new support projects would have their own agenda and the cycle of fragmented and poorly aligned assistance would continue. As in Timor-Leste, the new processes had to be designed to fit the capacity and commitment of the civil servants who would drive the reform plan.
As a result, the team-level plans in the inaugural rolling Fiscal Performance Improvement Plan (FPIP) are a mix of high priority flagship reforms and on-going activities that reflect what teams currently do. Some issues remained the focus of some contention and instead of agreement on a way forward, pilots or workshops were included in plans to help build a consensus on the best way to address certain challenges. Some of these are the most intractable of issues that have gone unaddressed for many years but would now be systematically monitored through the performance management system.

The role of donors has also been very important. The first challenge was what to do with the existing programs of support as they came to an end. Virtually all support was due to end in early 2016. Most of the projects were very technical assistance-heavy (TA) and worked on certain areas of the budget process within design limitations usually set by the donor. Projects did not really coordinate well with each other and reporting was by project. There was little if any performance management of advisers, certainly nothing internal to the MoF. There was no current analysis of technical gaps across the whole ministry and no link between TA and reform goals. With the 5-year planning process underway, a gap analysis was now being done and a performance management structure put in place that linked performance of TA with the performance of the teams.

There was also the issue of self-reliance. This had become a key government policy after the London Conference of late 2014. Through the Capacity Building for Results (CBR) program financed from the ARTF, the government had access to around $300 million to incentivize and top up civil servant salaries, but many directorates and ministries had resisted the move from contractor to civil servant. The TA programs in the MoF were essentially undermining a key plank of the government’s strategy.

The Finance Minister decided to allow current programs to lapse and seek support from donors for a new approach to assistance for PFM reforms. By allowing the current programs to lapse, the Minister would be able to achieve a number of important outcomes. Firstly, the ministry could clear out long-term technical assistants who were no longer required but were being maintained simply because the funding was available. Secondly, the loss of access to very high levels of TA would force managers to prioritize their long-term staffing plan and move all their teams into their civil service structure (tashkeel), with top ups from CBR where appropriate. Thirdly, it would create the space for the MoF to open a dialogue with donors about sector budget support and alignment of support with the government’s needs.

This was a difficult decision for the Finance Minister to make, given the still high level of dependency on international and local technical assistance still prevalent in the MoF. An assessment of the government’s Public Financial Management Roadmap by USAID published in November 2014 as part of its final evaluation of its economic growth and governance initiative showed that dependency ratios were as high as 400% in some departments.21

This means that for departments like Budget there were 105 advisers for 84 civil servants working in professional roles. These numbers even understated the problem, with some department’s ratio based on their civil service allocations, not actual staff. For example, in the Fiscal Policy Unit (FPU), the analysis showed seven advisers (one international and six national), for 11 tashkeel or civil servants. However, while 11 positions were allocated to the FPU, none had actually been filled. This was true also for the Policy Department with 27 advisers for 22 civil servants, with few or no staff actually employed. Key areas of public policy like budget, revenue, and fiscal policy were either being managed by non-civil servants or were virtually reliant on technical assistance for their day to day operations.

It is fair to say that both the donors and the government were aware of the extent of the on-going problems with reliance on TA, and despite the challenges, progress has been made in the last 12 months on moving key staff into the tashkeel. The newly established MFPD for instance has advertised all its positions and will phase out contractors by the end of 2017.

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Responses from donors have been mixed. On the positive side, donors like DFID postponed a design mission to replace its existing contractor managed facility and agreed to wait for the outcome of the 5-year planning process. The World Bank similarly extended its current program (PFMRII) for 18 months to ensure the replacement program is based on the government’s 5-year plans.

Discussions about sector budget support are more complicated. The government cannot expect its donors to provide more flexibility in the budget if it means more risk. The government for its part has agreed that any new sector budget support mechanism must not involve more fiduciary risk than it would by putting money into the ARTF, and must have higher potential development gains. The government has proposed a mechanism similar to Timor-Leste, with risk sharing at the core. The government is proposing fixed investments in the 5-year plans and flexible or performance-based incentives based on performance outcomes. The Minister has also proposed a pooling of TA under one MoF-managed framework to help break the fragmentation of support. Key donors have said they are open to a performance-based sector budget support arrangement subject to further discussion on details, but in practice most are reluctant to be early adopters of what seems like a risky proposition that will be hard to sell to their respective HQs.

In return for considering these types of instruments, the donors have the right to expect a higher level of accountability from the government. It is the government’s responsibility to provide performance information to the donors that shows progress on reforms and value for money. If the performance management system needs to include indicators or information that is not already there, then donors should ask for it and the government should provide it. Donors should actively participate in the assessment and validation processes for the 5-year rolling plans every six months, as should key implementing partners like the World Bank and contractors. Ultimately, the donors must hold the government accountable; if performance is poor and if there is no progress on reforms, they should not give the government more money. On the contrary, if performance is good and progress on reforms is strong, they should provide more funds and more flexibility. This is in line with New Deal principles.

As a positive sign of high-level ownership for the reform process, the President and the Minister of Finance publicly launched the Fiscal Performance Improvement Plan and the performance management system at the Presidential Palace in August 2016, with the CEO and the Cabinet present. The President gave the management of public investment the highest possible priority and flagged an expansion of this process beyond the current scope of core agencies in the MoF.

The Annual Assessment of the 5-Year Plans

The first mid-year and annual assessments of progress against the Rolling 5-Year Fiscal Improvement Plan were conducted in 2016. Teams conducted a self-assessment of progress against 2016 activities from their 5-year plans. These self-assessments were then subjected to a validation process facilitated by the Performance Management Team within the MoF’s Macro-Fiscal Performance Department. Each team’s performance was assessed in three dimensions – timeliness, quality and effectiveness – and assigned a performance score. The mid-year assessment was presented to donors at the Brussels Conference on Afghanistan in October 2016 and can be accessed on the MoF website. The annual assessment is expected to be published in February 2017, as are revised 5-year rolling plans. While not yet finalized, some broad outcomes from the assessment have been identified by the Minister.22

Leadership

There is very strong political leadership from the President and the Minister of Finance for fiscal and budget reforms, but this commitment must be backed up with sustained engagement from all levels of management and from key donor partners. These first signs of a change in the culture towards one of performance and effectiveness are still fragile and the program will take a number of annual performance cycles to become routine. The team-based performance management system that is designed to help create a performance-focused culture remains vulnerable to threats. It will take around two more cycles to embed the system and make it more resilient.

This section draws heavily on the independent validation report: “2016 ANNUAL PERFORMANCE ASSESSMENT REPORT OF THE 5-YEAR ROLLING FISCAL PERFORMANCE IMPROVEMENT PLAN – Afghanistan Building More efficient and effective public services; Stronger fiscal discipline; and Strategic fiscal policy.”
Ownership and clarity of reform plans

There are very positive signs that the performance management system and the rolling plans are starting to have an impact. Most teams demonstrated a much stronger sense of ownership and knowledge of the plans between the mid-year tracking assessment and the final annual assessment. The revenue department stood out as having progressed the furthest, with a commitment from the Director-General to monitor the implementation of the plans, and with teams preparing well for the assessment process. All teams in the revenue department presented strong plans to the validation team and came prepared with detailed evidence on their activities. This has set a high standard for other teams and future assessments.

Similarly, most teams recognized that their initial 5-year rolling plans were not as good as they could have been. As a first plan most teams acknowledge that with a much better understanding of the process they will produce a much better plan for 2017 that is much more closely aligned to their goals and work plans. Most teams demonstrated to the independent validation team an enthusiasm for rolling over their plans and adjusting them in early 2017.

Dependency on external support is still significant

While there is an increase in the level of ownership over the reform agenda across all teams, there is still a relatively high dependency on external assistance. This takes two forms: the first is key technical functions such as budget and treasury where large numbers of consultants—albeit more Afghans than internationals—are still being utilized. Second, teams that have suffered from low investment, especially the corporate, procurement, and accounting teams are unable to fully meet the needs of the teams they provide services to, and therefore must rely on donors to fill the gaps. This inadvertently fragments efforts to bring the ‘back of house’ operations up to a satisfactory standard. These two areas must be addressed through better targeting of resources to support national systems that utilize the 5-year rolling plan method.

Flagship Achievements

Despite a challenging year in 2015 due to the fiscal crisis and increased responsibility for meeting security costs, there have been some very good achievements in the first half of 1395/2016. Many activities in the areas of policy, budget formulation, budget execution, treasury, procurement, revenue, and operations are set to lay the foundations for significant improvements in the way the budget is formulated and executed in the future. A detailed account of these activities is provided below.

Policy

The successful development of the Afghanistan National Peace and Development Framework (ANPDF) and presentation to the international community in Brussels in October 2016 was a very significant achievement. The Citizen’s Charter, a National Priority Program completed this year, will provide $630 million or Afs42 billion to local Community Development Councils (CDCs) for them to spend on local infrastructure and services as well as investments through urban communities. Moreover, the High Economic Council is working well. It is meeting regularly and is supported by a secretariat in the Macro-Fiscal Performance Department (MFPD).

Budget Formulation

The budget process for 2017 included the first steps towards the development of forward estimates to give practical meaning to the medium-term fiscal framework. In order to make the national budget a tool to drive national priorities, a medium-term expenditure framework that is focused on delineating how much fiscal space is available over the medium-term is a crucial step. Some progress has been made on this front, as the 2017 budget includes tables of provincial breakdowns.

Budget Execution

There is a very good story to tell on budget execution. The estimate for actual expenditure for 2016 is around Afs370 billion or $5.5 billion, representing a budget execution rate of 83% against the original budget. This represents an increase of 16% on the Afs318 billion the government spent in 2015. This good result is unfortunately overshadowed by the continuation of over-budgeting, which also keeps the focus on budget execution at the expense of budget quality and credibility.
**Treasury**

The government’s accounting system is on its way to becoming a tool to detect and deter corruption. The long-awaited upgrade to the Afghanistan Financial Information Management System (AFMIS) has been approved. The $2.8 million contract will set the foundation to move from a basic transaction recording system, to a fully integrated management solution that links all parts of the public finance systems from budgets, to accounts, from payroll to personnel, from procurement to contracts, and from banking to payments.

**Procurement**

The National Procurement Authority (NPA) has made outstanding progress in establishing a high-quality institution with a strong performance culture. This has enabled them to carry forward the President’s vision for improving procurement across the government. Better use of competition and robust oversight and monitoring systems has led to significant savings to the budget of around Afs18 billion or $270 million.

**Revenue**

The Afghanistan Revenue Department (ARD) is delivering on its mandate – with tax revenue collection up by 11% from the previous year (Y-o-Y) and with pro-rata forecast actual tax collections at Afs92 billion at the end of the third quarter. Non-tax revenue is up 70% Y-o-Y, with pro-rata forecast actual collection being Afs44 billion up from Afs33 billion. Excluding custom revenues, this equates to an overall increase in tax and non-tax revenue compared to 2015 of 25% (Afs35 billion).

The Afghanistan Customs Department (ACD) has undergone a significant leadership and culture change that is beginning to show results, particularly in combatting corruption. ACD has been able to double revenue from mobile collection units, and the roll-out of the customs information management system (ASYCUDA) to more provinces is on track. With new leadership in both ARD and ACD there is a significant culture change towards a performance and client-oriented focus that, if supported politically, will be a key determinant of Afghanistan achieving its goal of self-reliance.

**Operations**

The MoF has invested a significant amount of funding towards establishing an IT backbone. This has been an area of under-investment, but progress is being made. The policy to move staff onto the Capacity Building for Results (CBR) program is progressing with most teams now having revised tashkeel approved and processes to move staff onto CBR underway. The Minister of Finance has also initiated a 7% reduction in the total number of tashkeel positions in the MoF, which has been completed.

**CHALLENGES**

**The budget process**

The formulation of the budget is the single biggest risk identified in the Annual Assessment and needs significant attention in 2017 if the government is to achieve its reform goals. Despite some progress in the first half of the year, there was poor progress on reforms, such as putting in place a medium-term expenditure framework, constructing forward estimates, developing methodologies for costing existing and new policy, removing allotments, and switching the focus of the team to quality of expenditure. Without a significant commitment to these reforms, it will be difficult to achieve a consolidated national budget and align the budget with new priorities identified in the ANPDF. The routine practice of the automatic carry forward of underspends in programs from one year to the next is largely driving the endemic over-budgeting problem.

**Leadership**

More progress in establishing an effective leadership group within the MoF is required to drive reforms. The MoF has two acting Deputy Ministers (Policy and Administration) and the leadership group of the Minister, Deputy Ministers, and Director-Generals has not met regularly throughout 2016.
Ownership and clarity of reform plans

Ownership of the plans has improved significantly in most teams, but there is some way to go. Directors have generally been engaged, but they often delegate the assessment to one member of staff, often a technical adviser or contractor. Participation by all team members is still too low, especially tashkeel staff. This lack of a team-based approach to the FPIP by some teams hinders the ownership and understanding of the plan.

External support and progress with donors will be an issue in 2017

Discussions with donors on support for the FPIP are progressing, but will not be concluded until the middle of 2017, at the earliest. This means many of the gaps identified in the 5-year rolling plans will not be funded this year, resulting in slower progress than otherwise might have been made. The main partner will be the World Bank, who has indicated that it will support the whole Fiscal Reform Program in principle, across all activities in the 5-year plans.

More investment and a bigger vision are required for revenue and customs

The revenue and customs departments need much bigger vision and a massive increase in investment. Despite their size and complexity, both departments have just one Director-General. There is no dedicated HR, IT, procurement, or operations function for either department. These are crucial departments for the government in achieving self-reliance. Therefore, treating them in the same way as other Directorate-Generals is not going to work. A long-term strategic plan to expand both departments is required as soon as possible.

The corporate backbone and development

The corporate backbone of the MoF remains gravely weak and cannot properly support the operations of departments. A very large and sustained investment in the backbone of the ministry – HR, IT, procurement, finance, accounting, operations, and maintenance – is required.

Figure 18

2016 Performance Outcomes – Satisfactory Progress Against Planned Activities

A total of 855 activities (65%) were scored during the annual assessment, out of the 1,308 activities that are on the Fiscal Performance Improvement Plan (FPIP).

Distribution of Raw Tracking Scores
Having completed the first annual performance cycle the commitment to the reform program within the government remains strong. An agreement has been reached with the World Bank to support the FPIP, across all teams, using the 5-year rolling plans as the basis of the support program. In addition to using the 5-year rolling plans to underpin the reforms, the World Bank has also agreed to follow the performance cycle and will provide a mix of support, including an incentive-based mechanism linked to performance outcomes. These are significant achievements, considering that at the beginning of 2015 the government had multiple programs working on various aspects of the public finance and budget systems, along with a host of donors using varied mechanisms and requiring different deliverables and benchmarks for achievement.

Now, the MoF has one comprehensive fiscal reform plan and two sources of funding: the national budget and the ARTF. MoF is following a performance management system that provides consistent and detailed data on progress against its own 5-year rolling plan. As already noted, however, the system is fragile and necessitates many policy challenges ahead. Nevertheless, the establishment of a comprehensive fiscal reform plan represents a good start.

As a footnote, the President has decided that the fiscal reform program should expand to key agencies and line ministries starting in 2017. This was discussed at the October 2016 Brussels Conference and is now one of the Self-Reliance through Mutual Accountability Framework (SMAF) indicators. Work has already begun to include full 5-year rolling plans from the Supreme Audit Office, the Central Statistics Office, and the Independent Directorate for Local Government this year, plus plans that cover budget planning, execution, and reporting for the Ministry of Agriculture, Irrigation and Livestock; the Ministry of Interior; and the Ministry of Defense. The latter ministries are subject to further discussions within the government and are likely to publish plans in early 2018.

This is a truly ambitious undertaking, but it demonstrates a strong commitment to change by the current government. It signals a willingness to address issues that have been intractable despite the vast resources that have been applied to the task over the last 15 years.
Conclusion

There are a number of conclusions that flow from the analysis in these two case studies and the comparisons we have drawn between the two. In drawing these conclusions we have used a set of core principles that underpin our analysis of both countries.

1. The purpose of development interventions is, or should be, a continuous improvement in the capacity of civil servants to deliver core services. Outputs are important but the long-term goal for these countries is self-reliance.

2. Performance should not be measured through a binary process of whether outputs have been achieved or not. Performance should be graded on evidence that institutions are improving over time, which requires closer examination of whether outputs being measured are contributed to the desired outcomes. In other words, whether underlying theory is translating to real and positive change.

3. Incentives for staff matter. Performance management systems must provide incentives to staff to keep improving and to be honest about progress.

4. Building institutions is important. Investments need to be made in typically underserved areas such as HR, Admin, IT, procurement and operations.

5. Fragmentation leads to significant inefficiencies. Fragmentation comes in three dimensions, fragmentation of budgets and resource allocation systems, fragmentation in accounting and classification systems, and fragmentation in systems for scrutiny and reporting. Therefore, it is important to link the political settlement to standards and good practices in development financing.

In both case studies, the international community played a very large and generally positive part in the political settlement that was a precondition for peace and for reconstruction to begin. However, in both cases the political settlements focused largely on the political and security issues and did not adequately address link the process to issues of development financing and legitimacy of the state in the post-conflict setting.

In Timor-Leste, the UN established an administration and set about the very important process of working towards a new constitution and a long-term system for governing. Initially the Timorese were less in control of the process and the national budget; even after independence was restored they remained a limited player for some years. The vast majority of the development funds were held in trust funds or delivered by projects, which led to severe fragmentation of the development effort and low levels of
accountability for aid expenditures by donors. Meanwhile, the small amounts of government expenditures in the national budget were subjected to large amounts of scrutiny by both the parliament and donors. As a consequence, relatively low priority was given to building the capacity of the national government staff. It was not until the government had enough revenue from oil and gas and became less dependent on aid that it began to address some of the fragmentation issues and focus on the professional development of national staff.

Afghanistan suffered from some of the same issues, although through the management of the ARTF and the presence of an interim and transitional authority, national programs were established and partly funded. However, over time it became clear that these early administrations were in competition with the UN and humanitarian agencies for funds and for legitimacy, due to the parallel structures set in place at the outset. It also meant that, as with Timor-Leste, the development effort was severely fragmented and the government and the donors had little meaningful oversight on how effective and efficient any of these investments really were. More importantly by ignoring the need to use the national budget as the primary tool of development early on, development partners saw a plateauing of reform efforts in managing public finances, even as aid flows into the budget continued to rise.

Despite the inherent challenges, both case studies show a similar path and some notable successes. They also highlight the remaining challenges and draw the conclusion that self-reliance and sustainability can only be gained through the long and patient process of building local capacity and institutions. They also show that an overemphasis on inputs and outputs, especially if used as a pretext to avoid going through government systems, will not succeed in delivering the very governance outcomes the international community sees as a priority.

Both case studies illustrate this key point about the importance of using national systems to improve them. In Timor-Leste, the heaviest period of donor influence in the MoF also correlates to the worst period for developing systems of accountability. The early period up to 2007 saw some basic principles put in place, but the fact that most development investments were not made through the budget meant that the level of overall accountability for development investments was relatively low. As oil and gas revenues began to accumulate and the national budget increased dramatically, the government responded with big investments in systems and capacity. This is evident from the government’s improved performance outcomes from international benchmarks despite extremely challenging circumstances. Far from the budget becoming a tool of corruption, it became a tool of transparency, with persisting problems being systematically addressed.

Afghanistan also showed a promising start, notably the transitional administration’s efforts to get the foundations of the budget in place. The ARTF supported this process, as it was structured to support some fledgling national programs funded through the national budget. However, this good start plateaued in the period from 2008-2014, due to little incentive provided by donors for the government to continue to reform. Aid flows increased, often despite poor development outcomes. The budget remained split between the artificial constructs of an operational vs development budget. In a sense, the incentives for both sides, the government and the donors, was to maintain the status quo. The interdependence between the senior leadership and the donors to distribute the very large aid flows became an end in and of itself. Large amounts of aid provided in projects and even off-budget enabled this to become the norm.

A greater focus on national priorities and local capacity, with an emphasis on self-reliance and legitimacy of the government in the eyes of the people should have driven donors towards greater use of the national budget. The budget should be used not just as a distributor of money, but as a tool for addressing national priorities and for driving more efficient and effective allocation of resources. Given the share of aid in the total budget, donors should have been able to extract much higher levels of accountability for their aid. In return the Government would almost certainly have accepted more accountability and even less aid if it was made more flexible.
Both countries have employed team-based performance management to help attain the right institutional culture around performance. The history of development in Timor-Leste and Afghanistan has many examples of technical assistance projects cherry picking themes for reform and teams for support. Both countries are attempting to change the “how” of development by focusing on building the capacity of teams within government ministries and agencies, instead of focusing on just the themes, such as procurement or revenue. The finance ministries in both Afghanistan and Timor-Leste now have 5-year rolling plans for every directorate, a performance grading system that rates performance in different dimensions, and routine performance reporting twice a year. The institutional culture encouraged by these systems is one where team-based performance is central and monitored by a credible, agency-led system for recognising good performance and helping under-performers do better.

**Better Development Outcomes Do Not Require Higher Fiduciary Risks for Donors**

The case studies show through a range of indicators that both governments and donors have given development risk—meaning the risk that development outcomes are not achieved—a lower priority than fiduciary risk. Following a conflict, both countries were in a state of low capacity and systems for accountability were poor. The risk of corruption was high, and donors— and in particular the taxpayers of their home countries— understandably had little or no tolerance for money they see as a gift being stolen or misappropriated, especially when it was money they understood to be going to the poorest and most vulnerable in these countries.

This line of thinking often drives the project-oriented and fragmented approach to development. It is also driven by the misapprehension that there is a trade-off between the two; that, in order to achieve greater development outcomes, donors have to increase their fiduciary risk. In fact, the opposite is more common: by increasing a focus on reducing development risk (getting better development outcomes), including by using national systems and building self-reliance, donors are actually in a position to ask for higher levels of accountability and, in turn, lower their fiduciary risk. Donors, parliamentarians, and citizens monitor governments more readily when the amount of resources put through the national budget increases. The level of transparency and accountability can be increased, as everything is subject to the same rules and processes, which is not the case when there are a large number of projects with different rules and systems of reporting. This was clearly demonstrated in Timor-Leste when the budget increased from large amounts of oil and gas revenue.

Similarly, in the early stages of Afghanistan’s reconstruction, reform outcomes were moving at a fast pace, but as time went on and national systems were not being used in favor of processes that were designed to protect donors from fiduciary risk, the reform trajectory plateaued. We argue that these are related issues. The operational budget in Afghanistan comes under a great deal of scrutiny and is the part of the budget that the government has the most discretion over. It is locked into a small number of large drivers such as civil service salaries, regardless of the fact that the systems around the operational budget have continued to improve. There are financial statements that can be compared to budgets, and while there is no official public accounting standard as yet, financial accounting is in line with international standards. Execution rates are routinely above 95%, indicating the budgets are realistic and systems for executing the budget work well. Auditing activities need to be improved so that they can adequately assess the operational budget’s performance.

On the other hand, much of the investment in new programs funded through the development budget, as well as monitoring and reporting on the national budget, still needs much improvement. The development budget in Afghanistan is split between discretionary and non-discretionary spending. It is in multiple currencies, with multiple rules for different projects. Most of the discretionary budget is under the ARTF and follows World Bank rules. However, there are around 180 special accounts managed by the Afghan Treasury for various projects that while on budget, have their own set of parameters for each. No consolidated chart of accounts is used, and the development budget is not presented by economic
classification or administrative unit in the same way as the operational budget is. Reporting is mostly project based, making it very hard to reconcile actual expenditure and budgets. Most worrisome is that budget execution rates for the development budget are routinely low, typically around 50% or lower. What this indicates is that budgets are too high and systems are not working well.

The over-budgeting problem is quite entrenched. Budgets are allocated based on what funds are available from donors, not based on what funds are actually spent in any given year. There have been many instances when a project or ministry will spend less than half of its development budget for a year and will have its next year allocation increased. This practice has the opposite effect of the budget scale up in Timor-Leste, which resulted in successful reforms. It instead entrenches poor processes and ensures that reform efforts stall.

It is important to note that often what donors might see as a ‘safer’ channel by which to funnel aid, is actually increasing the chances of poor development outcomes for the country, and thereby not necessarily reducing overall fiduciary risk. The systems in the development budget for accounting for funds and monitoring outcomes are in fact more fragmented and weaker than for the operational budget. This is further highlighted by the fact that in Timor-Leste during its budget scale up, both development risk and fiduciary risk fell at the same time. This result shows donors and governments that using national systems could contribute to desirable development outcomes, while also posing less overall risk.

That is not to say that there are no risks in using country systems. National systems that are under development need to be given time to develop. Donors need to work at the pace of the government. This may mean that initially less aid is disbursed, but in a targeted way; this is likely to produce better outcomes. When money is not channelled through the national systems directly, it must at least fall under the policy framework of the government. This requires that donors make the space for a coordinated and detailed policy dialogue, preferably in the context of the annual budget process. At a minimum, all projects need to be considered in the context of other investments and donors must align to the budget calendar—and where possible—the budget costing and accounting methodologies and standards.

Returning to where this case study began, the g7+ group of countries have long understood these issues. Analysis of development projects, programs, country strategies and frameworks is almost always done from the perspective of the development partner or donor. Reports tend to focus on what is important to those who are paying the bills. The New Deal on Conflict Affected and Fragile States that was signed by most donor countries in 2011 set out a new narrative for development in these difficult contexts. Its twin principles of TRUST and FOCUS called on donors and developing countries to work together to focus on the priorities and capabilities of each country, not just the barriers and hurdles to development, and to work through country systems in a spirit of trust where accountability is shared and relationships are open and transparent. There must also be an understanding of the true challenge faced by these countries. In both Afghanistan and Timor-Leste there are teams that could not be working any harder, or with more diligence; and the pace of change, with its triumphs and setbacks, should not diminish their efforts because a project cycle demands short-term outcomes.

The time has come to look more closely at the “how” and the “why” of development. In the difficult context of an immediate post-conflict intervention, the long-term sustainability of the country may be quite distant. But how countries begin the process of reconstruction can have a big impact on whether a country reaches where it wants to go and how long it takes to get there. More effort needs to be made to support the legitimacy of the state in delivering the core functions that matter to ordinary people, and more emphasis needs to be given at every stage to the long-term goal of sustainability. Space for development must be created.