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Thematic Focus

Taking the Domestic Resource Mobilisation Agenda Forward

In the current economic context, marked in particular by the continuing global financial crisis, the issue of domestic resource mobilisation (DRM) has received increasing attention from developing country governments and donors alike. The stakes are enormous. Relying increasingly on domestic resources could allow developing countries to distance themselves from the vagaries and volatility of external financial flows and reduce dependence on official development assistance (ODA) – an objective which appears all the more critical at a time when donor country governments have to deal with fiscal constraints and public sector cuts at home. It also holds the potential of increasing the policy space of developing countries, opening up opportunities to strengthen accountability relations between governments and citizens and achieving greater country ownership of their own development strategies.

In essence, DRM comprises a revenue side and an expenditure side – two interrelated ends that should be jointly examined. Not only could efficient and effective public spending boost growth and development, thereby enhancing the revenue raising potential in developing countries, but the way tax revenues are spent also matters to taxpayers. Indeed, transparent, effective and equitable public spending geared towards fairer social outcomes and tackling inequalities could, to some extent, reinforce the “fiscal legitimacy” of public policies, strengthening the social contract between governments and tax-paying citizens and helping to boost “tax morale”, i.e. building a “sense of duty” around tax-compliance.

While fiscal space has increased in several developing countries, not least in Africa, the scope and popular support for raising taxation or debt may be limited, especially if expenditures do not boost growth and if the quality and reach of public services does not improve. For this reason, enhancing the effectiveness of public expenditure and the capacity of public spending is paramount, all the more since pressures on public spending in developing countries are likely to intensify in the coming years, not least because of the

sharp rise in the African population and of urbanization.

Against this background, the question is: how can government effectively link resource mobilisation to service delivery? What are the framework conditions and good practices that could enhance the effectiveness of government expenditures, including the political economy behind changing budget practices and making reform happen? What should be the role of the international community?

These were some of the questions analysed during the latest OECD Global Forum on Development (www.oecd.org/development/globalforum/), which gathered OECD and non-member governments, as well as development experts and civil society actors in Paris from 28-29 February 2012, back-to-back with a celebration of the OECD Development Centre's 50th Anniversary (www.oecd.org/dev/50years/).

The Forum highlighted the importance for governments and the international community to pay greater attention to the dual challenge of enhancing the effectiveness of revenue and expenditure policies, and the significant capacity bottlenecks that remain to be addressed. Specific examples in the area of the policy cycle for expenditures in infrastructure and the question of multi-level governance were discussed. Based on the discussions that were held during this global forum, ECDPM and the OECD Development Centre are joining their efforts this month to provide a platform for reflections on those questions. We have asked high-level participants to share their insights and expertise, not only on the linkage between resource mobilisation and service delivery, but also on priorities and best practices in making public expenditure more effective and efficient for development. It is thereby the intention of this special issue of GREAT Insights to provide critical analyses of policy instruments for DRM, be they linked to public revenues and/or public spending.



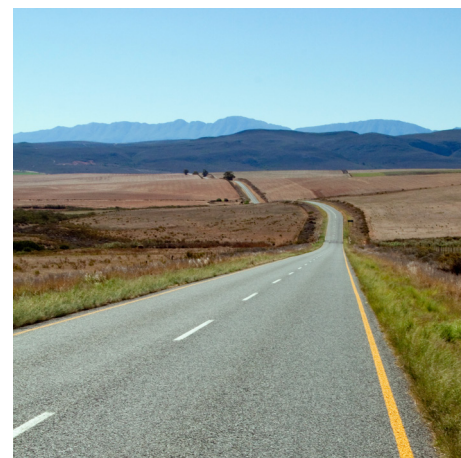
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Unlocking Private Finance for Africa's Infrastructure Development: Tips and Traps

Melissa Dalleau

Addressing Africa's infrastructure deficit has gradually become a national, regional and continental priority. For proof, one just has to look at the recent approval of the Programme for Infrastructure Development in Africa (PIDA) during the January 2012 Session of the African Union Summit to be convinced. This is not surprising. Research has shown that catching up on infrastructure could boost per capita economic growth in Africa by an average of 3 percentage points.¹ But whilst the prospective benefits are enormous, so are the financial means needed to unlock them.



The total requirement to address Africa's infrastructure needs in Sub-Saharan Africa has been estimated at about \$93bn a year.² In the current international context, marked by worldwide economic instability and changing donors priorities, there is therefore a sense of urgency among African countries to tap new sources of financing to address this challenge.

The good news is that Africa is on the rise to become one of the most attractive regions for investment and a pole for growth, offering an opportunity for governments across the continent to mobilise new resources, both domestically and internationally. Among these innovative sources of finance, those emanating from private channels are increasingly recognised as having a significant (and relatively under-tapped) potential, as stressed at the Busan High Level Forum on Aid Effectiveness.

Private sector involvement (PSI) -- in the form of foreign direct investment, portfolio investment, private equity, private infrastructure funds, Public-Private Partnerships (PPPs), etc -- could help finance infrastructure development, releasing public debt pressures on African governments already engaged in arduous efforts to mobilise more domestic public resources. Moreover, as they bring on board private sector expertise and technical know-how, PSI, and PPPs in particular, could also help ensure more efficient project design and service delivery, and help spread the risks that large-scale infrastructure projects may entail -- risks that are even greater when the project at stake is cross-border and multi-national in essence.

The challenge is to transform these opportunities into concrete deliverables for equitable, inclusive and sustainable development throughout the continent and avoid the technical and political traps that

may lie down the road. Six such challenges are detailed below.

Six challenges to greater PSI in infrastructure development

Enabling Environment

First, PSI can better be triggered in a conducive business environment. Poor property rights, unclear regulatory requirements and procedures, as well as hurdles to establish legal relations between governments and the private sector, may limit the possibilities of infrastructure projects getting off the ground and/or their financial/commercial viability in the long run. Yet, ensuring the appropriate enabling environment and addressing market failures requires some political will and capacity still too often absent in African countries. Admittedly, when there is a shared interest to engage in productive investment, informal relations between private and public elites could generate sufficient trust among actors to trigger private investments without the need for formal rules-based institutions.³ Whether informal structures are sustainable in the long run and can successfully deliver on public goods are however questions worth raising. Serious risk exists of collusion and corruption. Besides, without strong regulatory institutions, implementation and enforcement mechanisms in place, there may be in many instances little legal recourse for governments to take if a project does not deliver.

Project Preparation

Second, identifying viable infrastructure projects, conducting feasibility studies, and bringing them to a bankable status is a process requiring considerable preparatory work, which implies in many instances huge upfront sunk costs, typically ranging from 6 to 9% of total project costs (if not more in the case of arguably more expertise-demanding PPPs).⁴ A number of project

preparation facilities and support services have recently been set up to meet this challenge. However, African countries and regions still often lack both the resources needed to roll out services on such a large scale and the local professional expertise on those legal and financial structures that is required for initiating and managing such projects. Moreover, whilst building capacities in that regard would tremendously benefit from more donor assistance, stakeholders from all sides will also need to pay careful attention not to fall into the pitfall of the fragmentation in resources devoted to that area.

Risk Mitigation

Third, developing instruments to mitigate political, economic and financial commercial risks is important to catalyse private investments in general and in infrastructure projects in particular. Some potential risks relate, for instance, to long pay-back periods, with significant periods of negative cash-flow during startup, dollar-denominated inputs that can translate into currency risk; lumpy assets that are fixed in place with limited residual sale value except for the designated purposes (meaning limited collateral value of fixed investments); and government-regulated prices, often denominated in local currency terms and subject to political pressures in their adjustment over time.⁵ Concrete risk mitigation instruments may not be directly available in all countries. For instance, the development of debt and equity insurance and guarantee instruments is often limited by the capacity of low-income countries to borrow externally on competitive concessional terms. Similarly, mitigating foreign exchange volatility through devaluation liquidity schemes or currency hedging may not be an affordable solution for many African countries.⁶

Information and Negotiating Capacity

Asymmetry of information and negotiating capacity is a key factor in public-private contractual relations. In the case of PPPs, such asymmetry may place developing countries in a less favourable position to assess project proposals and negotiate the specific terms of contracts, which may leave them carrying a greater burden than they otherwise would. While this might relate to tax incentives (with private sector negotiating subsidies), it can also extend to the terms of contract for maintaining a PPP project, resulting in some instances in high costs and poor performance.⁷

Coordination

Besides, involving the private sector requires a high degree of capacity and willingness to coordinate and collaborate among/ between government agencies. Whilst a few countries in Africa have shown how a country can successfully establish PPP units in the Ministries of finance, it is probably not the case of most.⁸ Moreover, intra-agency frictions, lack of communication and separated systems can often hold up government work where collaboration and coordination are required.

Aligning Incentives and Interests for the greater good

Lastly, keeping in mind the interests of the various stakeholders and accountability relations between them is an important consideration when bringing in the private sector. The larger the number of parties involved, the more complex the set of incentives and the greater the need for coordination. Further, profit-seeking incentives of the private sector may not necessarily align with public priorities and motivations. This may lead to rent-seeking, corruption and “crony capitalism”, as well as inefficient outcomes. There is also a risk that increased PSI results in “sector orphans”, with a pattern of concentration in well-performing sectors where commercial returns are high.

In the absence of “public authorities capable of undertaking core governance functions”⁹, it would be illusory to believe that PSI could systematically bring socially beneficial outcomes. The degree of public accountability, budget transparency and effective governance are key factors to consider. So are the drivers behind political and economic elites’ decisions.

Towards a Pragmatic Approach

Despite the big opportunities offered by African growth rates, attracting private finance for Africa’s infrastructure development and establishing mutually beneficial public-private project finance schemes in a sustainable and accountable manner will be a challenging exercise, and in some countries more so than in others.

Whilst increased PSI may bear a number of technical and financial benefits that help close Africa’s infrastructure gap, the road to achieve this (arguably worthy) objective will certainly be bumpy, especially in those least-developed and fragile states where weak regulatory and legal frameworks may hamper investments, and which may be lacking the financial, technical and institutional capacity to prepare, implement and monitor large-scale infrastructure projects alongside private sector actors. Embarking on this journey may still be a sensible enterprise, however caution will be required to avoid failing negotiating the bend!

Most importantly, broader political considerations in specific country settings and the institutional context in which PSI are being implemented matter as much as technical (technocratic) considerations. This calls for a greater understanding of the costs and risks associated with PSI, and a fortiori for a balanced approach. This requires not only to factor in country specificities in terms of level of development, financial and technical capacities, governance indicators, level of indebtedness, and regulating environment, but also to seek to unfold political economy drivers or obstacles to the interaction between public and private actors and their respective incentives.

Finally, let’s remain pragmatic. Promoting better management of public spending -- in infrastructure development, as in any other sectors -- also means keeping in mind “value for money” concerns. In those lower-income countries where PPPs have their limitations, exploring other forms of innovative financing may be required. In this regard, the benefits of attracting private sector capital should be set against the current international low cost of capital globally, in terms of concessional loans for developing country governments, but also in terms of other possible innovative sources of financing that may be worth exploring. This may include tapping bond markets in those countries not too over-indebted, and/or the increasing opportunities offered by the African diaspora (diaspora bonds, securitization of remittances...). Regional options should also be examined. Ways to further involve African financial institutions, such as the African Development Bank and Regional Development Banks (for risk mitigation or for lending opportunities) should be considered. Currently, for instance the incapacity of regional economic communities to borrow (not least given the lack of guarantees to back up loans) limits their possible involvement in regional/cross-border projects financing. Regional development banks could yet play an important financial role in providing concessional loans to support projects in infrastructure areas where PSI has in the past been limited. Whether this is feasible (legally and technically) and desirable (in view of the

factors that shape political elites’ incentives and interests) are questions that should also be addressed moving forward. Similarly, defining strategies to make the most out of South-South cooperation and the presence of new emerging players in Africa could be critical.

In the face of Africa’s huge need, looking at ways financial sources may be combined to greater effect may therefore be where true innovation in financing may best reveal itself.

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This article draws from Lui, D. et al. (2012), *Rethinking Aid for Trade in the context of Innovative Financing*, ECDPM Discussion Paper 127, available soon at: www.ecdpm.org/dp127 ECDPM has been working on issues related to Innovative Sources of Financing, including for cross-border/regional infrastructure, and will continue to stimulate informal dialogues on these themes. Comments and suggestions should be sent to: md@ecdpm.org

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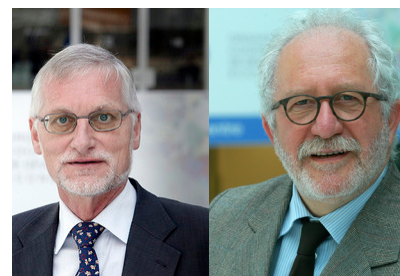
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Domestic Resource Mobilisation: From Taxes to Spending

Jon Lomoy and Mario Pezzini

The 2010 OECD Global Forum on Development discussed the challenges of domestic resource mobilization in developing countries and aimed to reverse an era of neglect of tax as a development catalyst. In 2012, the focus of the Global Forum shifts towards the critical linkages between revenues, expenditures and service delivery.



There is a tendency for the revenue and expenditure sides of the public finance equation to be treated as separate silos. But creating a virtuous circle of effective public service and tax compliance is a fundamental challenge for all countries.

The role of tax revenues

At the national level, moving towards simpler, more equitable and more transparent tax systems and a broadening of the tax base is not easy but would reap benefits over time. At the international level, striking the right balance between an attractive tax regime for local and foreign investment and securing the necessary revenues for public spending, is a key policy dilemma. Globalisation and competition between developing countries for investors can trigger a race to the bottom.

After the 2010 Global Forum, the OECD established a Tax and Development Programme supported by a Task Force on Tax and Development, whose role has also been acknowledged by the G20.¹ The Task Force brings together representatives from the tax and aid communities from OECD and developing countries, business, international organisations and civil society.

Linking tax reforms with other public financial management reforms, making public accounts transparent, assessing the pros and cons of taxes earmarked for particular expenditures and calculating the costs and benefits of tax expenditures and exemptions, and embarking on taxpayer education programmes, are all actions gaining currency with governments in developing countries. International and regional bodies can reinforce the role of supreme audit institutions, help bolster parliamentary scrutiny over both revenue and expenditures, and support non-state actors to monitor the use of public revenues. Improving the availability and quality of tax revenue statistics is also extremely important for informed policy making and better accountability. As a first step, the OECD, jointly with UN-ECLAC and CIAT, has

developed a Revenue Statistics in Latin America database and web platform to facilitate fiscal policy dialogue and support the assessment of alternative fiscal reforms supportive to economic growth and income distribution.²

Enhancing the effectiveness of government expenditures

Effective and transparent budgets are essential for sustainable economic management and public service delivery, thus contributing to broader development outcomes. According to recent evaluations, the main challenges of public expenditure in developing countries include the following:

- Budget planning and preparation is often considered more efficient than its execution and oversight.
- Whilst de jure improvements have often emerged, there are fewer de facto successes.
- Reforms have often overly focused on capacities, the number and quality of staff and systems, rather than the capabilities to use these capacities in the political and bureaucratic environment.
- There is often a high-degree of informality in budget execution systems- which often hinder sustainable reform efforts.
- Whilst the political nature of reforms are well known, there is little practical guidance on how to take politics into account both in the design and implementation of reforms.
- Evaluations of public expenditure systems have often concentrated on areas that are important to donor agencies rather than on the impact or sustainability of reforms.
- Many donors continue to provide aid off budget, undermining the sustainability and transparency of countries' budget systems.
- Support to domestic accountability institutions tends to be fragmented and ad-hoc.

On the positive side, interest in strengthening the performance of public expenditure systems continues to grow. At a regional level, Senior Budget Officials networks are

increasingly active in sharing good practice on and helping to identify priorities. At the international level, there is increasing awareness of the ways in which donors themselves must reform their practices in order to ensure their support leads to more effective budget institutions. In this respect, the Busan Partnership for Effective Development Co-operation recognizes the importance of strengthening institutions linked to public expenditure for development effectiveness.³

Effective public spending: the case of infrastructure

Infrastructure is a key ingredient to foster economic growth and to improve the competitiveness of economies. Greater availability and quality of infrastructure services typically leads to higher productivity of factors and lower production costs for producers. Current infrastructure gaps constrain both production development and competitiveness in developing countries. For this reason, infrastructure is a crucial component in the G20 Multi-Year Action Plan on Development endorsed by G20 Leaders in Seoul in 2010.

Important elements that need to be addressed to tackle infrastructure include:

1. Improving coherence and co-ordination among stakeholders. Co-ordination failures in infrastructure are often associated with the complexity of the institutional framework. It is essential to have an effective definition and application of responsibilities both at the horizontal level between ministries and at the vertical level between central and sub-national governments.
2. Assessing the whole cycle of the policy-making process. In each stage of this process – spanning prioritisation and planning; execution; operations and maintenance; and monitoring and evaluation – governments have to consider assessments, accountability mechanisms

and oversight to correctly evaluate the progress of the project. Appropriate allocation of responsibilities at each stage and adequate integration of policies throughout the whole project cycle both contribute to increasing the effectiveness of public infrastructure policies. Designing national systems of public investment helps governments improve the selection and evaluation of projects.

3. Involving the private sector. Despite their wide use, contractual arrangements between public and private sectors have revealed systemic failures in public policies. Exploiting the benefits of concessions requires above all strong regulatory capacity in terms of evaluating, tendering and managing the contracts. Faced with weak contract management, concessionaires may offer tendering prices below what they would offer in the absence of renegotiations and match or improve the initially expected revenues during the renegotiation.

Tackling infrastructure gaps requires better public intervention not only in terms of increased investment but also of adoption of better policies and greater coordination:

- Governments should conduct a thorough assessment of their infrastructure policy cycle, engaging the relevant stakeholders, to identify the most significant binding constraints. On the basis of such a diagnosis, they could improve the weaker phases in the infrastructure policy-making process as well as enhancing the overall co-ordination between the agents participating to this cycle;
- The analysis can help policy makers identifying the most adequate institutions to manage infrastructure expenditures and to guarantee an effective and efficient functioning;
- A regulatory framework that includes a system of checks and balances and clearly defines transparency and accountability mechanisms is paramount;
- Regular dialogues to share experiences among governments facing similar challenges have proved to be a cost-effective way for benchmarking performance and addressing the shortcomings.

A new conceptual framework to shape the future OECD Strategy on Development

Ever since the OECD was established in 1961, development has been at the core of its mandate and work. As the global landscape has evolved, the Organisation has begun to adapt its approach to development. Hence, at the 2011 Ministerial Council Meeting, OECD

ministers endorsed a Framework for an OECD Strategy on Development.

New poles of growth are emerging along with increasing economic and social interconnections between countries and regions. Worldwide, extreme poverty has decreased substantially and today a large number of poor people live in middle-income countries and urban areas. At the same time, the new “middle class” is showing increasing expectations for higher quality public services whilst many still remain vulnerable to falling back into poverty.

Today's global economic landscape has created both new opportunities and challenges for development. Additionally the international development architecture and agenda is rapidly evolving with new actors and new challenges associated with greater interdependence. These elements underline the importance of the need of broadening our approach to development, beyond development assistance. The OECD's unique way of working on policy issues, based on evidence-based policy dialogue and knowledge sharing, makes the Organisation well placed to respond to the need for dialogue.

A new comprehensive and inclusive approach to development needs an appropriate conceptual framework recognising that:

- “Development” is no longer a policy challenge for developing countries only – major trends and externalities concerning inequality, climate change and conflict make development a global objective with implications for both developed and developing countries;
- There is a need to go beyond the “North-South” and “donors-recipient” approaches;
- There is no “one-size-fits-all” approach. A new “economic thinking” necessarily demands a change in emphasis, from prescriptive to more diagnostic approaches;
- The progress made in many developing and emerging economies – and in many OECD economies – has been based on a diversity of policy solutions and has highlighted the co existence of different development trajectories;
- Approaches that cut across multiple disciplines and perspectives are required; along with better co-ordination and sequencing of policies to adapt to the multidimensionality and interconnectedness of development challenges.

In this respect, the Strategy on Development will build upon the Organisation's accumulated experience on development, on promoting effectiveness and impact of international development co-operation, and

better leverage its broad inter-disciplinary expertise in public policy making.

A key component of the Strategy will be to support OECD Member countries to promote development in a more coherent manner (i.e. policy coherence for development). In addition, the Strategy will promote an effective OECD participation in international efforts to seek effective solutions to global issues and development challenges, as well as engagement with developing countries on a demand basis (e.g. by providing platforms for knowledge sharing and mutual learning).

Notes

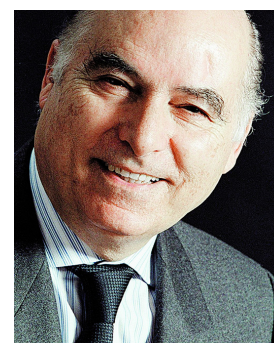
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Reflections on Changing Development Fiscal Strategies over Time

Vito Tanzi



Views on the government's role in economic development have changed dramatically over the past 60 years. In the late 1940s and 1950s the United Nations had alerted the world to the wide differences that existed in per capita incomes between countries in the "developed" world and countries in the "developing", or as it was then called the "under-developed" world. Foreign aid and technical assistance came into being, to assist developing countries, notably in fiscal matters.

Tax experts were sent in large numbers from developed to developing countries to advise and teach them how to reform their tax systems and how to collect more tax revenues. The experts usually tried to create tax systems that were similar to those in the countries where they came from. At that time, much of the attention was directed to the personal income tax because it was then considered to be the "fairest tax". The hope was that income taxes would help raise, in a progressive and equitable manner, the tax levels of developing countries, providing policy makers with more resources.

This was also the time when "capital accumulation" (i.e. net investment) was considered the main factor in promoting economic growth. It was the time when "Harrod and Domar's theories of economic growth" were widely accepted.

The capital accumulation could be public and private. Private investment could be stimulated by the use of tax incentives for investors while public investment required government spending and, consequently, higher tax revenue.

Developing countries were advised to: (a) increase their tax levels; (b) provide tax incentives to private investors; (c) keep current public spending low, because it was considered unproductive; and (d) use the (current) surpluses generated in public accounts to increase public investment in physical infrastructure. This was seen as a sure recipe to promote growth.

But problems soon developed. Raising taxes, especially personal income taxes, proved to be more difficult than anticipated. Public investment turned out to be less productive than assumed notably as the capital output ratios turned out to be very high. Tax incentives often stimulated the wrong types of private investments and also contributed to corruption and rent-seeking behaviours.

Some economists started to argue that current public spending (especially spending for education and health) could be as productive as investment in infrastructure. Other economists called attention to the importance of the quality of public institutions seen necessary for promoting good economic policies. Attention also shifted from policies to institutions, and from investment in infrastructure to "productive", current, public spending. Educational spending came to be seen as essential for improving the income distributions. It became an article of faith, among many economists, that higher literacy would directly lead to better income distribution, in addition to contributing to higher growth rates. Yet, as literacy went sharply up, income distribution did not change much in most countries while the impact of literacy on growth remained uncertain.

Tax reform continued to receive much attention, to make the tax systems: (a) more productive; (b) more efficient; and (c) more equitable. Lots of technical assistance was provided to developing countries by international and bilateral partners. There was definite progress in tax structures. For example, taxes on foreign trade became progressively less important, thus reducing distortions in the allocation of resources. Excise duties became more concentrated among items that were inelastic in demand and that, when consumed, generated negative externalities. The value added tax became an important and more efficient revenue sources in most countries.

However, the tax-to-GDP ratio did not change much, on average, remaining around 18 percent of GDP for the developing countries as a group. Also the revenue importance of the personal income tax did not change over the years and tax systems did not become progressive. The income tax remained unproductive and not-particularly equitable because most of the revenue from it came

from taxes on wages and not from capital incomes or wealth. The low tax revenues were attributed to high tax evasion rather than to inadequate laws.

Over the years, many economists gave up on the possibility that the tax system could play a significant role in improving income distribution and shifted their attention to the spending side of the public budget.

Over the years, many economists gave up on the possibility that the tax system could play a significant role in improving income distribution and shifted their attention to the spending side of the public budget. Many came to believe that desirable changes in the income distribution could be achieved more easily from the spending side of the budget, by giving more importance to particular categories of spending. For advanced countries the focus was on total public spending. For developing countries it was on more focused spending.

The above change of emphasis raises several questions. How efficient are governments in their spending activities? How good are the existing "public expenditure management systems"? Do they protect spending allocations from the influences of (a) elections?; (b) family, political, religious, or tribal connections?; and (c) corruption? Do the statistical studies on the incidence

of public spending on income distribution take account of inefficiency? Are these studies influenced by biases, classifications, and preconceived notions on the part of the analysts?

Is it true that it is easier to redistribute income from the spending side than from the revenue side of the budget? Is there convincing evidence for this notion? Have we abandoned too quickly the objective of progressivity in taxation? If it is not possible to have progressive tax systems, is it possible to have, except at a small margin, expenditure programs that are truly pro-poor?

An issue that should worry economists is the extent to which those who deliver the social services to the poor (in education, health, etc.) may appropriate part, or even a large share, of the spending through inefficiency (i.e. school teachers or nurses that do not show up), or corruption. There is a lot of evidence from many developing countries that a significant share of the social spending often leaks in this way and does not reach those it was intended to benefit, but to whom the benefits of the spending are attributed.¹

Another relevant question is whether the “fiscal space” that may be available to some countries should be used to raise the consumption (or the income?) of the poor; or to improve the quality of some essential public institutions; or the availability of infrastructures important to the poor?

On a different topic, much more coordination among countries is necessary to reduce the tax avoidance, that exists and that has been growing at the global level, to be able to raise higher tax revenue for developing countries. The time may have come to begin considering seriously the possibility of creating a World Tax Organization that might assist countries in the coordination of tax systems and in the surveillance over abusive tax changes. Such an organization would do for taxes what the World Trade Organization does, or attempts to do, for trade.

When creating pro-poor programs, it is important to look out for potential free riders, (beside those who deliver the services), that might appear within those claiming to be “the poor”. It is important to keep in mind a universal rule that states that: “if you want less of something, tax it. If you want more, subsidize it”. Pro-poor programs, unless they are strictly controlled, will attract “poor” people who are strictly not poor, or not so poor as the originally intended beneficiaries. This swelling will increase the costs of the programs and will also create “horizontal” inequities among the beneficiaries of the

programs. As a priest once put it: “to give equal response to unequal needs can generate great injustice”.

As a general rule, the longer a program remains in existence, the more likely it is that less deserving people will push their ways into it. Over the long run the standards for admissions to the programs will be relaxed legally, administratively, or, de facto, through poor governance, or even through explicit corruption. Thus the differences in the genuine “needs” between the originally intended beneficiaries of the programs and the latecomers (who may be considered “free riders”) will become significant. This will create injustice and growing public costs. Some examples of these problems are easily available. They are common for programs for school lunches; for pensions for invalidity; for unemployment programs; and for others.

(...) let us recognize that the move from relying on taxes to relying on spending, to improve Gini coefficients, represents the latest thinking or even the latest fad. We should not be carried too far by it and should continue to pay full attention to both sides of the budget. Both sides should play a role in redistributing income.

This characteristic of programs, that swell after they are introduced, thus becoming more expensive and less “equitable”, must be considered a “*general law of public expenditure growth*”. To prevent this effect, the population originally intended to benefit from a new public spending programs must be well - defined and its original, defining characteristics must not be allowed to change.²

In conclusion, let us recognize that the move from relying on taxes to relying on spending, to improve Gini coefficients, represents the latest thinking or even the latest fad. We should not be carried too far by it and should continue to pay full attention to both sides of the budget. Both sides should play a role in

redistributing income. However, they can play this role only if they have the support of good institutions.

Notes

1. Vito Tanzi, 1974, “Redistributing Income through the Budget in Latin America”, Banca Nazionale del Lavoro Quarterly Review, March.
2. The same law applies to some regulations. See for an interesting example the special preferential car tags given in some cities to progressively larger groups of citizens (handicaps, doctors, clerics, military, politicians, high level bureaucrats, etc.).

Author

Vito Tanzi is Former Director of the IMF’s Fiscal Affairs Department

Some of Vito Tanzi’s publications on the topic.

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Global Development Agenda and the Least Developed Countries

Gyan Chandra Acharya



Many of the noble ideas on promoting effectiveness of development cooperation have been initiated and analyzed by the OECD, which has created positive impact on the ground around the world. We are confident that this tradition would be continued, while giving due consideration to the concerns and aspirations of almost 900 million people living in the least developed countries (LDCs).

What binds all LDCs together is that all of them, irrespective of their location, have a high level of poverty in proportion to their total population, low human and social development, low income level and high vulnerability to external and internal shocks. Therefore, the main challenge for them is how to bring about structural transformation leading towards a sustained and inclusive growth, while building resilience from various shocks.

The UN conference on LDCs held last year in May, 2012 in Istanbul, Turkey, assessed the progress made so far in reducing poverty and promoting sustainable development in a holistic and comprehensive manner. It looked at both the domestic situations and global development cooperation framework. It set the economic growth target at 7 per cent with inclusiveness to have a dent on poverty alleviation. In order to achieve that, the conference gave due priority to a host of issues, but financing for development was particularly stressed, as there is a need for speeding up inclusive growth and huge resource gap in LDCs.

The LDCs are aware that ODA alone will not bring about development and progress in any country in a sustainable manner. But the capacity of the LDCs is so limited now that there is no alternative to it at least in the medium term.

Domestic resource mobilization in LDCs: limited prospects

LDCs face particular difficulties on financing for development due to various reasons. Because of the high level of poverty and low economic growth, they have less domestic resources available to them compared to the enormous development challenges. While the average rate of internal revenue to GDP is at around 10 to 13 per cent, the investment requirement is at least around 25 per cent of GDP. This gap in investment needs to be filled up to effectively deal with the challenges of grinding poverty.

Private investment is also low in LDCs precisely because a large chunk is spent on consumption. The capital formation is therefore at less than 10 per cent of the gross income. During the Istanbul conference, LDCs committed themselves to consistently enhance their domestic resource mobilization through internal reforms, better administration of tax, private sector development, and formalization of their economic activities, good governance, accountability and capacity building. But they also called for enhanced and strengthened international cooperation and support to fill the resource gap. They stressed that it is not only a moral imperative, it is in the interest of the international community that we lift all the boats together to have a better and peaceful world order. And, it is entirely feasible to provide more resources given the tremendous progress that has been made at the global level in the last 50 years and the capacity and commitment of the global community to promote global welfare.

The LDCs are aware that ODA alone will not bring about development and progress in any country in a sustainable manner. But the capacity of the LDCs is so limited now that there is no alternative to it at least in

the medium term. However, there has to be a comprehensive approach to extend the necessary support for the LDCs. ODA commitment should be met as promised and consider the possibility of enhancing the share going to the LDCs, given their structural constraints and limited capacity to deal with them on their own. There should be more facilitatory measures like Aid for Investment for promoting Foreign Direct Investment in the productive sector in LDCs, more comprehensive market access for the LDC products, facilitatory technology transfer and capacity building. Such a comprehensive and enhanced level of support for the LDCs in the short to medium term will not only have a salutary impact on reducing poverty rapidly in these countries, but that will also help create sustainable domestic resource base for self-sustained growth in LDCs.

Conclusion

Global development framework must be made more coherent, transformative and supportive of the LDCs. We need a paradigm shift to deal with entrenched poverty which has been exacerbated by the new and complex global challenges. The current global financial and economic crises, which are of a short term nature, should not detract us from the medium term to the long term promotion of the global development agenda. And LDCs should be at the forefront in pursuing our inclusive global agenda.

Author

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Asia's Infrastructure: Right Investments with the Right Partners

Woochong Um

The Asian Development Bank (ADB) has been in the business of reducing poverty in the Asia and Pacific region for the past 46 years. ADB takes great pride in delivering the most appropriate solutions in its operations, particularly in the dynamic field of infrastructure. To ensure this, we have been asking ourselves questions to help our operations evolve.



The obvious first question: What are the challenges facing Asian governments in meeting infrastructure needs? The answer: not enough money to meet demand.

Even if we add all the domestic resources and other development assistance from sources such as the World Bank and bilateral agencies, we are nowhere near the magnitude of financing needed to meet the total infrastructure demand.

To address this, two areas were identified where we can have immediate impact on bolstering our ability to support ADB's developing member countries in meeting their infrastructure development needs. The first is to make absolutely certain that the scarce resources allocated for infrastructure development are directed at the right kind of investment. The second is to mobilize private sector capital and knowledge.

Right resources for the right investments

The transport sector accounts for the largest share of ADB's investment throughout the years, at about a third of total lending operations. A full 80% of this has been invested in road and highway development. While it is clear that roads and highways are needed for economic development, we cannot focus on this sector in isolation of the big picture.

After years of helping to build numerous road and highway projects, ADB asked more questions: Are we focusing on the right issue? Are we focusing too much on moving cars and trucks? Shouldn't we be focusing on helping to move people and goods instead?

These were the right questions to ask. They resulted in us starting to shift paradigms from just doing roads and highways to embracing "multimodal transport systems" including railways, waterways, and efficient

urban transport, such as mass rapid transit (MRT), light rail transit (LRT), and bus rapid transit (BRT). We are even helping some cities develop nonmotorized transport systems, such as bicycle ways and walkways. These investments help countries become more economically competitive by lowering transportation costs and reducing the time it takes to get to a destination. A bonus is that they simultaneously combat climate change through lower carbon emissions.

The water and energy sectors provide other examples. We must ensure that the resources are used as efficiently as possible. What is the point of pouring money into a new water treatment facility if the city's non-revenue-water or water loss is over 50%? In such cases, we must fix the leaking pipes first. The same thing holds in the energy sector. Instead of looking to build a new power station, we should see where demand side efficiency can be gained. Lastly, we must continue to explore options for regional cooperation, such as power trade between neighboring countries with different peak times. Through creative arrangements, energy can be traded to meet demand without having to generate one extra kilowatt.

Mobilizing the private sector

The second issue is about mobilizing the private sector. ADB is sometimes referred to as a \$15 billion/year bank. We again asked questions. Can we turn ourselves into a \$100 billion/year bank? How can we maximize our scarce financial resources? The answers are driving our work to promote the public private partnership (PPP) initiative in our bank. The straightforward solution is to change the letter "L" in our lending program to "leverage". If we strive to make better use of our resources to create a better environment for private sector investors to actively participate in our development work, we could achieve this goal.

This approach, however, is not just about mobilizing more money. The private sector is often considered to provide greater efficiency than the public sector when managing infrastructure projects and developing infrastructure services. Benefits of involving the private sector in the delivery of infrastructure include efficient use of resources, improved asset and service quality, stronger public sector management, and improvement in public sector procurement.

Keeping all of these in mind, ADB's PPP agenda includes four pillars: 1) advocating and raising awareness, 2) creating an enabling environment by developing policy, legal, regulatory, and institutional frameworks to create certainty for the private sector; 3) creating more bankable projects for investment; and 4) providing financing/ transactions for actual projects.

All of these initiatives translate to the need for creating more capacity in ADB's developing member countries. I believe effective knowledge sharing as highlighted in the OECD's development strategy -- as well as with ADB's redefined focus -- is an excellent way of achieving this.

Author

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Strengthening the Capacity of Supreme Audit Institutions

Jørgen Kosmo

Supreme Audit Institutions (SAIs) constitute a key component of accountability and the separation of powers between the executive, legislative and judiciary. Independent, well resourced, multidisciplinary SAIs are uniquely positioned to provide objective assessments of the legality and economy, efficiency and effectiveness of a country's public expenditure and revenue, and serve as drivers of reform in domestic resource mobilization and better public expenditure.



Effective public sector auditing matters for three reasons. For one, It is a key component of public financial management (PFM). Weak government audit means that systemic problems in the collection and spending of public funds, and the use of public assets, may go unnoticed. Strong government audit can be a catalyst to continual improvement in PFM, strengthening government performance and service delivery, as well as reducing opportunities for corruption.

Secondly, public sector auditing strengthens state-society relations. Effective SAIs with the necessary independence from the executive are uniquely placed to contribute to building strong state-society relations. Where they are recognized by non-state actors as being independent and are able to undertake and report transparently to society on the collection and utilization of public funds, they enhance the legitimacy of the state and strengthen accountability between state and society. Their work also supports the core functions of the state: those basic building blocks which all states need to function effectively. For example, state revenue collection, management of natural resource revenues, legality of the use of public funds, and strengthening financial controls to reduce corruption.

And finally, it contributes to managing donors' fiduciary and development effectiveness risk. When development funds are channeled through partner government systems, donors rely on government audit to ensure funds are used for the purposes intended and achieve expected results.

Working together to strengthen Supreme Audit Institutions

While evidence suggests there has been a small improvement in SAIs' performance since Paris and Accra declarations on aid effectiveness, change is slow and progress uneven. Public Expenditure and Financial

Accountability (PEFA) reports show that public sector auditing in developing countries needs strengthening, and often constitutes one of the weakest components of PFM. A 2010 Stocktaking of the SAI community showed that for one in six countries, the SAI audits less than 10% of public expenditure annually. Further, only a limited number of SAIs in developing countries have the resources and skills to carry out performance auditing.

Recognizing the need to strengthen SAIs in many countries, two unique global partnerships exist to support SAIs in their capacity development endeavours.

The International Organization of Supreme Audit Institutions (INTOSAI) was established in 1953, and constitutes a unique peer partnership of 190 SAIs built around accepted global norms and a collegiate approach to achieving mutual goals. INTOSAI promotes the strengthening of SAIs globally, enabling them to help their governments improve performance, enhance transparency and accountability, fight corruption, and improve the use of public funds. SAIs work together to agree on global standards, develop global public goods, strengthen capacity development, create peer pressure for reform and foster knowledge sharing. The INTOSAI Capacity Building Committee, eight regional bodies and the INTOSAI Development Initiative (IDI) work with SAIs to build institutional, professional and organizational capacity. This includes practical and on the job assistance utilizing peer-peer, south-south and triangular cooperation. Stronger SAIs help the weaker: the 2010 SAI stocktaking demonstrated that 48 SAIs provide support to their peers. Similarly, SAIs in developing countries identified a clear added value from receiving support from peers.

The donor community shares many of INTOSAI's goals. Recognizing this, INTOSAI

and 16 development agencies¹ have established the INTOSAI-Donor Cooperation. This provides a strategic focus in supporting capacity development of SAIs in developing countries. It puts country leadership and priorities at the heart of support, and challenges SAIs to identify needs, manage capacity, development resources, and demonstrate delivery of results.

Unlocking the potential of SAIs for more effective public expenditure and resource mobilization

Most SAIs have the mandate to undertake audits of both public sector expenditure and revenue through financial, compliance and performance auditing. SAIs can play a key role in enhancing the effectiveness of government expenditure and revenue by providing parliament and the public with independent assessments on the collection and use of public funds. While the emphasis of SAIs has traditionally been on the audit of expenditure, SAIs are increasingly involved in strengthening domestic resource mobilization through the audit of taxation, profit from state enterprises and revenue from extractive industries. There are currently several planned initiatives to strengthen the role of SAIs in domestic resource mobilization, such as a capacity development programme on the audit of the petroleum sector run by the Office of the Auditor General of Norway; the development of guidelines on revenue audits (focusing on extractive industries) being developed by the African Organization of English Speaking SAIs; and work under the auspices of the INTOSAI-Donor Cooperation on SAI involvement in the audit of revenue from extractive industries.

Recognizing that SAIs have the potential to play a more significant role in enhancing public revenue and expenditure, it is pivotal that the SAI community, donors, civil society and others work together to scale up support to SAIs in developing countries and ensure

support is provided more effectively. INTOSAI and its membership, working in partnership with the donor community, have identified a number of lessons to ensure better and more sustainable results from efforts to strengthen SAIs. These include:

- 1) **SAI leadership of reforms:** Capacity development support must be based on the needs of the SAI, and SAI-owned and led, rather than focusing on reducing donors' fiduciary risks. This is the only way of ensuring ownership and sustainable and effective reforms. Interventions should be rooted in SAI-owned needs assessments and Strategic and Development Action Plans.
- 2) **Long term engagement:** Strengthening SAIs takes time. It requires building cooperation, trust and mutual understanding between partners. Previously there has been too much focus on short term, isolated initiatives and stop-go reform. SAI capacity development has been most effective when built on long term partnerships. For instance the successful development of the SAI of Zambia has taken place through a partnership with the Office of the Auditor General of Norway and Norwegian Embassy in Zambia ongoing since 1998. This illustrates that it may take up to 10 years to see sustainable impact from capacity development.
- 3) **Peer support:** Development partners should recognize the added value of peer support as a component of SAI capacity development. SAIs have a unique institutional knowledge and experience of reporting to parliaments, and of measures needed to maintain a reputation

Strengthening SAIs is not just a matter of money and technical advice on the auditing standards. While we need SAIs to be well resourced, we also have to help build an environment which promotes accountability through transparency and public participation.

and standing as an independent accountability organization. Peer support is the preferred modality of the SAI community and can be used to harness the benefits of triangular and south-south cooperation.

- 4) **Ensuring credible SAIs through SAI independence:** Promote strengthening of SAI independence from the Executive in line with the recent landmark UN General Assembly resolution which calls on all member countries to implement the Lima and Mexico Declarations on SAI Independence.
- 5) **Working with SAI stakeholders:** For SAIs to have more impact, they need to strengthen their capacity to engage and work with external stakeholders. It is also necessary to develop the capacity of Parliamentarians, Civil Society Organizations and donor staff to understand SAI reports and use them effectively.
- 6) **Support for strengthening the SAI's operating environment:** Strengthening SAIs is not just a matter of money and technical advice on the auditing standards. While we need SAIs to be well resourced, we also have to help build an environment which promotes accountability through transparency and public participation. These foundational factors are largely outside the SAI's control, though in the long term SAIs may be able to influence them. Prospects for improvement in the SAIs operating environment are also bounded by political-economy factors. This is where support from domestic parliaments, civil society, the donor community and other stakeholders is most needed: to create coalitions to advocate for change when windows of opportunity arise. Programs and donors should be able to respond flexibly to take advantage of political-economy changes which provide opportunities to strengthen the environment in which an SAI operates.
- 7) **Good practices and guidance on SAI capacity development:** Recognizing the accumulation of dispersed knowledge on SAI capacity development, INTOSAI and the donor community have begun documenting good practices and developing guidance on capacity development of SAIs. A guide on good practices in working with SAIs was recently published under the auspices of the OECD DAC Taskforce on Public Financial Management². The INTOSAI-Donor Cooperation will also develop, in partnership with Train4Dev³, a training

course on working with SAIs, targeted to the donor community.

- 8) **Country systems and SAI credibility:** Donors should continue to support the country systems agenda and avoid establishing parallel structures that could undermine national institutions. For example, in one country in sub-Saharan Africa donors assessed the SAI and found it to be too weak to use for auditing donor projects. Parallel structures for auditing donor projects were established, rather than supporting efforts to strengthen the SAI. This had an unintended consequence that the perception of a weak SAI was used by the executive to dismiss the findings of the SAI's audit reports as not being credible, thus undermining an already weak accountability structure in that country. This highlights the importance of working with country systems and accountability institutions, to enhance their capability and credibility.
- 9) **Stronger focus on results:** Recognizing there was a limited evidence base on SAI performance, work is ongoing to develop an evidence base and measure results of SAI capacity development. The 2010 stocktaking report 'Capacity Development of Supreme Audit Institutions: Status, Needs and Good Practices' painted the first ever global picture of the state of external government audit, covering 183 SAIs. Work is ongoing within INTOSAI to develop a global SAI Performance Measurement Framework, helping SAIs to apply performance management approaches to their capacity development. This will also enable tracking of changes in SAI performance over time.

Notes

1. INTOSAI, African Development Bank, Austria, Belgium, Canada, European Commission, Inter American Development Bank, IMF, Ireland, Islamic Development Bank, Netherlands, Norway, Sweden, Switzerland, UK, USA, World Bank.
2. <http://www.oecd.org/dataoecd/48/54/49066186.pdf>
3. Train4dev is a Joint Donors Competence Development Network.

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Reforming Public Expenditure Management in the Philippines

Florencio Abad

Over the last year, the Philippines appeared to be flush with good news, having made headway in various global economic and governance indices. In 2011 alone, this Southeast Asian country managed to climb up ten whole places in the World Economic Forum's Global Competitiveness Index—one of the highest jumps tracked in the 2011 index—as well as five places in Transparency International's Corruption Perception Index.



Efficient public expenditure management is at the heart of this drive for change. After all, the way government manages public funds has an immediate impact on its ability to deliver critical goods and services to its constituents. For the longest time, the national budget and its attendant processes were at the mercy of too many competing interests, underpinned by a systemic culture of patronage. This enabled an exclusive group of oligarchs, clans and cronies to exert their influence over public resource management, allowing them to effectively retain control over the distribution of wealth and economic opportunity in the country.

This, of course, yields devastating results. A firmly established system of patronage will ultimately give way to unjust relations of inequity and dependence, where the privileged stand to gain more and the disadvantaged remain shackled to poverty. In this light, fund management reforms in the Philippines should focus on restoring the government's role as a fair mediator of competing interests and an effective and impartial redistributor of wealth.

Generally speaking, the role of the Department of Budget and Management sounds simple enough: to ensure that each and every peso counts in improving socio-economic conditions for all Filipinos, particularly the poor. But fund management is naturally more complex than that, and its effectiveness should be measured against how it achieves three imperatives, the first one being aggregate fiscal discipline—utilizing resources in a strategic way so that government is able to spend within its means.

Secondly, fund management effectiveness should be measured against allocative efficiency, or how the allocation of scarce public funds can be aligned with a strategic socio-economic development plan. It's a no-brainer: government must spend on

the right priorities. Thirdly, operational effectiveness is key. Public goods and services must be provided at the most reasonable cost and lead to maximum benefit so that value-for-money is ensured.

Aggregate fiscal discipline

Success in achieving aggregate fiscal discipline could be the easiest to track. The trajectory in deficit-spending governments like ours should point towards attaining a sustainable level of deficit and debt. At the moment, we intend to reduce the fiscal deficit to 2% of GDP in the medium-term, as well as reduce the debt stock to around 40% of GDP, at par with our neighbors.

We are doing this through a combination of increased revenue efficiency and a smart borrowing strategy, coupled by prudent spending according to a Medium-Term Expenditure Framework. Already, these initiatives are beginning to bear fruit; more than ever, the Philippines is closer to attaining investment grade status from global credit watchers, with investors eyeing local shores with renewed interest and enthusiasm.

But what is prudent spending? Is it just about reducing government expenditures at all costs? And while we want to make our creditors happy, how about government's role in stimulating economic growth? Most importantly, how can we establish social justice in such an environment?

Allocative efficiency

The question of securing social justice leads to our efforts to measure allocative efficiency. This involves the politically charged question of how to measure and benchmark priorities at the macro level, within sectors, and even within an activity. Combating poverty has always been distinguished as a priority in previous

administrations, with social services being the premier budgetary sector.

But how is our social services budget—amounting to more than P560 billion or around USD13-14 billion—being distributed to education, health, social protection, and asset reform, among others?

Within education, for example, how is the budget optimally shared between the public basic education system and state universities and colleges? And within basic education, again, how will the pie be divided among classroom construction, teacher recruitment, learning materials, and other competing concerns?

In our first salvo of Zero-Base Budgeting, we discovered how P2 billion or \$46 million had been wasted per year on the School Feeding Program under previous administrations. The program was doomed to fail, not only because it was not a core function of the Education Department, but also because the program did not concentrate on in-campus feeding. Instead, bags of uncooked rice were distributed to the children. Rice distribution continued even during summer vacation, when students were presumably not attending classes!

Operational effectiveness

This leads to the objective that is trickiest to measure: operational effectiveness. Rather than mulling over the best way to benchmark procurement costs with prevailing market prices, we put a larger emphasis on institutional outputs versus their budget, as well as those institutional outputs versus desired social outcomes.

Too often, however, the link between spending and outcomes is poorly established. This is what we are trying to cure by establishing an Organizational Performance Indicator Framework, through

which each and every agency has a logical frame that links societal goals with outcomes, down to organizational outputs and specific programs and project targets.

Budgetary reform and its challenges

The initiatives above are just some of the many budgetary reforms pushed for by the Aquino administration. Ever since President Benigno S. Aquino III assumed leadership of the country, we instituted Zero-Base and participatory budgeting to improve transparency and accountability in expenditure management. These reforms also widen spaces for citizen participation in budget preparations, so that the government may address on-the-ground needs as efficiently and effectively as possible.

In preparing the budget for 2013, we also piloted the concept of “bottom-up budgeting.” So far, we have engaged 300 of the Philippines’ poorest municipalities to craft local poverty reduction and empowerment plans, in partnership with communities and grassroots groups in their jurisdictions. These will then be considered in the consolidation of the budget for submission to Congress. We are also pursuing the broad digitization

of government processes to streamline operations and improve the flow of information between agencies. To this end, we initiated the development of a Government Integrated Financial Management Information System (GIFMIS). Some of its components—which we will launch this year—are the National Payroll System, the Cashless Purchase Card system, and an Electronic Procurement System.

Parties and individuals who once benefited from the political tradition of patronage are even more resistant to the changes we are making. .

Our drive for reform has generated mixed reactions both inside and beyond the bureaucracy. Some sceptics have voiced their doubts at our ability to succeed, citing previous reform efforts that failed or backfired. Parties and individuals who

once benefited from the political tradition of patronage are even more resistant to the changes we are making. Nonetheless, many groups and individuals have expressed excitement over this administration’s reform thrust, having recognized that we are moving into a public management regime that values competence over connections.

While we know that corruption continues to lurk in government, we have to approach the bureaucracy not as an enemy but as a stakeholder and ally in reform. Many of its members, especially in middle management, have been silenced by the status quo and left at the sidelines. We are hoping that in the end, the very reforms we are fighting for will create a positive impact on the welfare of public servants and, ultimately, translate to direct, immediate, and sustainable benefits for all Filipinos across the country.

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Fiscal Sustainability — Lessons and Challenges from the New World

Vicente Fretes Cibils and Gustavo García Osío

The Latin American and the Caribbean (LAC) region learned its fiscal policy lessons from past mistakes—and it learned them very well. For several decades in late last century, pro-cyclical fiscal policies worsened LAC’s economic growth volatility. Policy makers increased (or decreased) spending and decreased (increased) taxes, enlarging the economic cycle’s boom (bust). Over the last two decades, however, most LAC countries reverted from the past and implemented structural reforms and strengthened fiscal sustainability - a necessary condition to accelerate and sustain economic growth.

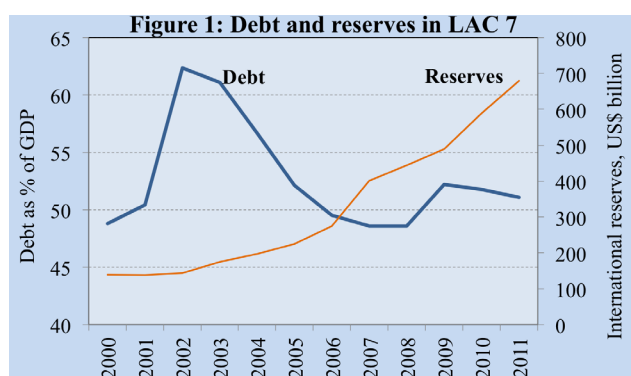
Fiscal reforms, together with a favorable external environment (both in developed and emerging markets, led by China) and high commodity prices paid off during the 2000s. As a result, for 2003-2007, LAC’s real GDP grew at 5 percent per year - and LAC’s income per capita expanded on an average annual growth rate of about 4 percent. This article reviews the fiscal response LAC countries implemented in the face of the crisis. It then goes on to consider the impact of fiscal

reforms undertaken in the past on this policy response. It concludes by underlining the necessity to further strengthen fiscal institutions and to take into account the federal nature of fiscal policy in LAC.

Latin America and the Caribbean and the financial and economic crisis

During the 2000’s most LAC countries simultaneously implemented prudent (and

relatively well-coordinated) macroeconomic policies, improving fiscal outcomes and accumulating net international reserves (NIR). LAC’s fiscal policy was less pro-cyclical as it saved much of the fiscal revenues “windfall”. The region also decreased public debt as percentage of GDP. This together with high NIR strengthened the region’s solvency and liquidity position making it more robust to confront external shocks (see figure 1).



LAC's initial condition, policy response, including fiscal stimuli, together with Asia's fast recovery and growing demand of the region's commodities contributed to (i) LAC's rapid economic recovery; and (ii) its fiscal outcomes post-crisis, contrasting significantly with OECD/European countries. LAC's strengthened fiscal institutions also contributed to these results.

of revenues automatically vary with the cycle, fluctuating pro-cyclically. In addition, countries with high fiscal dependency on revenues from non-renewable natural resources exports required more specific rules to (i) respond to volatile and unexpected price changes in the international market, and limit its pro-cyclical impact; and (ii) save for future generation and ensure fiscal sustainability. Finally, adopting and implementing fiscal rules, and particularly structural fiscal balance rules, proved to be institutionally and technically complex.

There were however significant intra-regional and country differences across the region, with large (e.g., Mexico and Brazil) and mid-size (e.g., Chile, Colombia and Peru) countries well prepared for absorbing external financial and economic shocks.

LAC's economic growth, fiscal consolidation and policies determined its ability to confront the external crisis of late 2000s. These initial conditions - fiscal balance, debt/GDP ratio, and NIR - and the extent and duration of the shocks were critical for LAC's policy response. In contrast to OECD/European countries, LAC's initial conditions "opened" fiscal and financial space. The region was thus relatively well prepared for responding to the external crisis, limiting the impact on economic growth to only one year (see figure 2).

LAC's GDP growth sharply slowed from 2008 as a result of the external crisis, with the recovery starting in 2010. The downturn in GDP depressed tax collections, and the fall in commodity prices reduced commodity-linked fiscal revenues, particularly for commodity-exporting countries. As a result, overall fiscal revenues as a percentage of GDP declined in 2008 and 2009, recovering when the domestic and global economy (led by emerging markets) recovered. Primary fiscal balances plummeted (typically by about 4 percentage points).

Most countries in the region did however respond with countercyclical fiscal policy, expanding primary fiscal expenditures and, in some cases, reducing taxes, providing effective fiscal stimulus. And, by the end of 2010, the vast majority of fiscal stimuli were progressively scaled back.¹ There were intra-regional differences, both in terms of initial conditions and external impacts. Small economies (Central America and Caribbean) and Mexico were significantly affected by the external crisis (see figure 3). These economies are closely integrated to the US economy through trade of goods and services and remittances. Mexico nevertheless had fiscal and financial space to implement countercyclical policies and recovered fast—by 2010, Mexico's GDP grew at 5 percent.

Fiscal reforms and the financial crisis: what lessons?

Over the last two decades, LAC made significant progress on fiscal reforms and on strengthening fiscal institutions to conduct credible, stable and sustainable fiscal policy. Most countries adopted fiscal rules and, more specifically, adopted numerical limit rules on fiscal aggregates without adjusting them to the business cycle.² These quantitative rules helped the region's fiscal consolidation, contributing to fiscal discipline. They however proved to remain pro-cyclical (even though less so than before).

Furthermore, to comply with the quantitative rules during the international crisis and to enhance the stabilization role of fiscal policy, most LAC's countries modified or abandoned (temporarily) the fiscal rules because these did not explicitly include escape clauses (except in Mexico) to confront severe external shocks. With the exception of Chile, no country in LAC adopted fiscal rules based on structural fiscal balance - until mid-2011, when Colombia became the second country in the region to adopt such a type of rule.

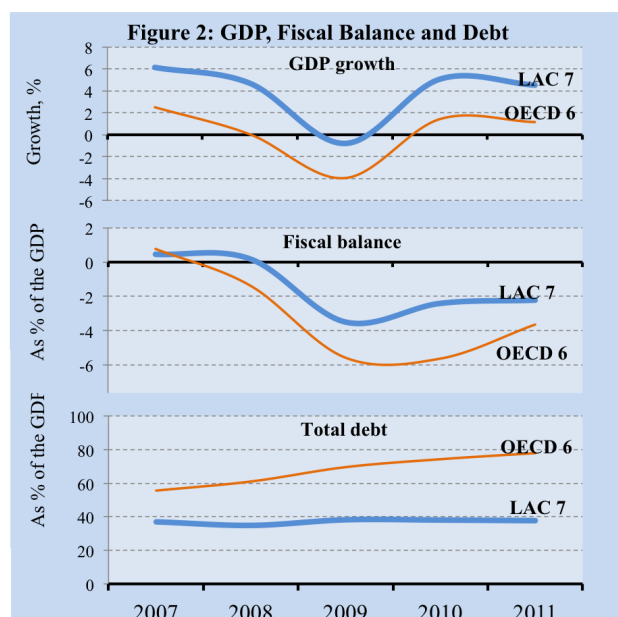
The international crisis unmasked the key weaknesses of the region's fiscal rules. Their temporary suspensions and/or violations in response to the business cycle and international crisis reduced their effectiveness to achieve sustainability and credibility. In addition, they proved to limit the stabilizing ability of fiscal policy if automatic stabilizers were small—the LAC's case.³

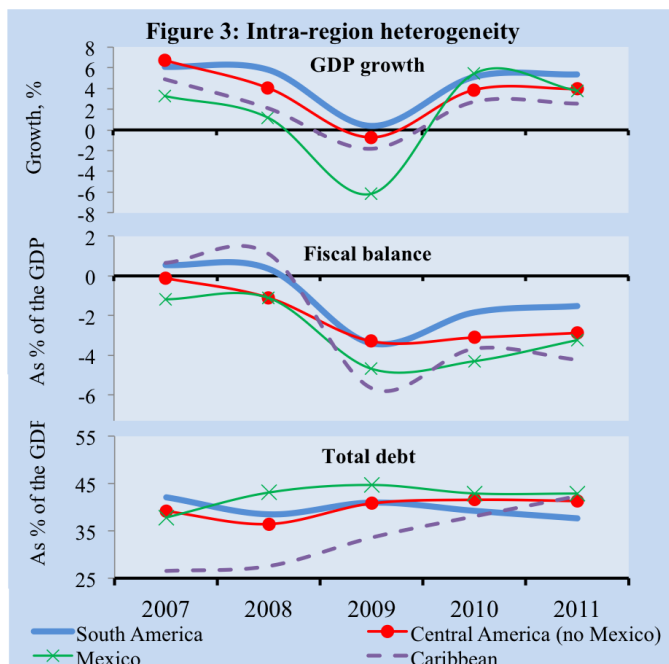
Moreover, transfers to sub-national governments, even with fiscal rules, may have limited fiscal policy's stabilizing role during the business cycle. Transfers defined as a fixed proportion

Therefore, they are probably a good option for large-medium size countries/economies with strong institutions and technical capacity. Consequently, LAC should continue to (i) strengthen fiscal rules, including explicitly incorporating escape clauses and adopting structural fiscal balance rules (if justified in large-medium economies); and (ii) use discretionary countercyclical policies, complementing fiscal rules, if international shocks are significant.

Taking fiscal federalism into account

LAC's fiscal federalisms further complicate the process of strengthening fiscal rules and the stabilization role of fiscal policy. Three facts characterized LAC's fiscal federalism: first, sub-national governments (both intermediate and local) are spending a large and growing share of total public resources; second, sub-national governments - with some exceptions such as Argentina and Brazil - have limited tax power (particularly at the intermediate government level); and third, sub-national governments depend heavily on fiscal transfers from the central government.





As a result, most sub-national governments have large vertical fiscal imbalances and pro cyclical public finances—governments' high dependency on direct transfers from central government that are fixed proportionally to annual central government ordinary revenues correlates positively with the business cycle. Finally, sub-national public finances in most LAC countries are not explicitly included in national fiscal rules.

There are several reasons behind this exclusion, including (i) a large number of local governments with different institutional, information and management system capacities; (ii) local governments' high resistance to adopt fiscal rules; (iii) centralized fiscal institutions' lack of credibility; and (iv) governments' weak incentives to smooth out and reduce transfers' pro-cyclicality through stabilization mechanisms - such as stabilization funds.

In light of these facts, LAC should likely continue to (i) strengthen fiscal rules by including sub-national finances in national fiscal rules; and (ii) reduce sub-national public finances' pro-cyclicality through stabilization mechanism and expansion of sub-national own resources.

Conclusion

LAC's performance during last decade and, in particular, during the international crisis of late 2000s provided some lessons and challenges that are important for the region itself and for other regions, including OECD/European countries. First, LAC's initial condition, policy response, including the fiscal stimuli, together with Asia's fast recovery and growing demand of the region's commodities contributed to (i) LAC's rapid economic recovery; and (ii) its fiscal outcomes post-crisis, contrasting significantly with OECD/European countries. Second, LAC's strengthened fiscal institutions contributed to these results - most countries in the region improved the overall public finance framework and, with few exceptions, reduced fiscal policy pro-cyclicality. Despite these results, the crisis unmasked the need to (i) further improve public financial institutions to strengthen fiscal policy stabilization role; (ii) increase policy makers' capacity to counteract exogenous shocks; (iii) strengthen fiscal rules, including adopting structural balance based rules (if justified) with escape clauses and covering sub-national governments public finances in national fiscal rules; and (iv) reduce vertical imbalances and pro-cyclicality of sub-national public finances through stabilization mechanism and expansion of sub-national own resources.

This article expresses the authors' opinions and does not represent the Inter-American Development Bank's (IADB) views or policy. It draws on an IADB study: Preconditions for Establishment of Fiscal Rules Based Structural Fiscal Balances, led by Gustavo Garcia (Forthcoming 2012). The authors would like to thank Luis Marciano for his excellent research assistance, including data and article production.

Notes

1. In contrast to OECD/European countries, most LAC's countries maintained all policy instruments available for policy makers, and complemented the fiscal stimuli with easing monetary policy—expanding credits and reducing domestic interest rates, and with adjustment in the exchange rates to ensure competitiveness for the external sector.
2. Fiscal rules are explicit goals to maintain credibility, sustainability and transparency of fiscal policy in the short and long term. They are established in a legal fiscal framework
3. LAC's automatic stabilizers were/are small for three main reasons: first, income tax (and particularly personal income tax) is small proportion of total fiscal revenues; second, the tax structure is not progressive; and third, high labor market informality limits unemployment insurance coverage.

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Cash Transfers and Poverty in Latin America

Nora Lustig



Although in Latin America cash transfers (also called Social Assistance) are still much smaller in scale than in advanced countries, in the last fifteen years they have become quite widespread. At the end of last decade, Brazil, Argentina, Bolivia, Mexico and Peru spent 4.2, 3.0, 2.2, 0.8 and 0.4 % of GDP, respectively, on cash transfer programs.¹ How much is extreme poverty reduced by cash transfers in Latin America?²

Standard benefit incidence analysis shows that cash transfers can reduce extreme poverty significantly especially if the per beneficiary transfer is of a certain magnitude and the coverage of the poor is large. Figure 1 shows the decline in pre-transfers extreme poverty caused by transfers, as measured by the percentage change in the headcount ratio between pre-transfers and post-transfers income. The pre-transfers and post-transfers incidence of extreme poverty is shown in Table 1. Extreme poverty here is defined as the proportion of individuals whose income falls below the international poverty line of US\$2.50 per day in purchasing power parity.³ Note that, for simplicity, poverty, extreme poverty and indigence are used interchangeably.

Comparing cash transfer programmes in Latin America

Flagship cash transfer programs such as *Bolsa Familia* in Brazil, *Oportunidades* in Mexico, *Jefes y Jefas* in Argentina, *Bono Juancito Pinto* in Bolivia and *Juntos* in Peru have become household names in their respective countries.⁴ In the case of *Bolsa Familia* and *Oportunidades*, they have gained international recognition as well. Except for *Oportunidades* in Mexico, these are neither the only cash transfer programs nor necessarily the largest in terms of

resources. Argentina's largest program is the *Pension Moratorium* (2.3% of GDP)—a special non-contributory pension that increased the proportion of women in retirement age who receive a pension by almost 30 percentage points (more than 90 % of women of eligible age now receive a pension). In Brazil, the largest is the *Special Circumstances Pension* (2.3% of GDP), a transfer designed to support, for example, widows and workers who become disabled (resources spent on *Bolsa Familia* equal 0.4%). In Bolivia, *Renta Dignidad*—a universal minimum pension—is the largest (1.4% of GDP). In Peru, food transfer programs cost 0.2% of GDP—twice as much as *Juntos*.

Although Argentina and Mexico are similar in terms of per capita GDP (measured in purchasing power parity the latter was around 14,000 dollars per year), Argentina spends more on cash transfers (3.0 % versus .75 % of GDP) and a larger percentage of the extreme poor are transfer beneficiaries in Argentina than in Mexico (92.5 versus 66.8 %). Unsurprisingly, transfers in Argentina reduce extreme poverty by a considerably larger amount. This is true, however, in the short-run. Since the pension moratorium program may incentivize informality, the formal social security system could face sustainability issues in the future. Also, public revenues in Argentina have been particularly high due to the commodity boom. The government may be unable to support generous cash transfers under more adverse conditions.

Interestingly, although Brazil spends the most on cash transfers of all five countries (4.2 % of GDP), the extent of poverty reduction is smaller than in Argentina because the share of transfers going to the poor is smaller in Brazil: 10 % versus 36 % in Argentina. In Brazil, the largest cash transfer—the *Special Circumstances Pension*—is not a program targeted to the poor.

Although Bolivia spends almost three times as much as Mexico on transfers as a share of GDP, Bolivia's GDP is lower so the per capita transfers are smaller than in Mexico. However, what makes Bolivia's redistributive machine less effective is that more than 60 % of the benefits of its largest transfer program —*Renta Dignidad*, a non-contributory universal pension (1.4 percent of GDP)—go to the nonpoor; meanwhile, only 43 % of the extreme poor are beneficiaries of any of Bolivia's flagship transfer programs. Bolivia's emphasis on more universal transfers (as opposed to targeted transfers) substantially diminishes its capacity to reduce extreme poverty through transfers.

Peru spends a fifth of Bolivia in transfers as a share of GDP, but because the transfers are better targeted to the poor and the coverage of the extreme poor is higher, the reduction in extreme poverty in Peru exceeds Bolivia's. The poor in Peru receive 47 % of the benefits while the poor in Mexico, Argentina, Bolivia and Brazil receive 38, 36, 32 and 10 % of transfers, respectively. In Peru, 58 % of the poor receive transfers while in Bolivia only 43 % do.

Policy lessons

For cash transfers to significantly reduce extreme poverty:

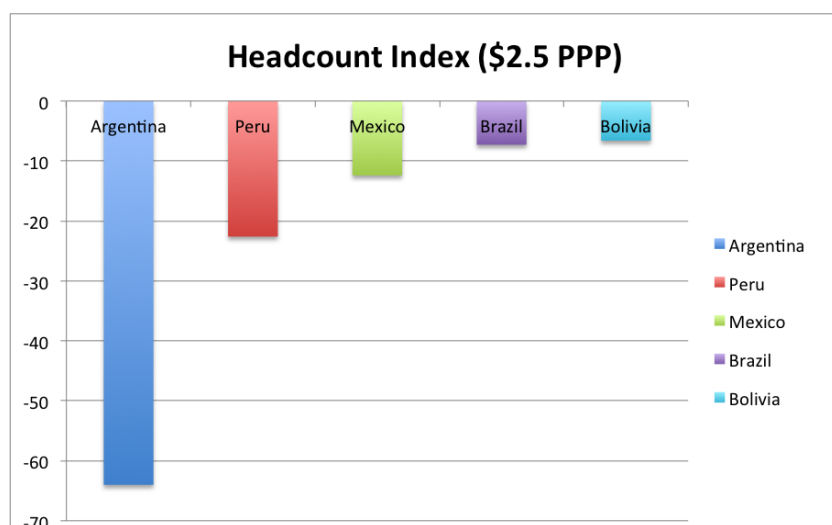
- The transfers per beneficiary have to be of an order of magnitude not too distant from the average poverty gap (i.e., the difference between the poverty line and the per poor person income/consumption).
- The existing range of transfer programs must be designed and implemented in such a way as to cover as close to the universe of the extreme poor as possible.

Table 1 – Cash Transfers and Poverty Reduction in Argentina, Bolivia, Brazil, Mexico and Peru (circa 2010)

	Headcount Ratio Pre-Transfers Income	Headcount Ratio Post-Transfers Income
Argentina	13.9%	5.0%
Bolivia	22.2%	20.7%
Brazil	15.4%	11.9%
Mexico	12.4%	10.8%
Peru	15.2%	14.0%

Note: Poverty line is US\$2.50 PPP/day. Argentina is for urban areas

Figure 1-Cash Transfers and Extreme Poverty Reduction (circa 2010)



Source: Lustig, coord., (2012)

Note: The size of the bar measures the decline in the pre-transfers headcount ratio induced by cash transfers in percent. The poverty line is US\$2.50 in purchasing power parity dollars per day.

These conditions imply that indicators such as the share of transfers as a proportion to GDP or the percentage of benefits going to the poor, by themselves, can be misleading.

If poorer countries such as Bolivia have large transfer programs but that are not targeted to the poor--everything else equal (e.g., the resources as a share of GDP allocated to the cash transfer)--they will reduce poverty by less. This is one of the important disadvantages of universal programs versus targeted ones. When resources are scarce universal programs get stretched too thinly.

On the other hand, even if programs are well targeted but the government devotes a small amount of resources to cash transfers, the reduction in poverty will be small as well. This is the case of Peru and—to a lesser extent—Mexico. This happens because—with very limited budgets—either the transfer per beneficiary is too small (compared to the poverty gap), a sizeable proportion of the extreme poor can't be covered by the programs, or because of both.

Coverage may be limited not because of budget constraints only, however. If the targeting criteria/mechanisms of cash transfer programs leave out important sections of the poor (for example, the indigent in urban areas or living in nonpoor regions, single persons without children, or the temporary unemployed), a significant proportion of the extreme poor are likely to be left uncovered by design. This situation can happen even in countries with programs

whose scale is similar to the number of people living in extreme poverty. For example, *Bolsa Familia* in Brazil (which covers around 11 million households) and *Oportunidades* in Mexico report having 11 and 5 million households as beneficiaries, respectively, figures that are similar to the countries' population in extreme poverty. However, in both countries the proportion of indigent not covered by any of the existing cash transfer programs is close to one third.⁵

Of course, to reduce poverty on a permanent basis, transfers have to be designed in such a way that households are not incentivized to increase fertility or work less. If existing programs have negative effects on adult labor supply or crowd-out private transfers, for example, in the medium-term the poor may become even poorer. Also, if anti-poverty programs do not emphasize improving the human capital of poor children or empower adults to become more self-reliant, they will not address the more fundamental causes of poverty. In contrast, when cash transfer programs are designed so that opportunities for poor children get more equalized and adults learn how to improve their livelihoods on a more permanent basis, poverty reduction policies can also be good for economic growth.

This article is an (adapted) excerpt of the relevant section in Lustig, Nora, coordinator, 2012. "Fiscal Policy and Income Redistribution in Latin America: Challenging the Conventional Wisdom," Argentina: Carola Pessino; Bolivia: George Gray Molina, Wilson Jimenez, Veronica Paz and Ernesto Yañez; Brazil: Claudiney Pereira and Sean Higgins; Mexico: John Scott; Peru: Miguel Jaramillo. Tulane University, Economics Department, Working Paper 1202, New Orleans, Louisiana

Notes

1. By definition, these cash transfers exclude contributory pensions funded through a formal social security system but include non-contributory pensions funded by government tax revenues.
2. This poverty line is close to the median of national poverty lines in middle-income Latin America. Extreme poor and poor are used interchangeably.
3. This poverty line is close to the median of national poverty lines in middle-income Latin America. Extreme poor and poor are used interchangeably.
4. The most important cash transfer programmes in Argentina include: Asignacion Universal Por Hijo, Jefes y Jefas, Familias, Food program, Pension Moratorium (non-contributory pensions), Scholarships and Unemployment Insurance. In Bolivia: Bono Juancito Pinto, Renta Dignidad (previously known as Bonosol), PAN and School Feeding. In Brazil: Beneficio de Prestacao Continuada (BPC), Bolsa Familia, Special Circumstances Pension, and Unemployment Benefits. In Mexico: Oportunidades (previously known as Progreso), Procampo and Adultos Mayores. In Peru: Juntos and food transfers. For a detailed description see Lustig, coord., 2012.
5. The number of beneficiaries in Brazil and Mexico is similar to the population living in extreme poverty.

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Fiscal Consolidation in Estonia

Ivar Sikk

This article provides an overview of the Estonian approach to fiscal responsibility, including societal and political consensus on deficit spending and examples of lessons learned from consolidation process. Estonia has a well-rooted culture of fiscal responsibility and extensive experience with consolidation during the 2008-2010 period, amounting to 17% of GDP.



There were numerous factors supporting the success of the consolidation. The relatively small size of the country and buffers of 11% of GDP collected during the previous years provided a favourable precondition for quick reactions to the changing economic environment. Estonia has followed sound fiscal management since the transition in the early 90s and has a natural preference for conservative fiscal policy. The fact that Estonia had currency board-backed fixed exchange rate from 1992 until 2011 and accessed the Eurozone in 2011 also played an important role.

Being an open economy, Estonia is very much dependent on the conditions of the European economy and the world at large and thus the fiscal stance has to be highly adaptive. When world trade collapsed in late 2008, Estonia's exports plunged by nearly 50% during the first half of 2009, and financial flows in the banking sector almost stopped.

Facing a simultaneous domestic shock the Government took a rather consistent line at the very outset of the crisis. Immediate measures were taken to maintain the credibility of state finances and to keep fiscal position within the Maastricht limits. Very strong political commitment can be considered as the main success factor of consolidation: the balanced budget rule has been in the coalition agreement for a decade.

Another supporting factor was lack of public objection. The consolidation need was well taken on board by the society – there were no protests on the streets, although most segments and sectors were affected by the consolidation.

The scope and measures of consolidating

No budget lines were saved from consolidation – the logic that almost each and every budget item can be cut was employed. Another realization was that laws could be amended to enable consolidating: 29 laws were modified with the negative supplementary budget of 2009.

Some examples of consolidation measures, on the expenses side, include a 20 % cut of operational expenditures of the public sector, lower increase of pensions from 2009, suspending government co-payments to the II pillar pension funds for 2009 and 2010 and gradual resumption of payments thereafter, reduction of health insurance costs by 8%, major cuts of road maintenance, local government funding, and defence budget.

On the revenues side, actions were taken to raise the unemployment insurance tax, the alcohol, fuel and tobacco excise, and the VAT, lowering of the income tax was temporarily stopped and additional dividends from state owned enterprises were paid. In short, the expenditure and revenue side measures were balanced, and EU funds were effectively used to save the pace of economic growth.

The fine-tuning of the budgeting process entailed useful legal discussions for the Ministry of Finance, and was a trigger in starting serious discussions on structural reforms, such as for example social security and education reform.

Effects of the consolidation

The Estonian economy emerged from the crisis with a substantially stronger fiscal position. From the point of view of the Ministry of Finance the consolidation had positive side effects, as it was used to improve public financial management. It resulted in increased control over other general government areas of expenditure, and increased capability to assess general government budget position, as more advanced tools and techniques for planning and monitoring were introduced. The consolidation also shifted the mindset of Estonian politicians, public administrators and the general public with regards to budgetary issues.

Lessons learned

In order to be able to withstand economic downturns, one needs to be prepared. In practice this translates into budget surpluses

resulting in fiscal reserves in good times to introduce countercyclical budget policy during the times of crisis. This ensures that there will be no need to borrow in turbulent times, when interest rates are high, to stimulate economic activity.

Budget surplus can be achieved through a balancing of the budget at times when GDP levels are above their potential - revenue windfalls during the boom years must not be spent. Keeping the structural budget position in balance and letting automatic stabilisers work helps to create confidence in public finances.

It is advisable to have fiscal rules in place. The rules are especially important in almost every country in times of change of the government. Legal framework of fiscal rules backs the sustainability of the fiscal system and curbs governments in pushing through irresponsible policies.

The balanced budget rule is the best known rule. However, it is usually not enough due to the tendency to underestimate cycles. Therefore it is useful to balance the impact of this rule with the expenditure limit rule. Another option is to set expenditure ceilings, which can become expenditure floors in boom periods.

Another key aspect is transparency and political independence of fiscal institutions that enables objective forecast. Keeping the political and public discussions active is essential for successful implementation as it builds ownership. Last but not least, creating buffers is essential for long-term fiscal sustainability.

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Food Security plans in Eastern and Southern Africa: COMESA or Tripartite?

Francesco Rampa and Quentin de Roquefeuil

This article is part of a five part series to share findings from a regional Comprehensive Africa Agriculture Development Programme (CAADP) mapping exercise undertaken by ECDPM. Each monthly article will highlight lessons learned from one of four African regions (COMESA, EAC, ECOWAS and SADC). A fifth final article will summarize and present crosscutting lessons relevant for successful implementation of the CAADP process at the regional level.



Agriculture, food security, and rural development: buzzwords that seem to be trending in the last few years. Most would agree that this is a welcome development, especially after decades of relegating Africa's agricultural development to the background. With the endorsement of the CAADP by African Heads of States in 2003, the continent's agriculture and food security agenda started to return to the spotlight (see Box 1).

Many stakeholders in the Common Market for Eastern and Southern Africa (COMESA) agree on the importance of delineating a regional approach to food security in the region¹. Acting at the regional level could help investing big sums of money in key strategic areas that individual countries could not afford by themselves. Agricultural growth could also benefit from regional spill overs and economies of scale in technology, human and policy development, trade and investment. Yet, the formulation of a regional investment plan in agriculture for the COMESA region, under the CAADP process, seems to be caught between a rock and a hard place. This article sheds light on COMESA's current progress with the CAADP, and outlines some ideas for taking the process forwards.

To Tripartite or not to Tripartite?

The CAADP process operates in a unique way, seeking to place the national and regional reform and investment process firmly in stakeholder's hands. A crucial part of this process is the formulation of national and regional compacts. Compacts are a form of 'agreement' amongst all agricultural stakeholders, outlining priority areas for action in each country and region (see Box 1), and are elaborated through national and regional consultations. Ideally, national compacts and regional compacts and the investment plans that accompany them operate in synergy.

The regional COMESA compact is almost finalised and ready. It was prepared through the facilitation of the Food Agriculture and Natural Resources Policy Analysis Network (FANRAPAN), and further elaborated by the COMESA Secretariat. However, at their third joint meeting in July 2010, COMESA Ministers of Agriculture, Environment and Natural Resources, decided that: "Given the progress made on the Tripartite Agreement between COMESA, EAC and SADC, COMESA Member States should take this development into consideration and approve further development of the COMESA Regional Compact within the Tripartite framework. The Tripartite CAADP Regional Compact will have to be approved and adopted by the three Regional Economic Communities (RECs)".

The momentum behind the Tripartite trade negotiations has thus spilled over to the CAADP process². At a first glance, the next step for implementation of the tripartite CAADP regional plans could seem simple:

submitting the draft COMESA compact to the SADC and EAC Secretariats and assess how this would relate to an hypothetical Tripartite compact.

However, the current situation is somewhat of a 'catch 22'. On the one hand, COMESA should design its own regional investment plans to show concretely the potential added value of a COMESA compact vis-à-vis the national CAADP compacts, something that is crucial given the low appreciation of regional level action by some stakeholders. On the other, designing credible and realistic plans would require knowing which programmes to undertake as COMESA and which should be undertaken jointly with other RECs as part of the possible 'Tripartite' compact.

The COMESA regional CAADP process is therefore caught between a rock and a hard place: designing an investment plan for food security first in order to fast-track the regional dimension of food security in COMESA, with the risk of seeing it poorly

Box 1: The Comprehensive Africa Agriculture Development Programme in a nutshell

CAADP is the agricultural programme of the New Partnership for Africa's Development (NEPAD), a programme of the African Union. Established by the AU assembly in 2003, CAADP's goal is to eliminate hunger and to reduce poverty through agriculture. To do this, African governments have agreed to increase public investment in agriculture by a minimum of 10 % of their national budgets. CAADP identifies four key pillars for food security improvement and agricultural investment: (1) sustainable land and water management; (2) market access; (3) food supply and hunger; and (4) agricultural research.

The CAADP is centred around the definition of national and regional plans ('Compacts'), agreed by all stakeholders (public, private, as well as donors) serving as a framework for partnerships, alliances and dialogue to design and implement the required policy interventions and investment programmes. The formulation of national and regional investment plans is one of the most important activities to implement the CAADP after the definition and signature of the Compact. To date more than 28 countries in Africa have signed CAADP Compacts.

connected to the future Tripartite compact; or wait for the Tripartite compact to take hold, but loosing momentum on the COMESA regional front of food security.

After the decision by the SADC Council of Ministers in August 2011 that SADC should join the process for a 'Tripartite' compact, informal consultations between officials of the three RECs Secretariats started, with a view to agree on which specific areas of cooperation will be covered by a 'Tripartite' food security framework as well as on which REC will take the lead in the preparations under each thematic areas. Moreover, despite the temporary pause in the COMESA compact process, the COMESA Secretariat continues to implement its overall CAADP work plan, which includes contributing to the formulation of a regional compact. It seems, then, that both tracks are moving in parallel, increasing the risk of overlap and duplication.

Solving the situation: adopting a 'differentiated gears' Tripartite compact

This situation could be solved by adopting a flexible approach to the Tripartite compact, a sort of compact 'à la carte', allowing each region to go at its own pace, defining its regional priorities first and engaging others on issues of common concern. This would entail that the Tripartite compact is conceived in flexible terms. Concretely, it should have limited binding provisions, differentiated policies, programmes, rules and implementation time frames.

This would allow each REC to achieve a minimum level of internal coherence, defining first how its regional investments complement and contribute the ones already undertaken at the national level under national CAADP processes. It would also give RECs the time to assess how their own policies, beyond CAADP, should feed into the food security plans identified regionally. It would thus allow COMESA to go ahead with its regional compact and investment plan, while choosing which part of the food security agenda it wants to tackle jointly with other regions.

This would translate into a 'differentiated gears' Tripartite compact, with RECs or blocs of countries entering different programmatic partnerships on specific sectors/themes, gradually, depending on existing progress of various parts of regional cooperation and

on voluntary basis. This 'comprehensive, internally coherent and differentiated gears' 'Tripartite' compact can be realistically built around existing REC plans and groups of countries which already cooperate well in specific areas, even beyond activities belonging strictly only to COMESA or EAC or SADC programmes.

This situation could be solved by adopting a flexible approach to the Tripartite compact, a sort of compact 'à la carte', allowing each region to go at its own pace, defining its regional priorities first and engaging others on issues of common concern.

Such a gradual approach would allow SADC, for instance, to simultaneously formulate its part of the 'Tripartite' CAADP and complete its on-going process for the Regional Agricultural Policy (RAP, i.e. the SADC regional CAADP compact), maintaining the objective of having RAP as a legally binding framework for SADC, but without imposing on non-SADC countries the same degree of legal value for other programmes that will be common to all the RECs on certain shared challenges.

Similarly, if one REC does not have (yet) within its priority mandate a specific cooperation area, it can still achieve full multidimensionality of a 'Tripartite' CAADP at its own pace. This for instance would be the case of COMESA, which does not have regional water resources management in its draft CAADP framework. COMESA would require first an expansion of its traditional agenda, focused at present more on economic regional integration.

Implementing and designing the approach

The mechanisms behind this flexible, overarching, compact (i.e. long-term institutional arrangements/structures that can coordinate 'Tripartite' CAADP investment

programmes), should consider the existing Tripartite structures as the starting point. Additionally, interesting proposals already on the table should be taken into account, such as the coordination structures proposed in the FANRPAN-led COMESA consultation process, for example the 'Stakeholders Compact Review Platform'.

The careful design of a 'comprehensive, internally coherent and differentiated gears' compact would also require a step-by-step multi-stakeholder consultative process, a 'road-map' facilitated through strong leadership, for instance by a Committee of the SADC/COMESA/EAC CAADP Focal Points; or a "Friends of the Tripartite Compact" group representing all key stakeholders. This lead group would have to start with identifying a minimum common ground among RECs and their Member State on what major bottlenecks and opportunities in each region are for food security, and define a constructive way forward.

Notes

1. COMESA is a free trade area covering 19 countries; Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Ethiopia, Eritrea, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe
2. The "Tripartite", as it has been called, is a process currently under development for establishing a Free Trade Area "from Cape to Cairo", bringing together the regional markets of COMESA, the East African Community (EAC), and the Southern African Development Community (SADC).

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EPA Update

Melissa Dalleau

Southern African Development Community (SADC)

Next Joint SADC-EC negotiating round planned for end of May

The date for the next Joint SADC-EC Senior Officials meeting on EPA has tentatively been set for 28-30 May, with technical meetings foreseen from 24-26 May. Some of the major issues remaining in the negotiations are likely to be discussed, prime amongst which market access. South Africa's demands are a point of contention and the EU, for its part, judged insufficient the latest proposal tabled by the countries of the Southern Africa Customs Union (SACU) on Non Agricultural Market Access (NAMA) and agriculture during the Johannesburg round of negotiations (November last year).

The EU and Namibia also have to agree on the sensitive question of rules of Origins (RoO) for fisheries, which continues to be an important bottleneck in the negotiations, although experts close to the negotiations seem to argue that most of these issues could be solved at the technical level. Other critical issues that continue to hamper the pace of the negotiations include the issue of export taxes, the MFN clause, trade in services, the cumulation in RoOs, trade-related issues, the definition of parties and the standstill clause.

The parties continue to work towards the finalisation of an agreement by the end of July 2012, bearing in mind that the EU process to conclude an agreement may require at least 18th month. One should remember that the temporary arrangement granted under Regulation 1528/2007 may come to an end by January 2014 for those countries which have not taken the necessary steps to implement an agreement. This timing appear however quite tight given the number of unsettled issues remaining on the table. Nevertheless, the European Parliament seems to be considering a possible extension of this 'deadline' to 2016.¹

East African Community (EAC)

EAC-EU negotiators continue to progress towards the finalisation of the EPA negotiations

A joint technical EAC-EU negotiating session was held from 18-20 April in Brussels, Belgium. During this meeting, the EU presented the changes it would like to see in the EPA consolidated text as compared to the Framework EPA (FEPA) – changes which will be considered by the region and discussed during the next negotiating session in May in Mombasa, Kenya.

On development cooperation, after a few exchanges between the parties on the substance of the text, the chapter seems

now to be relatively finalised. The EAC agreed in Brussels to examine the latest comments from the EU and send a clean version ahead of the Mombasa round. However, the place that the EAC Development Matrix should have in the text of the agreement (i.e. whether it should be an Annex to the Agreement or not) and the question of what would be an appropriate timing for the development of benchmarks, indicators and targets (i.e. after the signature or after the entry into force of the agreement) appeared once more too controversial to be settled at the technical level. Those have consequently been deferred to the level of Senior Officials.

According to sources close to the negotiations, some substantive progress has been made in Brussels on the Joint Agriculture text, not only on a few definitional issues, but also on the sensitive question of "domestic support and export subsidies". The EU submitted revised texts on this subject, including a commitment to discontinue export subsidies on products concerned by liberalisation. The region has positively welcomed these revised texts. The EU also provided comments on the text submitted by the EAC concerning Geographical Indications – comments which will be examined by the region ahead of the next negotiating session in May 2012.

Finally, the negotiations touched on the topics of trade and sustainable development (TSD) and good governance in tax matters – two "new issues" introduced by the EU in December 2011. The EAC expressed its intention to conduct consultations before reverting to the EU on this subject. The same will be done on the question of obligations from Customs Unions concluded with the EU (the so-called "Turkey clause").

As reported in the pages of the last issue of GREAT Insights, Rules of Origin (RoOs) were purposely kept out of the agenda to leave the time for the region to hold national and regional consultations on RoO for industrial products. RoOs should be discussed, along with unsettled provisions related to agriculture, dispute settlement and institutional arrangements in Mombasa.

The Mombasa round of negotiations is planned from 8-11 May 2012 at the technical level only. Given the scope of outstanding issues that remain to be settled at the technical experts level, the joint Senior Official meeting that was initially foreseen on the 14 May has been postponed to the 15th of July and will be preceded by another technical level meeting.

West Africa

West Africa meet its EU counterpart in Brussels
Following an apparently fruitful round of

negotiations on RoOs, technical experts and senior officials from West Africa and the EU met in Brussels from 17-25 April. This meeting was held shortly after a meeting of the Regional preparatory Task Force on the EPA development programme.

The specific wording of the non-execution clause continues to remain controversial. Similarly, the so-called "Turkey-clause" and the MFN clause will require further discussions. Both questions will be the subject of internal consultations within the region. The EU has also reportedly submitted a proposal on the text regarding agricultural subsidies to West Africa.

According to our sources, little seems to have been achieved during the Brussels meetings on market access. Discussions on the joint statistical basis behind the offer, the new categorization of specific tariff lines (and the analysis that underpinned the categorization), as well as the level of tariff classification that should be considered for this offer (HS6 vs HS10) continue to be the subject of heated debates, but according to a recent EU press release, "The EU is confident that a compromise can be found with a decision at political level on reciprocal market access"². Consultations on these issues should be held within the West African region ahead of the next negotiating round.

On the question of the EPADP, major progress seems to have been made, although the question of "additionality" of funds remains unsettled and has been deferred to the political level.

No date has currently been set for the next negotiating round between the parties, but the EU has indicated that it will be held after internal consultations in West Africa³.

Central Africa

Preparatory EPA meetings held in the region during the first quarter of this year

The Permanent Secretariat of the Regional EPA Committee, comprising of technical officials from the two regional Economic Communities (RECs) in charge of the negotiation in the region (i.e. the Economic Community of Central African States (ECCAS) and the Economic and Monetary Community of Central Africa (CEMAC) met from 13-17 February to agree on a draft negotiating programme and discuss common projects under the Regional indicative Programme (RIP) of the 10th European Development Fund (EDF).

On another subject, a meeting was held in Douala, from 29-30 March, to present the results of a study on trade in services. Commissioned by CEMAC and ECCAS and

financed by TradeCom, this study should help the region refine its position on services in the context of the EPA negotiations, and ensure a coherent regional approach.

Beyond these regional meetings, no joint EPA negotiating session has taken place between the parties since their encounter in Bangui (RCA) in September 2011. No further information is available at this stage as to when and where the next joint negotiating round should be held. GREAT was however informed that a meeting should take place early May in Brussels with EC and Central African representatives to evaluate the progress made on two commissioned studies, respectively focusing on the methodology and evaluation of the “net fiscal impact” of an EPA, and on capacity building to ensure that Central African economies benefit from the opportunities deriving from an agreement. In the meantime, CEMAC and ECCAS are actively preparing an internal regional ministerial meeting to validate the progress made at the technical level since February 2010 - a critical step in order to move forward.

Eastern and Southern Africa (ESA)

No joint negotiating round has been held between the parties on the EPA over the past few months, and as GREAT goes to press, no future date seems to have been set.

Zimbabwe's IEPA: notification of ratification

According to sources close to the negotiations, Zimbabwe has notified to the EU its will to ratify the EU – ESA interim EPA, which should then enter into provisional application. If this is confirmed, Zimbabwe will be the first country to do so in sub-Saharan Africa.

Extension of Derogation on RoO for tuna/tuna loins for Mauritius, Seychelles, Madagascar

The EU amended the 2008 Decisions of the EC regarding Rules of Origin for tuna and tuna loins applicable to Mauritius, Seychelles and Madagascar. This decision has been published in the Official Journal of the EU on 12 April.⁴

It extends the temporary RoO derogations granted to these countries under Council Regulation 1528/2007 applying temporary market access arrangements for ACP country during EPA negotiations. Concretely, it allows Mauritius, the Seychelles, and Madagascar, to export preserved tuna products under preferential rates even if the tuna was caught by foreign vessels. The quotas are set at 3000 tonnes of preserved tuna and 600 tonnes of tuna loins for Mauritius, 3 000 tonnes of preserved tuna and 600 tonnes of tuna loins for Seychelles and 2 000 tonnes of preserved tuna and 500 tonnes of tuna loins for Madagascar.⁵

Pacific

As GREAT Insights goes to press, regional preparatory meetings were to be held in Tongatapu, Tonga, to prepare the next joint negotiating round of negotiations. A Pacific ACP Meeting was being foreseen on Market Access on the 23 April 2011 – meeting which should have been followed by a PACP Technical working group on Fisheries issues (24-25 April), and a meeting of the Technical Working Group on Legal, Institutional and Capacity Building (26-27-30 April). Outcomes of these technical discussions were then to be considered by PACP Trade Officials (1-2 May) and Ministers (3-4 May). As we go to press, however, no information was available as to whether those meetings were actually taking place.

Caribbean

CARIFORUM and EU sign financial agreements in support of Regional Integration and EPA implementation

On March 28, the Caribbean Forum of ACP States (CARIFORUM) signed three financial agreements in support of regional integration in the region with the European Commission (EC). These funds should help CARIFORUM signatories of the EPA to meet their commitments and make the most out of an agreement (they come to support fiscal reforms, SPS measures, commitments taken on trade in services, rum industries, and the removal of Technical Barriers to Trade).⁶

Notes

- 1 DRAFT REPORT on the proposal for a regulation of the European Parliament and of the Council amending Annex I to Council Regulation (EC) No 1528/2007 as regards the exclusion of a number of countries from the list of regions or states which have concluded negotiations. Committee on International Trade. Final Parliamentary Decision should be discussed in June 2012.
- 2 EC DG Trade Press Release. EU and West Africa hold EPA negotiations in Brussels (18-20 April 2012). 2 May 2012.
- 3 Ibid
- 4 COMMISSION IMPLEMENTING DECISION of 4 April 2012 amending Decisions 2008/603/EC, 2008/691/EC and 2008/751/EC as regards the temporary derogation from the rules of origin laid down in Annex II to Council Regulation (EC) No 1528/2007 to take account of the special situation of Mauritius, Seychelles and Madagascar with regard to preserved tuna and tuna loins (2012/190/EU) Ibid.
- 5 Ibid
- 6 European Commission/CARIFORUM Agreements to Boost Regional Integration. St Kitts and Nevis Observer. 31 March 2012.

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Monthly Highlights from ECDPM's Talking Points Blog

www.ecdpm.org/talkingpoints

European Report on Development 2012: the EU's role in promoting development-friendly natural resource management. A sneak preview, Water, energy and land belong to the most under-pressure resources today. This year's European Report on Development, to be launched in mid-May 2012, focuses on these 3 key natural resources and analyses how the ways they are managed affect development objectives. The Report examines the constraints on each, the interrelationships

between them and considers how water, energy and land can be managed together to promote economic growth in the poorest developing countries – growth that is both socially inclusive and environmentally sustainable. While the Report's layout and formal launch are being prepared, this blog post (...)

Monthly highlights from ECDPM's Weekly Compass Update

www.ecdpm.org/weeklycompass

Member States' positions on the proposed 2014-2020 EU Budget

The EU institutions and Member States are currently negotiating the EU's budget for the period 2014-2020. On 26 March, the European Commission's proposal for the budget was discussed for the first time at the level of the Council of the European Union. Each Member State had 3 minutes to convey its priorities. ECDPM's most recent Briefing Note reports back and analyses these statements, particularly those with a focus on EU External Action and the European Development Fund. Questions whether there will be cuts in development spending or if the European Development Fund will lose its special status outside the regular budget can't be answered at this stage, but the Council will resume discussions on 24 April.

Spotlight on new blending mechanism

Blending, the complementary use of grants and loans, could increase the available volume of development finance. To improve the quality and efficiency of EU external cooperation blending mechanisms and financial instruments, the European Commission proposed to establish an "EU Platform for External Cooperation and Development". A public consultation is currently taking place on this. ECDPM, as part of the European Think-Tanks Group, published a report on blending, which points out that there is only a limited evidence-base on its effects. The European Parliament's Development Committee will discuss EU regional blending facilities with the European Commission and the European Investment Bank next week.

Reprogramming EU development cooperation: who will do what?

Two years until the new financial regulations for external action will enter into force, the EU has launched the programming process setting how and where the 57.57 billion EUR budget proposed for development cooperation will be used. In preparation for the first step of the planning and budget cycle, detailed responsibilities have now been agreed amongst EU stakeholders. This process is of strong importance to developing countries

as it will determine what the development assistance resources will be spent on from 2014 to 2020. A new ECDPM Discussion Paper analyses the process of programming the EU's development assistance by looking at the roles that the different EU institutions, partner countries, as well as EU member states may play. The authors, Simone Gortz and Niels Keijzer, point to key moments and analyses the changes foreseen.

Getting ready for take off: boosting agriculture and food security initiatives

It is almost a decade since the launch of the Comprehensive Africa Agriculture Development Programme (CAADP) in 2003. Since then, this initiative has recorded both successes and challenges at national and regional levels. However, while all African Regional Economic Communities recognize the need to increase efforts around agricultural development and food security, the manner in which action is taken, and degree of progress differs from region to region. Building a series of mapping studies, which assessed CAADP progress by region, a new ECDPM Briefing Note entitled "Getting ready for take off: Lessons for regional CAADP" provides a synthesis of crosscutting messages and challenges from all regions. It provides ideas on how to make regional CAADP more effective and helps to identify concrete actions for faster progress, which could be useful for stakeholder discussions during the 8th CAADP Partnership Platform meeting on 3-4 May.

ACP-EU relations at a critical juncture

The Cotonou Agreement, the largest North-South partnership between the EU and the ACP countries, will expire in 2020. "In political terms, this seems an eternity" Geert Laporte writes in a new ECDPM Briefing Note, but in view of economic and political changes world wide "it is not too early to open the debate on the future of the partnership". Obviously, the EU will remain interested in Africa and to a lesser extent also in the Caribbean and the Pacific, but does it want to continue working with the ACP as a group of about 80 countries with increasingly differing ambitions and levels of development? How committed are the ACP to keeping their

group and the ACP-EU Partnership alive? What new common interests, beyond aid can be identified between the two groups of countries? Laporte's Briefing Note gives an updated overview of the state of this debate, points to major challenges on the way ahead and proposes a number of concrete steps for a constructive and well-informed process.

Impact assessments a weak link in policy coherence

Donors should better take into account the views of developing countries in order for Policy Coherence for Development (PCD) to have a positive impact, according to the report of a recent meeting of OECD Focal Points on PCD published this week. Participants called for more concrete targets and evidence to measure the impact of policy incoherence and to provide the basis for decision-making. Niels Keijzer presented ECDPM's work on potential indicators for measuring PCD impact. Findings show that better defining objectives for PCD can improve political accountability and provide a basis for clear result-oriented action plans. But this requires research to explore the actual effects of OECD members' policies on developing countries, Keijzer said.

Billions less for development?

In a response to the economic crisis in the EU, the current overarching trend is a decrease in, or freeze of, development budgets despite commitments to the contrary. In addition to this, there is a trend where Member States wish to repatriate spending to the national level, particularly those who are net contributors to the EU budget. Although the European Commission has proposed an increase in the total amount for the 11th European Development Fund (EDF), some EU Member States are advocating for no real growth in any area of EU expenditure which would include the EDF. How would efforts to impose "austerity" on overall EU expenditure possibly affect the amounts available for EU's largest development financing instrument? ECDPM's Ulrika Kilnes explores the impact of different of "zero growth" scenarios in a new Briefing Note and finds that they could in practice mean billions less aid to ACP countries.

ACP-EU Trade Calendar

May

- 1-2 Pacific ACP Trade Officials Meeting, Tongatapu, Tonga
- 2 Meeting on Intensifying progress towards EPAs through Smart Partnership Dialogue, Brussels, Belgium
- 2-3 Meeting (ACP Secretariat) on Development Strategy for Services Sector in ACP Countries, Brussels, Belgium
- 3-4 Pacific ACP Trade Ministers' Meeting, Tongatapu, Tonga
- 4 62nd meeting of the ACP-EU Committee of Ambassadors, Brussels, Belgium
- 8-12 EAC-EU Technical Officials Meeting, Mombasa, Kenya
- 9-10 Forum Trade Officials Meeting (FTOM), Majuro, Marshall Islands
- 11 Forum Trade Ministers' Meeting (FTMM), Majuro, Marshall Islands
- 23 Meeting of the Delegation to the ACP-EU Joint Parliamentary Assembly, prior to the 23rd session of the ACP-EU JPA, Strasbourg
- 24-26 Joint SADC-EC technical negotiating session on EPA (venue TBC)
- 28-30 23rd Session of the ACP-EU JPA, Horsens, Denmark

- 28-30 Joint SADC-EC Senior Officials meeting on EPA (venue TBC)
- TBC Meeting between EC and Central African officials on commissioned studies with regards to EPA accompanying measures, Brussels, Belgium
- TBC Third Meeting of the COMESA-EAC-SADC Tripartite Trade Negotiating Forum (TTNF)

June

- 11-13 95th Session of the ACP Council of Ministers, Port Vila, Vanuatu
- 14-15 37th Session of the ACP-EU Council of Ministers, Port Vila, Vanuatu
- TBC Joint EAC-EU technical and Senior Officials Meetings (venue TBC)

July

- 27 Pacific ACP Officials Meeting, Suva, Fiji
- TBC 2nd CARIFORUM-EU Business Forum, with the theme "Making the CARIFORUM-EU Economic Partnership Agreement (EPA) Work", United Kingdom

Resources

ACP-EU cooperation on readmission: Where does it stand and where to go? Henrike Klavert, Jeske Van Seters, ECDPM Briefing Note 33, April 2012
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