

JICA's Position Paper on Public Financial Management (PFM) (Second Version)

The objectives of this position paper are three-fold.

First, JICA should establish a basic recognition that Public Financial Management (PFM) is a core capacity with which a developing country should be equipped for its effective management of the social and economic development process.

Second, JICA should deliver its aid for PFM more strategically. PFM should be defined as a key policy and institutional factor that would affect aid and development effectiveness in JICA's delivery of its aid.

Third, JICA should better integrate a PFM perspective into its PDCA (Plan–Do–Check–Act) cycle.

This paper has been developed not only for the Public Governance and Financial Management Division (PGFM Division) but also for the relevant JICA departments involved in aid activities. First and foremost, PFM should be addressed from the wider perspective of social and economic development in developing countries.

JICA has already produced the following: (i) "PFM Handbook of Financial Planning of Pilot Projects on Technical Cooperation" (December 2013); (ii) "PFM Handbook of How to Assess Public Financial Management (PFM) in Developing Countries?" (February 2014); (iii) "Key Principles of JICA's Delivering Effective Technical Assistance in Public Financial Management" (June 2012); and (iv) "Thematic Evaluation Report on Financial Sustainability of JICA Projects from a PFM Perspective" (January 2014). We expect this Position Paper to be read together with these documents.

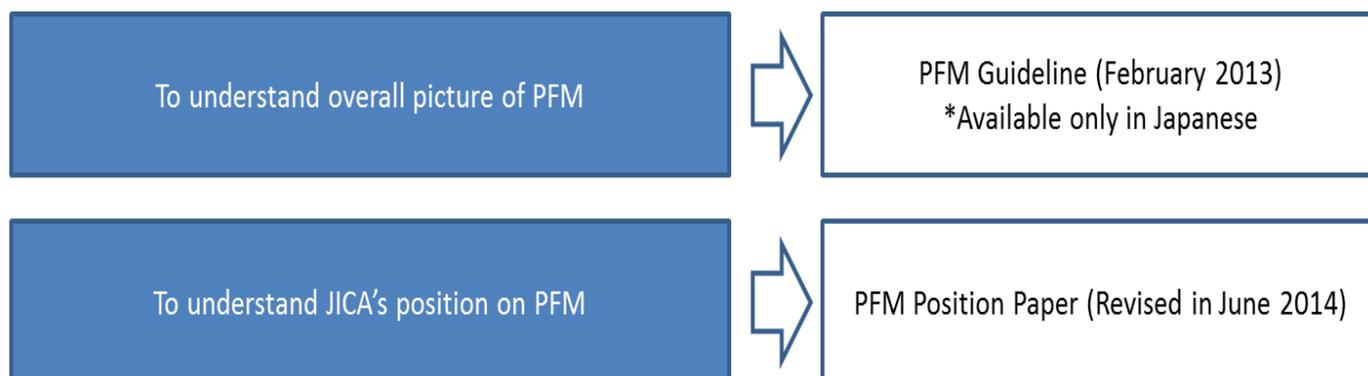
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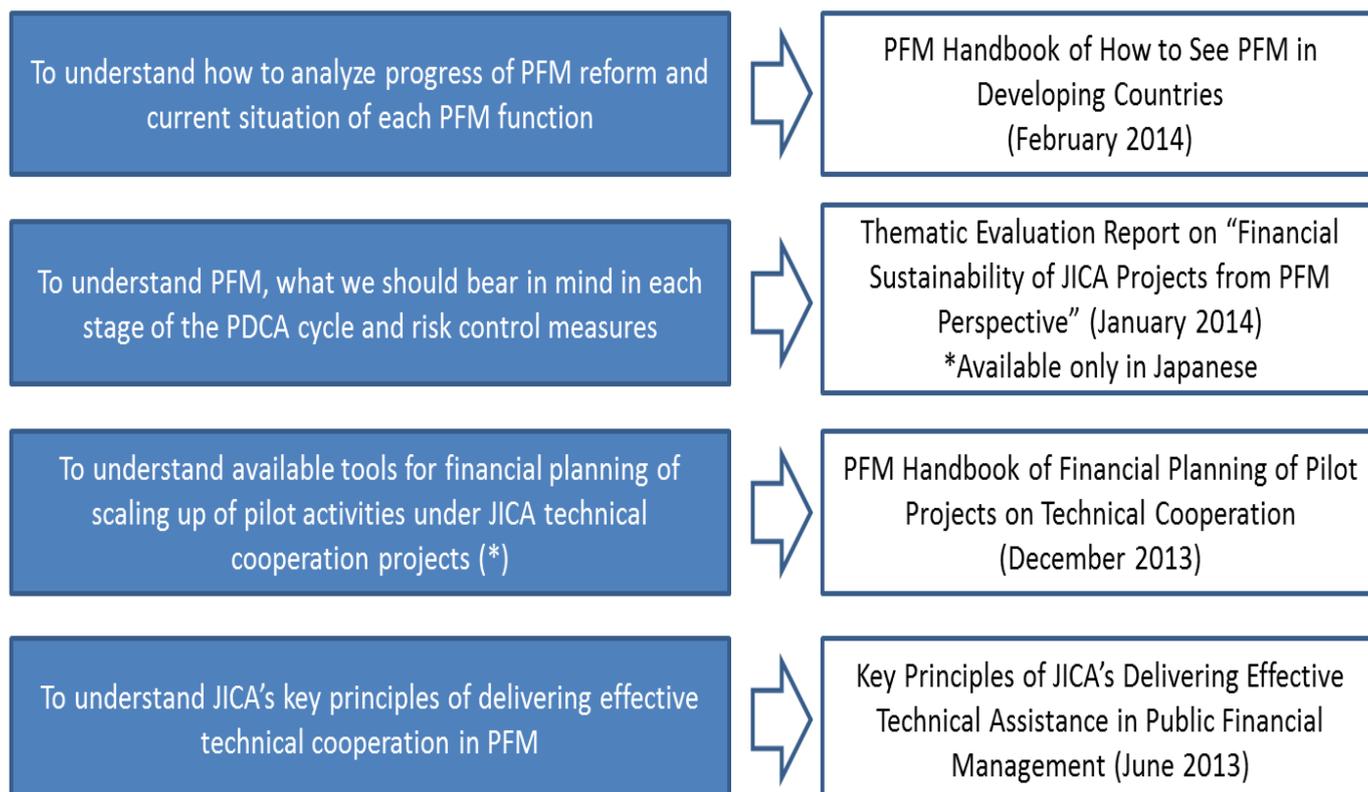
Reader's guide

We suggest referring to the following documents along with this Position Paper. They can be downloaded from JICA's website.

<Overall>



<Tools>



(*)Pilot activities are those to be implemented under JICA technical cooperation projects for the purpose of examining the effectiveness of the model or concept. These are implemented on a small scale at first on a trial basis, and subsequently, expanded on a large scale after their effectiveness is examined.

I. Background

1. PFM is an institutional framework to put the following into practice
 - (1) Aggregate fiscal discipline
 - (2) Strategic resource allocation
 - (3) Effective and efficient service delivery.

These are very important key principles for sound and sustainable financial management in any country. The coverage of PFM as defined in this paper is shown in Table 1.¹

Table 1: Categories of PFM

| Development objectives | Intermediate targets | Sub-categories | Securing aggregate fiscal discipline | Improving strategic resource allocation | Improving effective and efficient service delivery |
|--|---|--|--------------------------------------|---|--|
| I. Planning budget and expenditure with aggregate fiscal discipline and strengthening revenue capacity | I-1. Improving comprehensiveness, reliability, and transparency of budget | Improving comprehensiveness and transparency of budget | ○ | ○ | - |
| | | Building capacity of budget and expenditure planning | ○ | ○ | - |
| | | Improving budget planning process | ○ | ○ | ○ |
| | I-2. Improving capacity of revenue forecasting and tax administration | - | ○ | - | - |
| II. Improving treasury management and budget execution and holding accountability properly | II-1. Improving treasury management and budget execution | Improving treasury management | ○ | - | ○ |
| | | Improving cycle of budget execution | ○ | - | ○ |
| | | Improving accounting system and procedures | ○ | - | ○ |
| | | Improving public procurement system and its operation | ○ | - | ○ |
| | | Improving public asset management | ○ | - | ○ |
| | II-2. Holding accountability properly | Improving internal control and audit | ○ | ○ | ○ |
| | | Improving financial reporting and monitoring | ○ | ○ | ○ |
| | | Improving external audit | ○ | ○ | ○ |

¹ Regarding the intermediate targets, “Improving comprehensiveness and transparency of budget” includes debt management policy and related capacity building. “Building capacity of budget and expenditure planning” includes budget and expenditure related institutional capacity building.

2. Since the late 1990s, the importance of PFM has become widely recognized in development cooperation for the reasons noted below.
- (1) Introduction of the PRSP process: As the Poverty Reduction Strategy Paper (PRSP) process was introduced in developing countries, the linkage between PRSP and PFM became increasingly important.
 - (2) Increased recognition of improving effective use of aid: Since no drastic increase in official development assistance was expected in a climate of “aid fatigue,” the international development community became increasingly cognizant of the need to improve aid efficacy.
 - (3) Increased recognition of accountability of aid: It was imperative to ensure accountability for the use of additional resources provided by debt relief and financial support, and to prevent countries eligible for debt relief from falling back into a similar situation as before, by enhancing accountability including PFM.
 - (4) Coping with aid fungibility: Influenced by the concept of foreign aid fungibility, donors became more aware of the need for monitoring the fiscal soundness of developing countries as well as budget support so as to understand the additional development results provided by financial aid.
 - (5) In line with its commitment to the international aid effectiveness agenda, the international development community agreed to minimize transaction costs and to further promote inclusive ownership of national development processes by using the development countries own “country system” (public finance system, public procurement) toward greater aid effectiveness.

Nevertheless, many developing countries have yet to establish sound PFM systems, and their day-do-day operations are inappropriate. These remain as a major constraint on delivering services to the public, as laid out in Table 2.

Aggregate fiscal discipline: In some developing countries, macro-economic and revenue forecasts are not conducted properly, and their results are less reliable. If a budget were to be prepared in this situation, aggregate fiscal discipline would not be secured (e.g., notice of an expenditure ceiling is not provided to line ministries by the finance ministry); fewer cost-saving incentives are provided to the relevant ministries; and the budget would be approved beyond the projected revenue size. Consequently, in reality, the budget would not be allocated based on the priorities of the development policy.

Strategic resource allocation: In some developing countries, the medium- and long-term perspectives are missed in the budget preparation process. As a result, expenditure obligations in subsequent years after the completion of an infrastructure project would be not considered properly in the budget

process. For example, even if it takes many years to complete construction work in a road project, an annual tranche would not be considered for construction and O&M(operation and maintenance) in subsequent years. As another example, the national development plan and sector plans have few links with the budget process; targeted development issues and policy priorities laid out in those plans would not be reflected in multi-year and annual budget planning. As a result, scarce resources would be allocated to programs and projects with fewer social benefits, resulting in under-funding of urgently needed social development such as investing in people and health, or creating fungibility problems.

Table 2: Major Issues in PFM

| | Major issues |
|---|--|
| (1) Aggregate fiscal discipline | <p>(1) Necessary framework: Legal, regulatory, and institutional frameworks for ensuring aggregate budget discipline do not exist. As a result, compliance with aggregate budget discipline is not easy.</p> <p>(2) Quality of macro economic and revenue forecasts: The quality of these forecasts is low. Financial reporting is not produced and disseminated on a timely basis. As a result, the budget authority cannot always make a budget plan and follow budget process.</p> <p>(3) Budget credibility: Supplementary budget are made frequently in the political economy situation. As a result, the gap between the initial budget and its out-turn are large in the fiscal year.</p> |
| (2) Strategic resource allocation | <p>(1) Policy linkage in budget allocation: Budget is not allocated according to the national development goals and their priority.</p> <p>(2) Medium-term perspective in budgeting: Budget is not planned with any medium-term perspective.</p> <p>(3) Budget classification: Budget classification is not used properly. As a result, actual spending cannot be tracked.</p> <p>(4) Financing the government programs: Government's budget is allocated to projects that should be financed by the private sector or Public-Private Sector Partnership (PPP) as the line ministries requested.</p> |
| (3) Operational efficiency of public service delivery | <p>There is no mechanism for the following:</p> <p>(1) Improving efficiency such as cost saving and unnecessary spending</p> <p>(2) Inspecting improper spending of public money</p> <p>(3) Budget disbursement is not made as scheduled and the predictability of budget release is low, because of which the executing organizations need to consider cash planning and cash release on a daily basis.</p> |

Operational efficiency of public service delivery: Typical problems are

observed in cash management, single treasury accounts, accounting and reporting, and cash flow forecasting. For example, an approved budget would not be disbursed on a timely basis and as scheduled, and so implementation organizations are forced to conduct cash and spending management on a daily basis. Sometimes they are then forced to spend their annual budgets in the last two months of a fiscal year.

In addition, these problems would be aggravated if internal control and audits and external audits are not established or implemented.

Influenced by PFM reforms in developed countries, developing countries have been introducing PFM reforms as a tool to improve the structure of the public sector and the budgeting process. Responding to these movements, multilateral and bilateral donors have conducted various diagnostic work since the latter half of the 1990s, as exemplified by Public Expenditure Review (PER), Country Financial Accountability Assessment (CFAA), and Country Procurement Assessment Report (CPAR). Furthermore, in the context of the aid effectiveness agenda, Public Expenditure and Financial Accountability (PEFA) was launched in 2001 and the Performance Measurement Framework (PMF) was established in an attempt to harmonize the innumerable diagnostic tools used by donors. Within the PMF, assessments were conducted on a total of 90 countries for some donors to see whether or not budget support should be given.

Table 3: PEFA Performance Measurement Framework

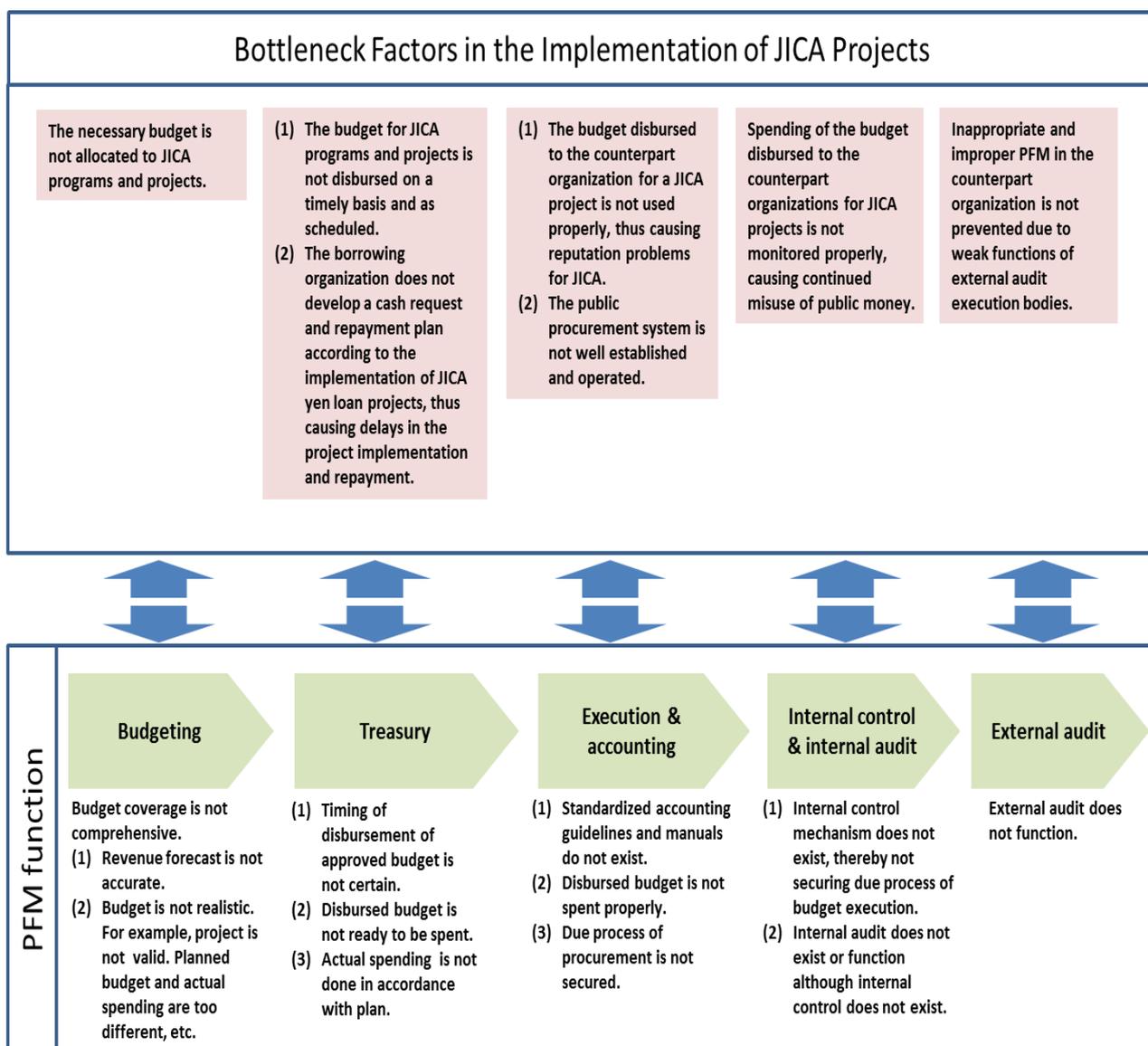
| PFM High-Level Performance Indicator Set |
|---|
| A. PFM out-turns: Credibility of the budget |
| B. Key cross-cutting issues: Comprehensiveness and transparency |
| C. Budget cycle |
| C (i) Policy-based budgeting |
| C (ii) Predictability and control in budget execution |
| C (iii) Accounting, recording, and reporting |
| C (iv) External scrutiny and auditing |
| D. Donor practices |

- PFM is an essential component of a country's policy and institutional framework. Furthermore, for smoothly implementing Japanese yen loans, grant aid, and technical cooperation projects as well as ensuring the sustainability of aid effectiveness and development results, defects in this framework would pose a potential risk to the implementation of JICA projects.

<Example: PFM as a policy and institutional framework in which to implement JICA projects>

When JICA implements its programs and projects, the following problems sometimes occur and hinder realizing aid and development effectiveness and its sustainability. These are common in any aid instruments.

Diagram 1: Bottleneck Factors in JICA's Project Implementation and their relevance to PFM



More specifically:

- The necessary budget is not allocated to JICA programs and projects.
- The budget for JICA programs and projects is not disbursed on a timely basis and as scheduled.

- The borrowing organization does not develop a cash request and repayment plan according to the implementation of JICA yen loan projects, thus causing delays in the project implementation and repayment.
- The budget disbursed to the counterpart organization for a JICA project is not used properly, thus causing reputation problems for JICA.
- The public procurement system is not well established and operated.
- Spending of the budget disbursed to the counterpart organizations for JICA projects is not monitored properly, causing continued misuse of public money.
- Inappropriate and improper PFM in the counterpart organization is not prevented due to weak functions of external audit execution bodies.

In many cases, these challenges are fundamentally caused by weak or non-existent PFM. Therefore, JICA should approach solving development challenges not only from the technical aspect but also from the PFM aspect when JICA plans and implements its programs and projects.

4. Against this background, JICA first needs to fully understand the following points on PFM, and has developed this position paper to clarify its basic thoughts on PFM and future action plans.

Box: Key principles of PFM to be shared in JICA

- (1) PFM is a reform process that would have extensive effects on the public sector. It covers from a blueprint of the overall economic and social sector reform process to its implementation in developing countries. It describes the overall picture of development planning and public sector management in the country.
- (2) PFM is a basic policy and comprises institutional elements necessary for all sectors and programs/projects when JICA addresses development challenges. The reliability of a country's PFM would be a potential risk factor for JICA activities.
- (3) Based on this recognition, JICA should recognize PFM as a potential risk factor, and integrate a PFM perspective into its PDCA (Plan–Do–Check–Act) cycle and operationalize it properly.
- (4) JICA should deploy technical assistance for PFM as a key development issue more strategically.
- (5) PFM is an issue relating to a country's policies and institutions. It cannot be managed by a single donor. Considering the recent international trend of aid effectiveness, the concept of PFM is being standardized at the international level to some extent. Thus, when JICA plans and implements PFM assistance in a country, JICA should bear in mind the importance of coordination and harmonization with the partner country and other donors. With this in mind, it is important for JICA to actively participate in various forums on PFM at the international, regional, and country level.

II. JICA's Current Support for PFM

1. To date, JICA has implemented various PFM projects, which can be grouped into four clusters:
 - (1) Support for promoting government-wide or sector-specific PFM systems;
 - (2) Support for implementing concrete policy measures and actions under PFM reforms;
 - (3) Support for improving financial and asset and debt management of recipient organizations (e.g., public corporations) of JICA's financial assistance (Japanese yen loans); and
 - (4) Actions to facilitate the implementation of yen loan projects.

Support for promoting government-wide or sector-specific PFM systems: Currently, JICA is sending policy advisors to Indonesia, Lao PDR, Cambodia, and Thailand. It has provided financial assistance (soft loans and grant aid) to Indonesia, Vietnam, the Philippines, Cambodia, Lao PDR, Tanzania, and Ghana. Development Policy Lending (DPL) for Indonesia, for instance, has shown the achievements laid out in Table 4.

The Development Policy Support Program – Investment Climate (DPSP-IC) for the Philippines aims at improving the investment environment. At the same time, it is also expected to promote policy coordination among the relevant ministries and organizations and the budget preparation process led by the finance ministry in the areas of trade and industry, laws and justice, transport and communications, revenue, customs administration, and special economic zones.

As an example of sector-specific PFM system assistance, the Financial Management Improvement Project of the Ministry of Food and Agriculture of Ghana (technical cooperation project) is now underway. This project focuses on the reinforcement of accounting rules and the improvement of internal audits in Ghana.

Table 4: Achievements in DPL for Indonesia

| Related PEFA Indicators | | Sub-target | Achievements by DPL |
|-------------------------|--|--|---|
| PI-11 | Orderliness and participation in the annual budget process | Enhance budget compilation process management | PBB(Performance Baed Budgeting) guidelines were prepared towards the introduction of full PBB. Indicators and targets were additionally set for the national medium-term development plan's programs. These efforts reinforced the performance-based approach. |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy, and budgeting | Improve capacity to plan annual expenditure | Expenditures are more strategically planned than before due to (i) the reflection of mid-term revenue and expenditure forecast in budget documents, (ii) the concept of "programme" introduced in the government's national medium-term development plan, and (iii) budget allocation in line with the poverty reduction-focused policy set in the national medium-term development plan. |
| PI-13 | Transparency of taxpayer obligations and liabilities | Enhance analytical capacity of tax policy and improve tax administration | Organizational change in the Bureau of Internal Revenue that divided departments into functions, revisions in tax return certificate forms, and the implementation of e-tax contributed to improved efficiently in operations and reduced cost for taxpayer compliance. |
| PI-14 | Effectiveness of measures for taxpayer registration and tax assessment | | |
| PI-15 | Effectiveness of collection of tax payments | | |
| PI-16 | Predictability in the availability of funds for commitment of expenditure | Improve treasury management (cash management) | The computerization of financial affairs helped reinforce commitment to budget execution. |
| PI-17 | | | The integration of the ordinary budget and development budget and the introduction of a treasury single account system to manage government cash resources contributed to the enhancement of transparency and efficiency in financial management. |
| PI-17 | Recording and management of cash balances, debts, and guarantees | Aid/debt management policy (planning and dissemination of borrowing policy and public debt management policy in the public sector) | After the financial crisis, Indonesia started to manage its debts with a focus on recovering the creditworthiness of its economy and enhancing access to external finance including aid. The country successfully stabilized its macro economy and reduced its public debt to GDP ratio and fiscal deficit. It improved the external financing environment. |
| PI-19 | Competition, value for money, and controls in procurement | Improve procurement | Newly-established National Procurement Office is responsible for preparing public procurement-related policy and regulations and developing the workforce necessary for operations. Forms/documents were standardized. These efforts contribute to fair and efficient use of the national budget. |
| Other | - | Improve national property administration | No comprehensive database on national property existed before. Now a database on national property has been prepared, based on the findings of surveys on ministries and government offices as well as local governments. The database allows for more efficient management of national property. |

Support for implementing concrete policy measures and actions under PFM reforms: Currently, JICA is providing technical assistance in the areas of (i) Performance-Based Budgeting (PBB) in Indonesia; (ii) modernization of

tax administrations in Cambodia, Indonesia, Mongolia, the Philippines, Tanzania, and Vietnam; (iii) improvement of treasury management in Cambodia, Indonesia, and Lao PDR; (iv) maximization of national asset management in Indonesia; (v) internal audit capacity development in Tanzania and Mongolia; and (vi) capacity development for the office of the auditor-general (national audits) in Thailand and Uganda.

Support for improving financial and asset and debt management of recipient organizations of JICA's financial assistance: JICA's efforts include: (i) the Study on the Assets and Liabilities Management of Power Sector Assets and Liabilities Management Corp. (PSALM) in the Philippines, and (ii) Administration of Universal Charge Funds in the Philippines to redress the National Power Corporation's fiscal management, which causes deficits in the central government and the public sector as a whole in the country. Similar cooperation has also been extended to the preparation of infrastructure projects financed by Japanese yen loans.

Table 5: Technical Assistance Programs to Facilitate the Implementation of Yen Loan Projects

| Name of country | Year | JICA' s actions |
|---|------|--|
| South Asia | 2011 | Study on public procurement systems in South Asia |
| Bhutan | 2011 | Sending experts for effective debt management |
| Peru | 2012 | Sending experts for procurement management |
| Kenya | 2012 | Sending experts for facilitating implementation of yen loan projects |
| Whole world | 2012 | Risk assessment and risk analysis framework for formulation of yen loan projects (e.g., risk management, project performance evaluation, financial management, procurement management, portfolio review/project implementation review at the country office level) |
| India | 2013 | Seminar on Japanese yen loan disbursement for the South Asian countries |
| Nepal | 2013 | Sending expert for facilitating implementation of yen loan projects |
| Kenya | 2013 | Sending expert for facilitating implementation of yen loan projects (including public procurement and disbursement) |
| Central & South America and Caribbean countries | 2013 | Sending expert for facilitating implementation of yen loan projects in the Central & South America and Caribbean regions |

In yen loan project operations, a PFM perspective is already integrated. More specifically, the PMF issue is included in the appraisal process on: (i) whether the necessary budget is registered in the government budget of the borrower's country, budget appropriation in the medium-term expenditure framework (MTEF),² and Public Investment Program (PIP); (ii) whether the requested projects are realistic and feasible (e.g., whether or not financial projections are properly done compared with revenue forecasting and projections of aid volume received from donors, and whether the timing of spending is forecasted properly); (iii) whether capital investment and recurrent expenditure processes are well coordinated; (iv) whether the financial soundness of the yen loan project implementing organizations has been secured; and (v) whether the public procurement system is well-established and operationalized.

In addition, JICA has conducted a study on public procurement systems in the South Asian region in order to assess the relevant systems and practices in each country and come up with possible options for future assistance.

At the implementation stage of yen loan projects, JICA provides technical assistance to the borrower's country if necessary.

2. In sum, JICA has taken many actions so far. However, it is strongly suggested that JICA continuously ask itself about how to deliver its aid to PFM more strategically and to integrate a PFM perspective into its PDCA cycle more systematically, thereby creating a more favorable environment for the smooth implementation of JICA programs and projects.

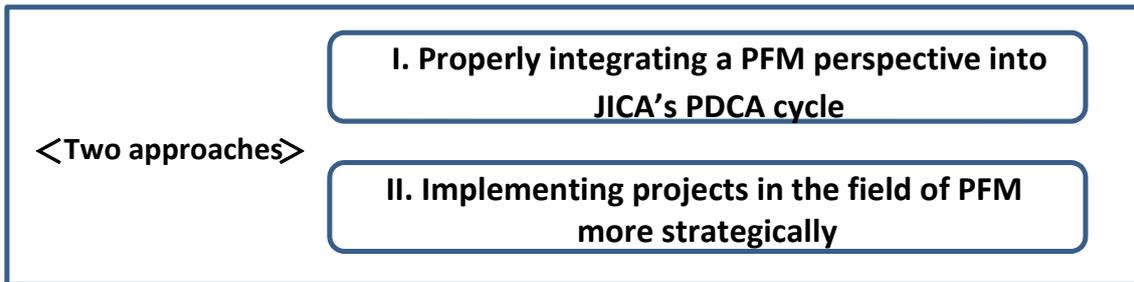
² The MTEF is a multi-year expenditure framework incorporating actual conditions, developed based on the medium-term macro economy and revenue forecasts.

III. Future Directions of JICA's Support for PFM

1. JICA's two approaches to PFM

JICA intends to reinforce its efforts in its PFM approach through the following.

Diagram 2: JICA's Two Approaches to PFM



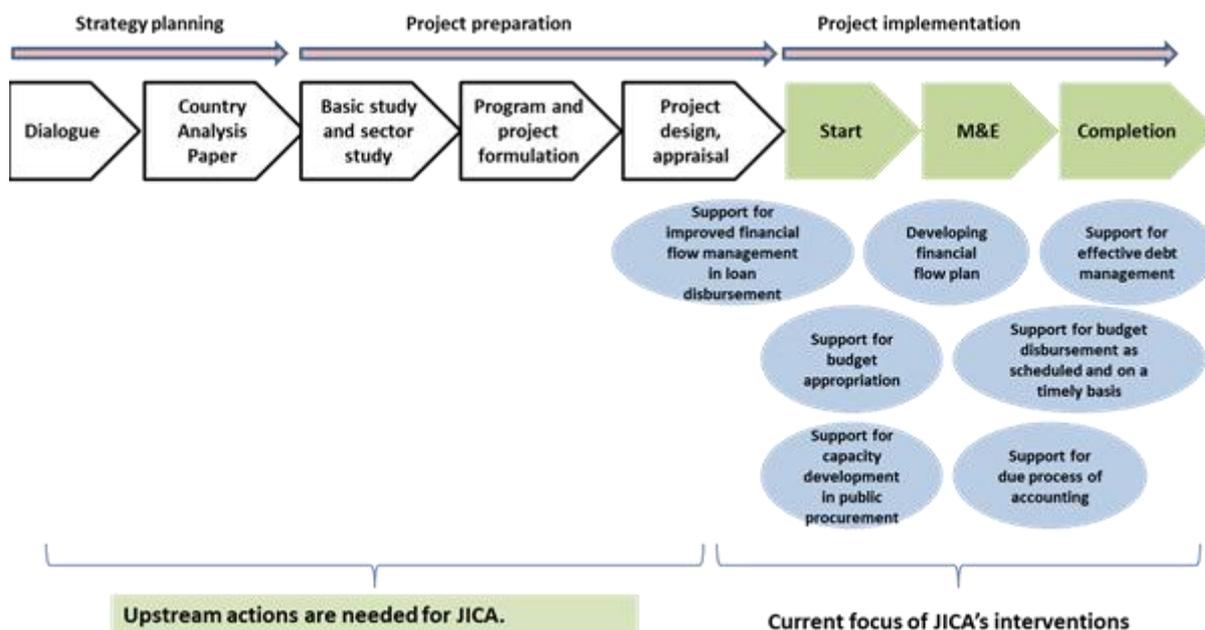
Approach I: Properly integrating a PFM perspective into JICA's PDCA cycle

JICA's PDCA cycle consists of four stages: (i) strategy planning (e.g., country analysis paper, a country assistance plan, a JICA-defined program, and a multi-year rolling plan); (ii) preparation (e.g., project formulation, design, appraisal, and agreement); (iii) implementation, and (iv) completion and follow-up stages.

Thus far, JICA has taken actions when problems occur, as noted in Table 5. For example, in the case of yen loan projects, JICA sends short-term consultants to the borrower organization, facilitates procedures relating to financial flows in disbursements, comes up with plans for financial forecasting, and gives suggestions on effective debt management and capacity development of the public procurement system and its operation, if necessary. In the case of technical assistance and grant aid projects, JICA assists the counterpart organization to take budget measures, to make timely disbursements, and to follow due process in accounting for the smooth implementation of JICA projects.

These actions focus on the project implementation stage of individual projects. Activities in the strategy planning and preparation stages tend to pay more attention to issues on how to provide technical solutions. Potential risks rooted in PFM receive less attention in some cases.

Diagram 3: PDCA Cycle of JICA's Programs and Projects



Therefore, JICA should recognize PFM as a potential risk factor that could affect aid and development effectiveness regardless of the differences in sectors, JICA's aid instruments, and programs/projects, and introduce a PFM perspective into the operation cycle from upstream to downstream. (Note: Other donors' efforts to address PFM in their PDCA cycle are shown in Attachment 2.) In addition, it is important to see the two PFM related problems: one to be addressed at the individual project level, and another that is not to be addressed at the individual project level. Even in the latter case, it is important to work with a mindset that incorporates a PFM perspective, and try to see what is happening in PFM behind the problems.

Table 6: Possible Directions of Integration of PFM Perspectives into JICA's PDCA Cycle

| Stage | Possible direction of PFM integration | Possible concrete measures for PFM integration |
|-------------------|---------------------------------------|---|
| Strategy planning | Dialogue | When JICA holds bilateral dialogues and meetings with the partner country, it always properly bears in mind and addresses PFM issues. JICA's recently produced handbook on how to see PFM in partner countries (February 2014) can be used. |
| | JICA Country Analysis | Sections and/or paragraphs describing PFM issues will be |

| | | |
|------------------------|---|--|
| | Paper(JCAP)/ Country analysis paper(CAW) | added in the JCAP and CAW document. (Note: This does not always imply that JICA should conduct diagnostic work by itself. It can use the results of surveys by PER, PEFA, and other donors.) |
| Project preparation | Basic study and sector study, and program and project formulation | PFM related assessment will be added in the scope of work of the study. Depending on the nature of the study, its assessment will cover the whole nation or the specific sector only in the country, and include identification of the country's needs. |
| | Project design integrating a PFM perspective | In some development issues, addressing PFM issues is essential, for example, local governance, subsidy programs, and pension schemes, regardless of the difference in aid instruments. Another example is the health and education sectors. One possible approach is to improve the quality of public service delivery by combining technical and PFM solutions. |
| Project implementation | Addressing PFM properly as external factors of the logical framework | One possible approach is to include PFM related issues as an agenda item of, for example, the steering committee meeting of a project. In addition, if PFM is a serious bottleneck factor impeding aid and development effectiveness in a specific project, one possible approach is to formulate and implement PFM assistance. |
| | Ensuring aid and development effectiveness, and spreading out aid outputs and | One possible approach is to consider budget implications necessary for scaling up the outputs and outcomes of the pilot project and activities |

| | | |
|--|----------|--|
| | outcomes | implemented under the framework of the JICA technical assistance. ³ |
|--|----------|--|

If JICA further integrates a PFM perspective into its PDCA cycle, it will be possible for JICA to identify development challenges faced by developing countries from various angles and to provide more effective solutions to address those challenges from a more holistic view. Consequently, JICA can avoid implementing PFM related assistance in a stand-alone way with weak linkages to interventions in other sectors and less strategic delivery of JICA aid for PFM.

To practice these approaches, JICA will utilize its recent publications, namely, “PFM Handbook of Financial Planning of Pilot Projects on Technical Cooperation,” “PFM Handbook of How to See PFM in Developing Countries,” and “Thematic Evaluation Report on Financial Sustainability of JICA Projects from a PFM Perspective.”

In the case of yen loan projects, JICA should not solely pursue only the completion of physical infrastructure construction work (for example, completion of building a bridge and increased traffic or mitigated traffic jams after the infrastructure facilities are completed) and the realization of development impacts in the short term. Through providing technical assistance in the related areas, JICA should also address capacity development of the counterpart organization of the recipient country, in terms of procurement and expenditure management, internal control and audits, and external audits. Sharing good practices of such capacity development among organizations is also important.

For example, in the education sector, in some countries, JICA assists the partner country to establish a teacher training system, and provides the client country with technical solutions such as curriculum and teaching material development. However, it is expected that JICA should also consider combining a PFM approach into the project, addressing proper staffing and salary issues, and providing budget training, thereby realizing aid and development effectiveness and ensuring the financial sustainability of the project.

Another example is the health sector. Typically, a JICA project addresses improving health and medical facilities and access to health care services at the primary and secondary level, and improving quality of health care services to improve more comprehensive maternal and child health care.

³ More specifically, one possible option to address PFM as a sustainability issue is to calculate the cost necessary for scaling up the outputs of the pilot projects and activities that are implemented under the framework of a JICA TA project to other regions in the country, or JICA would consider taking actions for ensuring financial sustainability.

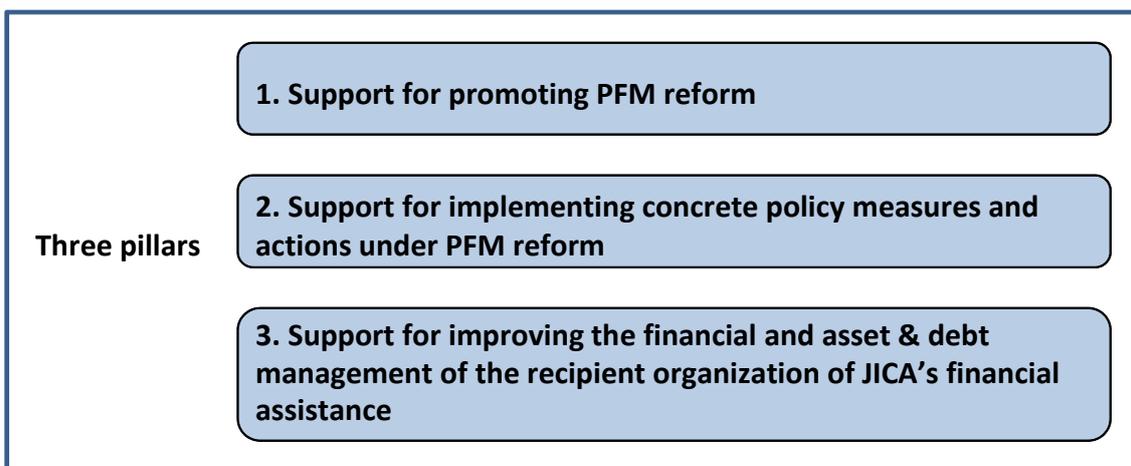
These are mainly accomplished through providing technical solutions. The process of decentralizing administrative and public financial management from the central to lower-level government is underway in some countries. In this situation, JICA should attach importance to health sector governance at all levels in parallel with pursuing technical solutions such as human resource development and improving physical facilities. In these processes, PFM should be addressed from budgeting to expenditure, treasury management, budget execution, and accountability mechanisms (including internal control and audits, and external audits).

These issues of integrating PFM into JICA's PDCA cycle will be discussed in a later section in more detail.

Approach II: Implementing Projects in the Field of PFM More Strategically

2. JICA will focus on the following three pillars in its aid to PFM and enhance its strategic perspective.

Diagram 4: JICA's Three Pillars of PFM Assistance



Pillar 1: Support for promoting PFM reform through DPL, etc.

In providing program loans such as development policy loans and PRSC loans, JICA should address PFM issues properly, and more specifically include PFM in its policy matrix.

Pillar 2: Support for implementing concrete policy measures and actions under PFM reform

JICA helps implement individual policy measures and actions listed in PFM reform programs mainly through its technical cooperation. In addition, in some countries, the public sector may be allocating resources to activities that can

be undertaken by the private sector. The possibility of Public-Private Partnership (PPP) should be considered. To be specific, in formulating a Medium-Term Expenditure Framework (MTEF) and selecting public investment such as economic infrastructure (power stations, roads, ports and water, etc.), the possibility of a PPP should be examined. In addition, mechanisms to facilitate PPPs, such as financing, should be also examined. JICA will also explore the possibility of collaboration with the IMF and the World Bank Fund, which are trusted by the Government of Japan in delivering its PFM aid. By so doing, JICA can expect leverage effects, and obtain good opportunities for learning-by-doing in support for PFM.

Pillar 3: Support for improving the financial and asset and debt management of the recipient organization of JICA's financial assistance

JICA should address the matter of the long-term fiscal sustainability of the borrower's organization in existing infrastructure projects financed by Japanese yen loans through assisting it to improve its asset and debt management. Such insufficient financial and asset and debt management would become one of the key causes of central government and public sector deficits in developing countries.

3. Basic ideas about the implementation of individual PFM-related projects

(1) To get involved in the whole PFM reform process in cooperation with the recipient country's government and other donors

- To actively participate as a member of the development community in a development partner working group operating in the field of PFM in the recipient country
- To actively share the project concept, its progress, and its achievements with other donors when JICA implements a project

(2) To reinforce strategic focus in developing projects

With its three pillars, JICA needs to reinforce its strategic focus, as follows.

Table 7: Strategic Focus in Project Identification

| Three pillars | Strategic variation | Criteria |
|----------------------------------|--|---|
| Support for promoting PFM reform | (1) Dispatch policy advisors. (2) Loan assistance that requires the formulation of a policy matrix (e.g., DPL and Poverty Reduction Support Credit (PRSC)). | (1) The conduciveness of a host country's policy and institutional framework (e.g., The World Bank's Country Policy and Institutional Assessment (CPIA)). (2) Progress in PFM reform |

| | | |
|--|--|--|
| | Where loan assistance is granted to a country with a considerable amount outstanding in yen loans, it is noted on the policy matrix as a PFM-related issue. | (existence/non-existence of a PFM reform program, aid recipient country's political commitment to PFM reform program, and PFM reform-related areas). (3) The share of Japan's ODA in aid recipient country's outstanding yen loan amount and the central government's revenue. |
| Support for implementing concrete policy measures and actions under PFM reform | Enhance/reinforce existing technical cooperation projects that show favorable performance and have potential. Increase budgets during the project cooperation period; scale up a project when moving into the next phase (e.g., PBB in Indonesia, internal audit in Mongolia, internal audit in Tanzania, etc.). | (1) The conduciveness of a partner country's policy and institutional framework (e.g., The World Bank's CPIA). (2) Progress in PFM reform (existence/non-existence of a PFM reform program, aid recipient country's political commitment to PFM reform program, and PFM reform-related areas). (3) Project performance. (Counterparty's commitment, judged against OECD/DAC's five evaluation criteria, relevance, effectiveness, impact, efficiency, sustainability.) |
| | Facilitate the implementation of measures listed in the policy matrix for DPL and PRSC. | Of PFM-related measures, areas for which implementation efforts should be facilitated and that JICA can deal with. |
| | Priority for new projects will be given to countries with bigger outstanding amounts in yen loans that face difficulties in enhancing budget execution and solving short-term delay of debt services. | The share of Japan's ODA in aid recipient country's outstanding yen loan amount and the central government's revenue. The frequency of short-term delay of debt services. |
| | Other (countries for which cooperation by international organizations | Requests for cooperation from multilateral development banks (MDBs) |

| | | |
|--|---|---|
| | and others is expected to produce aid effects/development effects). | such as the World Bank; trends in international aid such as the aid effectiveness agenda. |
| Support for improving financial and asset and debt management of the recipient organization of JICA's financial assistance | Entities with large outstanding yen loan balances. | Outstanding amount of yen loan and financial condition of recipient organization. |

4. Identifying comparative advantages of JICA's technical cooperation in PFM

The table below summarizes areas of potential technical cooperation. JICA will focus on categories (A) and (B) for the time being. With regard to category (C), the use of third party resources will be considered (e.g., South-South Cooperation).

Categories "B" and "C" mean that JICA cannot always mobilize human resources in its PFM assistance and respond to the needs of developing countries. Therefore, JICA should take the actions mentioned in the next section "IV. Challenges in JICA's PFM Assistance," and particularly "Approach I: Fostering and mobilizing human resources in Japan." By so doing, JICA should increase the number of PFM functions categorized into "A".

Table 8: Comparative Advantages of JICA's TA in PFM

| Development objectives | Intermediate target | Sub-categories | Areas of potential technical cooperation | | | Current human resources availability | |
|--|---|--|--|----------------|---|--|---|
| | | | Current (A) | Potentials (B) | Areas that JICA hopes to make feasible in future through efforts for capacity building and workforce development (C). | High probability of being available in related authorities | Availability of consultants at this stage |
| I. Planning budget and expenditure with aggregate fiscal discipline and strengthening revenue capacity | I-1. Improving comprehensiveness, reliability, and transparency of budget | Improving comprehensiveness and transparency of budget | | | ○ | | x |
| | | Improving capacity of budget and expenditure planning | | ○ | | | △ |
| | | Improving budget planning process | | | ○ | | x |
| | I-2. Improving capacity of revenue forecasting and tax administration | - | ○ | | ○ | | |
| II. Improving treasury management and budget execution and holding accountability properly | II-1. Improving treasury management and budget execution | Improving treasury management | | | ○ | | x |
| | | Improving cycle of budget execution | | ○ | | | △ |
| | | Improving accounting system and procedures | | ○ | | | △ |
| | | Improving public procurement system and its operation | | ○ | | | △ |
| | | Improving public asset management | | ○ | | | △ |
| | II-2. Holding accountability properly | Improving internal control and audit | ○ | | | | △ |
| | | Improving financial reporting and monitoring | | ○ | | | △ |
| | | Improving external audit | | ○ | | △ | ? |
| Support for improving the financial and asset & debt management of the recipient organization of JICA's financial assistance | | | ○ | | | | △ |

Note: Possible concrete measures for “Areas that JICA hopes to make feasible in future through efforts for capacity building and workforce development” are explained in Section IV.

5. To pursue “getting the basics right”

JICA should bear in mind the principles of “getting the basics right”⁴ in assisting the overall PFM reform program and the implementation of concrete actions. It should also bear in mind the balance between (i) the picture of the necessary reform agenda and processes, and (ii) the capacity of the recipient country at the national and local level (in other words, this is a similar way of thinking as putting the DFID’s “platform approach” into practice).⁵ At the same time, in exploring the possible direction of its aid for PFM, JICA should consider (i) what needs to be done, (ii) what can be done, and (iii) what is locally demanded.

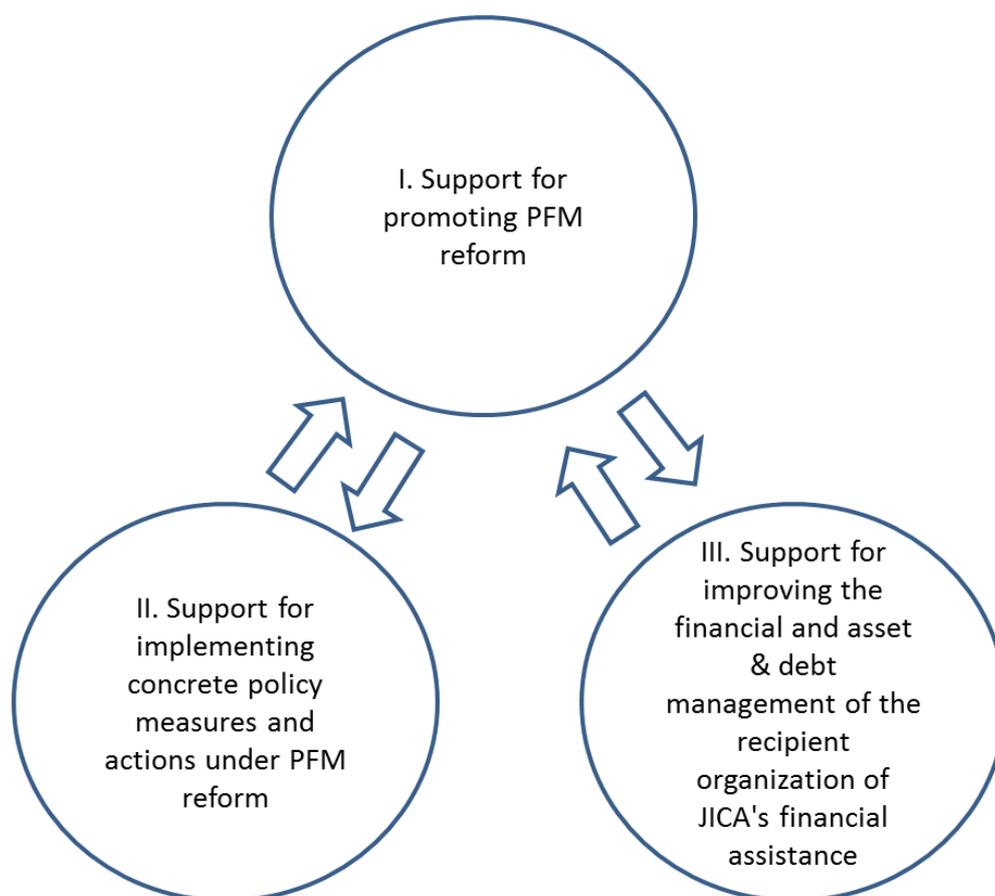
6. To enhance complementarity among the three pillars of JICA’s PFM supports

Technical cooperation should be formulated and implemented to facilitate the action plans prepared in the policy matrix. In cases where the aid/development effectiveness of various projects are hindered by policy and institutional factors resulting from the country’s PFM system, these factors should be coped with, for example, in the policy matrix of development policy loans.

⁴ The international development community points out that budget system reform in a low-capacity country should, first and foremost, focus on the country’s current fundamental needs.

⁵ The platform approach aims to implement a package of measures designed to achieve increasing levels (“platforms”) of PFM capability within a set timeframe. A target or outcome is set for each platform (e.g., delivering a credible annual budget). The number and definition of platforms will vary depending on the country’s PFM situation. Each target has a package of measures for achieving it and indicators to monitor progress in moving to the next platform.

Diagram 5: Complementarity among the Three Pillars



Where the quality of the PFM system in a certain sector is a bottleneck to implementing a JICA project in the sector, a technical cooperation project may be implemented to remove the bottleneck (e.g., Financial Management Improvement Project of the Ministry of Food and Agriculture of Ghana).

7. A new keyword in JICA's aid approach is "integrating sector and PFM perspectives"

One of the main objectives of PFM reform is to improve the operational efficiency of public service delivery. Traditionally, donors provide their assistance to the central finance ministry.

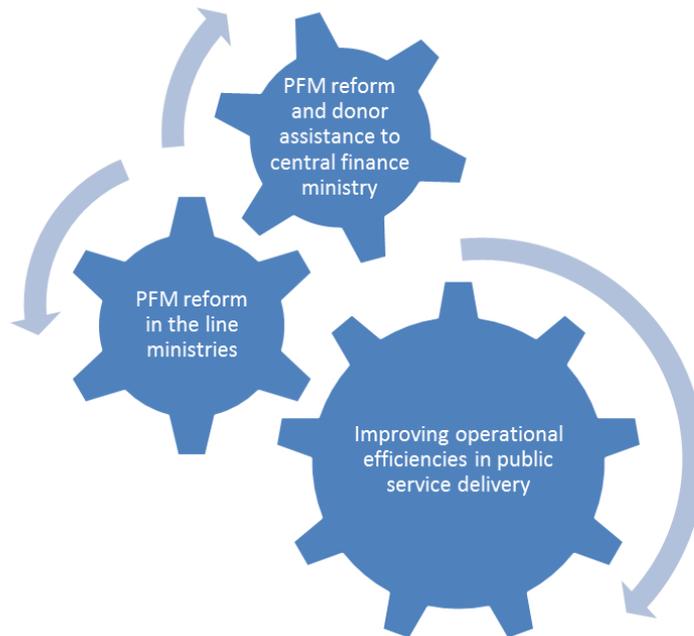
However, considering that line ministries are responsible for providing public service delivery in each sector, JICA should consider PFM not only at the central finance ministry but also at the level of line ministries.

With this in mind, when JICA is engaged in planning, project design, implementation, and M&E of a PFM project for a central finance ministry,

JICA should not forget the sector perspective, and more specifically, how it impacts on the improvement of public sector delivery.

On the other hand, when JICA delivers aid programs/projects in a specific sector, it should not forget the PFM aspect (e.g., budgeting, execution, and improvement of accountability mechanisms).

Diagram 6: Integrating Sector and PFM Perspectives



8. Methods for integrating a PFM component into JICA aid programs

Possible options are as follows. JICA should consider this in a realistic and flexible manner, bearing in mind the selectivity of the target country and sector.

Options 3, 4, and 5 are examples of how to exercise the integration of PFM and sector perspectives. Therefore, JICA is strongly recommended to explore these possibilities.

Table 9: Possible Options for Addressing PFM in JICA's Programs/Projects

| | Option | Description |
|---|----------|---|
| More comprehensive  | Option 1 | To establish a JICA defined program to address PFM in the country operation |
| | Option 2 | To newly establish a JICA defined program to address governance issues that incorporates PFM issues into the target issue, or to incorporate PFM issues into the existing program as a target issue |
| Focusing on specific projects and activities  | Option 3 | To formulate and implement PFM related projects into a JICA defined program for the specific sectors and issues, thereby addressing PFM issues as key policy and institutional factors of the project |
| | Option 4 | To incorporate PFM related components into the individual project |
| | Option 5 | Other (to integrate a PFM perspective into JICA's PDCA cycle and address PFM in each stage of its cycle) |

- By adopting a hands-on approach, JICA sees to it that developing countries “learn by doing,” depends on the capacity of the aid recipient organizations.

In fact, many recipient countries highly appreciate this practical and process-oriented approach as one of the comparative advantages of JICA's assistance, for example, in tax administration, customs administration, internal audits in Tanzania and Mongolia, and sector-focus PFM support for PFM in the agriculture sector. In TA for introducing Performance-Based Budgeting (PBB) in Indonesia, the Government of Indonesia has highly appreciated the intensive consulting process provided by the JICA consultant team to respond to various matters arising within the government in the process of introducing PBB.

IV. Challenges in JICA's PFM Assistance

1. Capacity building of JICA staff members

(1) The capacity required of JICA staff for PFM issues is summarized as the three levels mentioned below.

Table 10: Capacity Required of JICA Staff for PFM Issues

| Level | Content | Target |
|-----------|---|--|
| Level I | Can roughly understand the progress of PFM reform of the partner countries and current situation & challenges of each PFM function. | All project planning/implementation staff at JICA |
| Level II | Can make influential contributions to meetings on PFM reform programs at the partner country level. Can present JICA's view on PFM on behalf of JICA and actively participate in discussions on PFM | PFM-related staff members in the regional department and the thematic department |
| Level III | Can identify the PFM-related challenges of the client developing country, lead the discussion on PFM among donors, and propose a solution to policy makers of the partner countries. | As above |

(2) PFM is one of the core skills with which staff should be equipped from now on. In line with the above three levels of capacity, JICA should make efforts to improve the skills of its staff through training (e.g., training and seminars at headquarters, long-term training, etc.). To train staff members to help them acquire better knowledge of PFM, deploying staff to departments in charge of related themes and/or overseas offices should be also considered to allow them to gain practical experience.

2. The mobilization of human resources

One of the comparative advantages of JICA's TA is to mobilize necessary human

resources widely from the public (i.e., government officials with much practical experience) and private sectors and to combine these resources for the same programs and projects. There are a limited number of Japanese human resources with strong expertise in PFM in both the public and private sectors. It is observed that human resources have been accumulated in the public sector, for example in the fields of customs administration and tax administration, because the public sector has been playing a central role in this area. Human resources have been accumulated in consulting departments of think-tanks and auditing firms, especially in the fields of performance-based budgeting, accounting rules, internal audits, etc., although there has been a persistent lack of human resources in the public and private sectors to be supplied to development cooperation.

Current human resources availability is summarized in Table 8.

To address the issue, the following efforts will be intensified.

Diagram 7: JICA's Two Approaches in Human Resource Mobilization



Approach I: Fostering and Mobilizing Human Resources in Japan

Table 8 indicates the areas where JICA cooperation does not always mobilize human resources successfully. The causes and solutions for this are summarized in Table 11. JICA intends to take actions to address this challenge.

Table 11: Challenges in Mobilizing Human Resources in JICA's PFM Assistance

| Cause | | Solution |
|--|--|---|
| (1) Human resource shortfall | <p>Consulting firms have a shortage of highly skilled/experienced consultants. Their involvements in JICA have concentrated on research projects and consultants are not familiar with the schemes of technical cooperation and underlying uncertainties.</p> <p>Their lack of knowledge of current trends in PFM reform and general situations of PFM assistance in developing countries prevents them from submitting proposals to JICA's advertisement of contract works.</p> | Training and capacity building, etc. |
| (2) Low predictability | The lack of JICA's clear short- to medium-term vision for the field of PFM prevents consulting firms from establishing an appropriate framework to tackle the PFM issue as a company. There is no opportunity for JICA and development consulting firms to discuss the issue. | Continue to hold meetings to exchange opinions. Explain visions through talks. |
| (3) Short preparatory period | Since JICA has placed a limited number of advertisements for contract works in the PFM area to date, consulting firms cannot easily establish a framework to recruit and maintain PFM-related staff. The current preparatory period between JICA's advertising placement and deadlines for proposal submissions may be too short for consulting firms to ensure sufficient staff coverage.(e.g., six months running up to advertising placement would be long enough for preparation; alternatively, a longer preparatory period should be provided between advertising placement and proposal submission). | Continue to hold meetings to exchange opinions. Explain visions through talks. Advance notice prior to advertising placement. |
| (4) The lack of considerations for consulting firms at the project design stage. | <ul style="list-style-type: none"> • In some cases, operational feasibility has not been fully considered when designing PFM-related technical cooperation and preparing the Terms of Reference.(e.g., prospects for consultant availability). • For instance, due to other works and engagements in Japan, experts' participation in local surveys does not live up to JICA's expectations in the number of days/times. • As a result, in some cases, despite their interest in JICA projects, Japanese development consulting firms are rather reluctant (find it difficult) to submit proposals to JICA's advertisement of contract works. | Continue to hold meetings to exchange opinions. |

JICA should examine how to set unit costs in contracts with consultant firms, meeting the standard level of the market. To mobilize Japanese personnel who used to work for multilateral financial institutions (e.g., the IMF, the World Bank, and regional development banks such as the Asian Development Bank, etc.), and who have a strong PFM background, is also an option.

Approach II: Mobilizing Human Resources from Abroad through Establishing Partnerships Outside Japan

Mobilizing human resources in the recipient country and a third country should be promoted in fields where the probability of securing consultants at this stage is low. Specific examples include: the use of human resources in a recipient country⁶ within the framework of a technical cooperation project; study visits to a third country instead of training in Japan; and the dispatch of third-country personnel to a recipient country. Alternatively, South-South Cooperation may be also considered.⁷

In order to explore the feasibility of mobilizing human resources from abroad in ways such as those mentioned above, JICA visits the recipient country to exchange views with government representatives in the field of PFM, and collects information on which countries can provide the necessary human resources in the field of PFM.

3. Establishing a network with stakeholders in Japan and abroad

Since PFM reform addresses issues regarding a country's system and policies, JICA cannot deal with it as a sole donor. Therefore, JICA should collaborate with other donors in exploring options for its assistance approach to the overall PFM reform process and its concrete measures. In addition, it is effective for JICA to implement projects and programs jointly with other donors, thereby obtaining opportunities for "learning by doing" with regard to PFM assistance approach and methodologies.

Meanwhile, Japan has numerous practices of (1) policy performance assessment at the national level, and (2) PBB and internal control/internal audits at the local government level. These practices could be applied to local administrations in developing countries. In fact, many counterpart personnel in JICA projects have visited several local governments in Japan as part of their cooperation programs.

Therefore, possible directions for networking with stakeholders include JICA

⁶ For instance, experts from the Institute of Internal Auditors (IIA) and universities in Tanzania were partly involved in technical cooperation in the Capacity Development Programme for Internal Audit in Tanzania.

⁷ In this paper, South-South Cooperation is referred to as a cooperation project based on an agreement between JICA and a third-country government (its equivalent in JICA's scheme is Third Country Training and Third Country Expert). "The use of third-country resources" means activities such as a study visits to a third country with JICA's counterpart and the invitation of personnel from a third country, regardless of such an agreement. Examples of study visits to a third country include: visits to Kenya and Uganda in capacity development for internal audits in Tanzania; a visit to Kenya in a PFM project in Ghana; a visit to the UK in capacity building for internal auditing in Mongolia; and a visit to the United States and Canada in the Indonesia PBB project.

establishing relationships with Public Expenditure and Financial Accountability (PEFA) and overseas think tanks, while establishing relationships with local governments in Japan that have pioneering practices in the field of PFM, in one way or another.

Table 12: Establishing a Network with the Stakeholders In Japan and Abroad

| Objective | | Establish a network with: |
|-----------|---|---|
| Overseas | Make a diagnosis of PFM system, plan a menu of PFM assistance/schedule and establish a network with stakeholders | Public Expenditure and Financial Accountability (PEFA) Committee/Secretariat and overseas think tanks (Overseas Development Institute (ODI), etc.) |
| In Japan | Share good practices and offer examples of PFM reform by local government in Japan and establish strategic partnerships to deliver assistance to developing countries (e.g., Local governments and other institutes that JICA trainees visit and/or that sends their staff to JICA project sites in developing countries) | (1) Reinforce relationship with universities/research institutes (including discussion of the development of a highly skilled and valued workforce in the PFM area.) (2) Reinforce relationship with local governments in and near Tokyo: e.g., trainees' visits to local governments of Yokohama city, Shizuoka Prefecture and Kawanishi City (in "Planning and Budgeting Reform for the PBB System Implementation in Indonesia") and to Tokyo Metropolitan and Osaka prefecture (in "Capacity Building of Internal Auditing and Performance Monitoring in Mongolia") |

[END]

[Reference papers]

PFM guidelines (February 2013) *Only Japanese version available

[http://gwwweb.jica.go.jp/km/FSubject1001.nsf/ff4eb182720efa0f49256bc20018fd25/47125d86f3a53a6d492579d400295663/\\$FILE/%E8%AA%B2%E9%A1%8C%E5%88%A5%E6%8C%87%E9%87%9D%E3%80%8C%E8%B2%A1%E6%94%BF%E2%80%95%E5%85%AC%E5%85%B1%E8%B2%A1%E6%94%BF%E7%AE%A1%E7%90%86%E2%80%95%E3%80%8D\(H25\).pdf](http://gwwweb.jica.go.jp/km/FSubject1001.nsf/ff4eb182720efa0f49256bc20018fd25/47125d86f3a53a6d492579d400295663/$FILE/%E8%AA%B2%E9%A1%8C%E5%88%A5%E6%8C%87%E9%87%9D%E3%80%8C%E8%B2%A1%E6%94%BF%E2%80%95%E5%85%AC%E5%85%B1%E8%B2%A1%E6%94%BF%E7%AE%A1%E7%90%86%E2%80%95%E3%80%8D(H25).pdf)

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