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**A NOTE FROM THE PUBLISHER:  
WHY PUBLIC FINANCIAL MANAGEMENT MATTERS**

*By Robert P. Beschel*

**O**ne of the most important tasks governments perform is that of mobilizing financial resources and deploying them to achieve their policies and objectives. In the classic BBC parody of government life, *Yes Minister*, the consummate British bureaucrat, Sir Humphrey Appleby, once wryly observed: "the Treasury does not work out what it needs and then thinks how to raise the money. It pitches for as much as it can get away with and then thinks how to spend it." While such thinking has not been entirely banished from public sectors around the globe, the public financial management (PFM) agenda has moved quite a bit since this episode first aired in January 1986. Over the past two decades, there has been relentless pressure in both developed and developing countries to improve the quality of public expenditure and generate more value for money from government operations.

For governments to perform their spending function well, their PFM practices should meet certain well-established criteria. Government spending should be affordable, in that it takes place within a macroeconomic framework which ensures that the level of spending is consistent with the government's monetary and external policy objectives, and is sustainable in the long term. Governments should optimize the allocation of public resources between different sectors and expenditure categories in a way that reflects their policy priorities, including sustainable growth as well as human and social development. Such expenditure should be efficient, in that it maximizes output for a given set of inputs, and effective, in that it supports the successful realization of the government's goals. It should also be transparent; conducted in accordance with the relevant laws and regulations; and undertaken with appropriate checks and balances to ensure financial probity.

In many MENA countries, PFM reforms have been on the agenda for a decade or longer. Some are seeking to implement basic financial management and information systems that will ensure resources are spent in a timely fashion for the purposes intended. Others are pursuing changes that will allow for greater efficiency and predictability in spending, along with an enhanced focus on performance and value for money. Many are dealing with issues such as enhancing transparency, ensuring adequate internal and external audit, or expanding the scope and comprehensiveness of the budget. The next two issues of *Governance News & Notes* will examine reforms in two contexts: Lebanon and Palestine.



Our September issues features a discussion of the Lebanese reforms, including a governance newsmaker interview with the former Minister of Finance, Dr. Jihad Azour. Robert Bou Jaoude, the primary author of the Bank's Country Financial and Accountability Assessment (CFAA) for Lebanon, will provide some additional perspective on these reforms. Mark Ahern, the Bank's new Senior Public Sector Specialist in Palestine, provides a broader overview of the status of PFM reforms in MENA (Formerly, Mr. Ahern was with the IMF's Middle East Technical Assistance Center, METAC, in Beirut, where he worked on PFM issues in many countries throughout the region.) We have also incorporated a box on the Public Expenditure and Financial Accountability or "PEFA" indicators, which are the next generation of detailed, actionable indicators for assessing the quality of expenditure management. They are being rolled out both in MENA and other countries around the globe. Finally, we have an update on some interesting work that our UNDP colleagues from the Programme on Governance in the Arab Region (POGAR) are doing in establishing an Arab Anticorruption and Integrity network.

#### **GOVERNANCE NEWSMAKER INTERVIEW: LEBANON'S LESSON – REFORM NEEDS A CULTURE OF CHANGE, SERVICE DELIVERY**

**H.E Jihad Azour, Former Minister of Finance,  
Lebanon**

**BY RAMI G. KHOURI**

BEIRUT: When Jihad Azour assumed the post of director of policy reforms at the Lebanese Ministry of Finance in 1999, he could not foresee that in the decade to come his handiwork would be subjected to the toughest political test imaginable: a devastating war with Israel, a smaller war with local militants, a populist revolt, a string of high profile assassinations, sporadic domestic clashes, a broken political system



whose parliament did not meet for months at a time, and price shocks in energy, commodities and foreign exchange. Looking back on the period, including his three years as Minister of Finance in 2005-07, he believes the financial sector reform program that he helped to design and implement largely succeeded due to a blend of many factors that revolved around a core of Three Cs: commitment, communication, and continuity.

“Our reform program not only survived the two wars, economic upheaval and internal political stress,” he said in two interviews in Beirut recently, during and immediately after his ministerial incumbency. “We survived the very difficult environment because our reforms allowed the public finance system to continue functioning even in the worst days, including paying salaries and collecting customs duties and taxes.”

He believes that strong leadership and sustained commitment from the top of the government were critical initial steps, in this case in the person of former finance minister and now Prime Minister Fouad Siniora.

“Reform is not something you can just present and explain. You need the vision and leadership to define clear objectives, then to fight for it, and to integrate it into your governance functions and decision-making process,” he said.

The second important step was communicating the entire reform concept, and its benefits, to three different audiences: the public sector employees who are the principal instigators and guardians of the process, the other government agencies and parliamentarians who must implement it, and the public that will benefit from it.

“Whether on routine changes or on big strategic issues like privatization, you will face resistance; the best antidote to this is to communicate, communicate, communicate! Explain to people why reform is important, how it will enhance government, serve the public, strengthen the country, and improve the lives of their children. Once government employees grasp the value of the reforms, they

become the guardians of the reform process. They make it work, and they protect it.”

Communicating to staff is crucial in order to change the culture of how business is done, by changing the mentality of those who operate the system. Azour explains the basic change in the public finance system since reform efforts started in 1993 as a change in emphasis from hardware to software. He explains:

“The basic infrastructure for reform is this: automation, re-design of procedures and processes, development of reform units, change in management, and a training center that is in charge of creating a new culture. We were able to go to a new dimension, leaving the infrastructure for the hardware, and stressing the software. We shifted our attention to

things like improving the quality of services, improving the dialogue with the private sector, and fighting corruption. The new culture is there now. The middle-managers or the young staff, even the directors, they speak the right language. They are now convinced about the importance of improving services. This is not imposed by a leader. It has become part of their day-to-day management, part of their culture.”

In Lebanon’s case, he believes, this is why the reform process survived devastating wars and political stress. Among the specific achievements that helped the country operate in a dreadful environment was the electronic integration of all ministries with the budget department, and the ministry’s integration with the Central Bank for

some payments and with other public agencies for tax and customs management. The customs department never stopped functioning during the 2006 war because of its electronic accounting system, and all public sector employees received their salaries through automated systems linked to commercial banks, even when they could not get to their offices.

The third critical factor was continuity and consistency. Reforming public sector finances is not a three-year project that starts and ends, Azour says. Rather, it is a continuous process that builds on the achievements of predecessors, and needs regular monitoring and adjustments along the way, and coordination among many different government units.

“Nothing cannot be undone,” he notes somberly, including successful public sector reforms. “The best way to ensure that reforms continue to achieve their goals – such as efficiency, equity, better service, economic prosperity, less corruption – is to anchor the process in strong institutional mechanisms.

Awareness by employees generates buy-ins; when they feel they own the process, they will protect it.”



**Dr. Jihad Azour**

- Former Minister of Finance for Lebanon, July 2005-July 2008
- Senior Advisor to the Minister of Finance, & project director of the UNDP project at MoF, Lebanon, 1999-2004
- Subject matter expert for Booz Allen Hamilton, Lebanon, 2005
- Consultant at IMF, 2005
- Professor, American University of Beirut (AUB) 1998-2000, 2004
- Managing partner of AM&F Consulting, 1996-1998
- Specialized management consultant, McKinsey and Co., 1989-1993
- PhD in Economics Institut d’Etudes Politiques de Paris (IEP), Paris France
- Post-doctorate fellow at Harvard University
- Master’s in Applied Economics, Dauphine University, Paris, France

The initial reform effort required translating broad aims and programs into an action plan, he notes, which in turn “needed initiatives, specific actions and activities, and key performance indicators that could be measured within a clear program of implementation.”

One important factor that allowed Lebanon’s financial reforms to weather the country’s wars and

political storms was creating small units in charge of following up on the implementation of the program in over 15 ministries and agencies. These were paralleled by three inter-ministerial committees that coordinated across the public sector. This structure allowed the government to translate a broad reform agenda into specific actions.

“Now we have more than 300 different initiatives,” he explained, “including 40% in the social sector, 36% in economic and financial areas, and the rest in infrastructure and privatization.”

Another success element was forging new alliances and relationships with the private sector, citizen groups, professional associations and NGOs. The gap between state and society was a major constraint to change, he recalls, and dialogue and partnerships were needed to turn skepticism into cooperation.

The process has not been all smooth, however, and several weaknesses and constraints have been identified that need action. One problem has been lack of sufficient accountability, especially when parliament was idle. Insufficient middle level managers are another weakness that needs recruitment and training to be resolved. A third is the time-consuming legislative process, or the political compromises that sometimes dilute reform goals. Also some staff lag behind others in adopting a reform and change mentality. Reforms that needed coordination among several ministries were difficult to achieve in some cases, i.e., when ownership of the process was not clear to all, or leadership was not explicit among equals. Another weakness was the inconsistent enforcement of discipline in cases when rent-seeking political behavior made it hard to apply the law.

“There have been successes and failures in the past 15 years of reform work,” he concluded, “and we can learn from both.”

What is the single biggest lesson he takes away from this experience?

“You have to persist and always have a bigger ambition; otherwise, reform will become just process-redesign and changing some procedures. You must understand the reason behind automation, or redesigning processes, or reorganizing institutions. These are not reform – these are the tools to achieve reform. Reform is to improve the way you deal with your customers, to make your institution more effective, to invest in human resources, to create an internal culture that makes your people feel that they are agents for change – that they are leaders.”



## MENA BUDGET PREPARATION

BY MARK  
AHERN

With a few exceptions budget preparation reform in the region is a recent development, and traditional methods dominate. Where there is interest in reform there is often a desire to move quickly to adopt modern techniques – particularly performance budgeting. However, these techniques will not succeed unless a range of basic improvements are first made to the budget system. I will focus on three basic areas of reform that are important to improved budget preparation in the region.

### *Making the budget the primary tool for fiscal management*

In many countries spending decisions (such as starting a new project or adjusting wages) are taken throughout the year, and the budget is an annual exercise to add up the cost. Individual decisions are taken without appreciating the impact on government finances, and trade-offs between alternative options are often not explored. As anyone managing personal finances knows, small spending decisions taken independently can add up to a problem.

Modern budgeting techniques attempt to bring the budget and policy processes together, guided by an assessment of what can be spent to remain consistent with the government's debt or other objectives. With this in mind, Egypt and Jordan have established units in the Ministry of Finance (MoF) capable of preparing an overall framework for budget preparation at the start of the process. Lebanon and Palestine are attempting to use budget ceilings to link the budget framework with the detailed preparation work of spending units. These steps can improve budget management provided there is a will to bring major policy decisions with spending implications within the budget process.

### *Integrating the current and capital budget processes*

While both the UK and France integrated the budget management of current and capital spending many years ago, countries in the region have continued with the separate processes they inherited from these countries. Having separate processes for current and capital spending is an obstacle to introducing performance budgeting, which involves assessing performance against the full cost (current and capital) of an activity. A number of countries have also experience problems when the current cost of capital projects is only considered once the project is complete.

Integrating current and capital spending processes is not the most complicated reform, but because it involves institutional change there is often strong resistance from the administrators. Syria is one of the few countries in the region that has formally integrated budget management by transferring responsibility for the capital budget from the State Planning Commission to the MoF. However, it is important that integration occurs not only at the level of the central agencies, but also of the separate planning and finance departments within spending units.

### *Strengthening the budget classification*

The quality of the budget classification will determine the usefulness of information available for decision makers, and the opportunities to devolve

## **Public Expenditure and Financial Accountability (PEFA) Program**

**By David Biggs**

Public Expenditure and Financial Accountability (PEFA) is a multi-agency program sponsored and developed by the World Bank, the International Monetary Fund, the European Commission, the UK's Department for International Development (DFID), the French Ministry of Foreign Affairs, the Swiss Secretariat for Economic Affairs and the Strategic Partnership for Africa.

The purpose of the PEFA program to provide an objective, standardized and internationally accepted assessment of the performance of a country's public financial management (PFM) systems. The PEFA methodology is set out in the Public Finance Management Performance Measurement Framework (available in various languages at [www.pefa.org](http://www.pefa.org)). It is based on 28 high-level performance indicators covering a country's PFM system, and 3 indicators addressing the interaction of donors with a country's budget process and PFM system. PEFA assessments provide a snapshot picture of the effectiveness of PFM systems at a particular point in time and therefore provide an indication of priority areas for reform, and a good basis for measurement of their improvements over time.

The 28 Performance Indicators cover all aspects of government financial management. They are clustered into the following six dimensions: budget credibility; comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit. Each indicator is scored in terms of a four-point rating scale from A to D, where A represents strong performance and D weak performance. All assessments are required to produce adequate evidence to justify the scores awarded. Because the framework applies equally to both advanced and developing systems it is expected that those countries in the early stages of PFM reform will initially have weak scores for many of the indicators. In order to monitor progress over time, a 3 year cycle of assessments is considered appropriate.

Over 80 PEFA assessments have been completed worldwide. In the Middle East and North Africa, PEFA reports have been produced for Syria, Jordan, West Bank and Gaza, Iraq and Yemen. Work is in progress in Morocco and assessments are planned in the next year for Tunisia and Egypt.

responsibility to spending units. It is surprising how many countries in the region had, until recently, poorly structured economic classifications, which, for example, mixed the costs of running a spending unit with transfers that the spending unit was making on behalf of the government. Similarly, many countries organized the budget on the basis of functional activity, and did not have an administrative classification that clearly identified the budget for each spending unit.

Progress has been evident in recent years with major reforms of the economic classification in, Sudan, Yemen, Egypt and Iraq amongst others. These reforms aligned the classification with the structure of the IMF's Government Financial Statistics 2001 manual, and have sometimes dramatically improved the understanding of the budget. However, further reform is needed to strengthen the administrative classification so that there is clear accountability for spending in future performance budgeting reforms.

## **REPUBLIC OF LEBANON: GOVERNMENT PUBLIC FINANCIAL MANAGEMENT REFORMS**

**BY ROBERT BOU JAOUDE**

The Government of Lebanon has historically confronted a number of important challenges that have reduced its ability to manage its finances efficiently and effectively. The legislative framework for budget preparation and execution is the 1963 Law on Public Accounting, which is over 45 years old and does not include any of the modern PFM practices that have been introduced by governments over the past two decades. The absence of a modern budget law has stalled significant reforms. The Government continues to rely on the annual budget law for instructions on the content and structure of the



budget submissions. As a result, line ministry budgets continue to be constructed from the bottom up with no link to macroeconomic objectives and with no defined hard budget ceilings.

Another significant problem is the scope and comprehensiveness of the budget. Around 19 percent of government spending takes place outside the approved budget. The foreign-financed portions of public investment executed by the various government entities are not part of the government budget as discussed by parliament. Also, the budget law does not contain any information on the financial position of public autonomous entities, which operate outside of the regular budget. Thus, a completed capital project will not automatically generate an approved operations & maintenance budget.

The overall control environment within budget execution and verification requires strengthening. The Lebanese Court of Accounts does not meet the criteria for independence as defined by international practices and does not conduct attest audits in a way that would enable the expression of the auditor's opinion on the fairness of the Government's annual financial statements. Also the function of internal audit does not exist, and the budget execution cycle is subject to complex and repetitive controls for processing payments.

One factor that has slowed the pace of reform has been the political reality of coalition government in a highly fractured system of multiple political parties operating in Parliament, and the inevitable

accommodations that are required in order to govern. As a result, important legislation, whether new laws or amendments to existing laws, has been stalled in Parliament (in some cases for years), and the Government has been unable to break the stalemate.

In spite of these challenges, and with the support of various donors including the IMF and the World Bank, the Government was able to introduce some reforms that do not require amending current laws. These reforms concentrated on consolidating the budget by including treasury transfers to autonomous agencies in the budget and including an annex within the yearly budget capturing projects being financed by foreign sources. This has allowed the budget to become a tool to report and monitor all government activities and facilitated parliament's efforts to monitor the overall expenditures of the government.

All salaries of public sector employees are now being transferred through the banking system by direct deposits as compared to the previous monthly cash payments made. All shadow employees have been identified and removed from the payroll, resulting in a saving about US \$4 million every month.

The reporting system was bolstered and monthly reports on the Government's financial status and debt levels were initiated. This reform is presently being improved through the development of a module that will report on capital projects financed through the budget or from foreign sources. This has rendered the budget reporting to become more transparent and provided the public and parliament with a tool to monitor the overall expenditures made within a fiscal year.

In spite the above mentioned reforms, the Government of Lebanon still has a long way before an effective and transparent public financial management system is in place. The next wave of reforms should concentrate on budget preparation, budget execution and controls, accounting and treasury management, fiscal reporting, capacity building at the MOF and line ministries, and the legislative framework. Reform of the country's external auditor, the Court of Accounts, remains a challenge that requires immediate attention.

For this purpose, the Bank has finalized the preparation of a grant to address issues of budget preparation through the introduction of multi-year planning, a strengthening of the control environment, and better management of the country's debt through

the establishment of a modern debt management unit at the Ministry of Finance. (Lebanon's debt to GDP ratio is among the highest in the world.) Efforts are also underway to develop a communication plan to better coordinate work among the various donors assisting the Government of Lebanon.

### **THE ARAB ANTI-CORRUPTION AND INTEGRITY NETWORK:**

#### *An Achievement and a Challenge*

**BY ARKAN EL SEBLANI AND WASSIM HARB**

#### **Programme on Governance in the Arab Region, Regional Bureau for Arab States: United Nations Development Programme**

After months of planning and intensive consultations, high-level representatives from 60 governmental bodies from 17



Arab countries, including specialized anti-corruption agencies and commissions, audit bodies, inspection bodies, ministries of justice, ministries of administrative development and higher judicial councils, gathered in Amman, Jordan on 30 July 2008 to declare the establishment of the Arab Anti-Corruption and Integrity Network (ACINET).

ACINET, which will be supported by UNDP's Programme on Governance in the Arab Region (POGAR) together with its partners, the OECD, UNODC and the League of Arab States (LoAs), is expected to provide Arab governmental anti-corruption bodies with (i) a permanent forum for exchanging knowledge, expertise and experiences on anti-corruption issues and (ii) a regional platform to support national efforts aimed at implementing related regional and international best practices and instruments, especially the UN Convention against Corruption (UNCAC).

ACINET will be supported by a parallel network composed of parliamentarians and representatives of

non-governmental actors including civil society organizations and the private sector, with whom ACINET will consult and meet at least once a year during an annual forum organized to support anti-corruption and the promotion of integrity, transparency and accountability in the Arab region. The establishment of this parallel network is currently underway, with the first annual forum bringing the two networks together expected to be taking place in mid 2009.

The landmark achievement of establishing ACINET, which consecrates the Arab countries' desire to play a more active role in the global fight against corruption, and which provides an unprecedented governmentally-supported regional framework for dealing with the sensitive and complex issue of corruption in Arab countries, owes itself to three defining factors.

- First, it builds on the outcomes of more than three-years of results-oriented policy dialogue held in the framework of the *Good Governance for Development in the Arab Countries (GfD) Initiative*, and other similar initiatives including the MENA-OECD Investment Programme, which have contributed to building and sustaining informal networks of Arab reform drivers and which have helped governments identify common reform challenges and design and implement related responses.
- Second, it builds on the strong recognition by Arab governments that corruption is a serious impediment to reform and development and that a serious coordinated effort is required on their side to confront this complex and dangerous phenomenon in a more effective and coherent manner.
- Third, it builds on the pro-active ownership of participating Arab governments who have exhibited exceptional commitment to the process and who have nominated and supported high-level delegates, who in turn worked for seven months to develop the network's Charter and Rules of Procedure which are the legal instruments that govern ACINET's structure and functions.

As such, ACINET emerges as a concrete step for Arab governments that have committed themselves to modernization, development and reform during the 16<sup>th</sup> Arab summit held in Tunis in 2004. Nevertheless, the challenge is far from being met. The question of transforming this political commitment to tangible results requires continued technical and financial support from Arab governments, the donor community and concerned regional and international institutions. Furthermore, the question of gaining the public's trust, which remains a major challenge for reform actors, requires the prompt accomplishment of concrete successes. As one of the distinguished speakers at the regional conference in Amman said when addressing the founding members of ACINET, "Nothing succeeds like success."

## UPCOMING EVENTS AND ACTIVITIES

- **October 6-8, 2008. 2nd Annual European Anti-corruption Summit. The Hague, Netherlands.** The conference looks at how to mitigate corporate corruption risk through effective ethics and compliance management. In collaboration with representatives of the World Bank and the Center for International Private Enterprise (CIPE). [ross.vincent@ethicalcorp.com](mailto:ross.vincent@ethicalcorp.com) and [www.ethicalcorp.com](http://www.ethicalcorp.com)
- **October 8-10, 2008: 3rd International CSR-Conference 'Corporate Responsibility and Governance. Berlin, Germany. Institute of Management Forum Business & Society Humboldt-Universitat.** Aimed at practitioners, scientists, government representatives, NGOs and other organizations in an effort to discuss new challenges, survey the current research, and to find joint solutions. [schwerk@wiwi.hu-berlin.de](mailto:schwerk@wiwi.hu-berlin.de) and [www.wiwi.hu-berlin.de](http://www.wiwi.hu-berlin.de)
- **October 23, 2008: Company Secretary Workshop: Essential Company Secretarial Practices in Corporate Governance. Jumeirah Emirates Towers Hotel, Dubai UAE.** Develop the essential knowledge and skills required to ensure that the Board practices are effective and are benchmarked against best international practice. [info@hawkamah.org](mailto:info@hawkamah.org) and [www.hawkamah.org](http://www.hawkamah.org)
- **October 30-November 2, 2008: 13<sup>th</sup> International Anti-Corruption Conference: Athens, Greece.** Will survey the role of corruption and governance in reference to social, political and environmental factors. [iacc@transparency.org](mailto:iacc@transparency.org) and [www.transparency.org](http://www.transparency.org)
- **November 6, 2008: UAE Nationals' Corporate Ethics Building Conference. Dubai, UAE.** The "UAE Nationals' Corporate Ethics Conference" will cover all facets of ethics and compliance management in major UAE public and private sector organizations. It will examine UAE Nationals' corporate ethics management practices and their relationship to organizational success. [info@datamatixgroup.com](mailto:info@datamatixgroup.com) and [www.datamatixgroup.com](http://www.datamatixgroup.com)
- **November 17-20, 2008: 3<sup>rd</sup> Global Conference of Parliamentarians Against Corruption. Kuwait City, Kuwait.** Focuses on the role of parliamentarians in the UN Convention against Corruption (UNCAC) and its effective implementation and oversight. [campbme@gopacnetwork.org](mailto:campbme@gopacnetwork.org) and [www.gopacnetwork.org](http://www.gopacnetwork.org)

## NOTEWORTHY LINKS

World Bank MENA Governance Website  
<http://www.worldbank.org/mena-governance>

World Bank General Governance Website:  
<http://www.worldbank.org/governance>

Global Organisation of Parliamentarians Against Corruption: [www.gopacnetwork.org](http://www.gopacnetwork.org)

Public Expenditure and Financial Accountability (PEFA) Website: [www.pefa.org](http://www.pefa.org)

Trace International: Anti-Bribery and Compliance Network: [www.traceinternational.org](http://www.traceinternational.org)

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**FOR FURTHER READING**

A. Premchand, *Government Budgeting and Expenditure Controls: Theory and Practice* (IMF: Washington, 1983)

A. Premchand, *Public Expenditure Management: A Handbook* (IMF: Washington, 1993)

Public Expenditure and Financial Accountability (PEFA) Framework,  
[http://www.pefa.org/pfm\\_performance\\_frameworkmn.php](http://www.pefa.org/pfm_performance_frameworkmn.php)

Salvatore Schiavo-Campo, *Governance, Corruption and Public Financial Management* (Asian Development Bank: 1999)

Salvatore Schiavo-Campo and Daniel Tommasi, *Managing Government Expenditure* (Asian Development Bank: 1999)

Salvatore Schiavo-Campo and P.S.A. Sundaram, *To Serve and To Preserve: Improving Public Administration in a Competitive World* (Asian Development Bank: Manila, 2001)

World Bank, *Public Expenditure Management Handbook* (World Bank: Washington, 1998)

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