

Report No. 10785-NI

Nicaragua Public Sector Expenditure Review

(In Three Volumes) Volume I: Main Findings and Recommendations

September 11, 1992

Country Operations Division 2
Country Department II
Latin America and the Caribbean Region

MEMORANDUM FOR THE DIRECTOR

Request for a Public Sector Expenditure Review (PSE) for Nicaragua. The PSE will be conducted by the Country Operations Division 2, Country Department II, Latin America and the Caribbean Region. The PSE will be conducted in three volumes. The first volume will be the Main Findings and Recommendations. The second volume will be the Detailed Findings and Recommendations. The third volume will be the Implementation Plan.

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CURRENCY

One Cordoba (CO) = One

Hundred Centesimos (¢)

5 CO = US\$1.00 (1992)

FISCAL YEAR

JANUARY 1 TO DECEMBER 31

NICARAGUA
PUBLIC SECTOR EXPENDITURE
REVIEW

JUNE 12, 1992

MAIN FINDINGS AND RECOMMENDATIONS

This report was drafted by Claudio Sapelli (LA2C2), based on the findings of two PSER missions which visited Nicaragua during June 24 - July 6, 1991 and September 29 - October 16, 1991. The first mission was comprised of Messrs. Claudio Sapelli (LA2C2, mission leader); Norman Hicks (LACCE, public investment program); Gustavo Arteta (consultant, statistics); Jerri Romm (consultant, health); Stephen Klees (consultant, education); Pablo Ihnen (consultant, public expenditure analysis); and Ercis Kurtulus (consultant, management of public expenditure). The second mission was headed by Claudio Sapelli (LA2C2) and included Messrs. Ivan Rivera (LA2C2, macroeconomic framework); Gustavo Arteta (consultant, statistics); Gaston Labadie (consultant, education); Robin Carruthers (consultant, transportation); Enrique Crousillat (IENED, energy); Jerri Romm (consultant, water and sanitation); Martin Raine (RUTA, agriculture); Pablo Ihnen (consultant, public expenditure analysis); and Ercis Kurtulus (consultant, management of public expenditure).

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EXECUTIVE SUMMARY OF POLICY RECOMMENDATIONS

I. BACKGROUND

1. The main purpose of the Public Expenditure Review is to assist the Government of Nicaragua (GON) in improving the allocation of public resources, and strengthening the institutions involved in financial management and project implementation. This summary will focus on the agenda for action that results from the analysis presented in the main report.

2. Although the government has taken steps to improve the fiscal balance, larger efforts are required on the current expenditure side. The overall level of public expenditures remains too high (it is projected to be 24% of GDP in 1992, only for the Central Government). Per capita expenditures in real terms are at the same level as 1970, while GDP per capita decreased to a third of the 1970 level. The fact that there are severe institutional and management problems magnifies the difficulties resulting from the large size of the public sector.

3. The sectoral analysis (education, health, agriculture, transport, energy, and water and sanitation) shows that the lack of planning of expenditures, the inadequate allocation of current expenditures, the influence of foreign aid on project selection, the weakness of management and of institutional structure are problems shared by most institutions in the public sector. Some specific problems were also detected such as the divergence between stated sectoral priorities and the actual allocation of resources (in particular within the education and health sectors). The quality and quantity of public services has deteriorated, mostly due to inappropriate policies and misallocation of resources. Consequently, services could be improved by modifying policies and reallocating expenditures.

4. The institutional analysis showed many areas where a sustained effort is needed to strengthen and/or restructure institutions. The importance of this aspect should not be underestimated. The passage from a centrally controlled economy to a market economy implies an ambitious reform of the economic structure and institutional organization. Among the prerequisites for successful conclusion of these reforms are efficiency in public expenditures and avoidance of the misuse of public funds. These are not assured in the existing institutional setup. As outlined in the main report, the operation of the public expenditure management system needs to be restructured and strengthened.

5. In sum, the diagnosis of public sector expenditures contained in the main report brought out six pressing issues: (a) there are serious institutional, procedural and processing problems of budgeting, investment planning and aid coordination; (b) the accounting function is very weak, leading to poor ex-post control and non-existing auditing; (c) recurrent expenditures continue to be too high; (d) expenditure patterns (in particular in the social sectors) do not reflect government priorities; (e) institutional and administrative capacity is weak, both in the line ministries and the public enterprises; and (f) the PIP is too large for the Government's implementation capacity.

II. STRATEGY OF REFORM

6. All of the problems identified above have to be addressed if public expenditures in Nicaragua are to make a significant contribution to the economic and social development of the country. However, clearly the government cannot tackle all the problems at once, and expect to make good progress on all fronts. We would, therefore, propose a phased approach. These phases could overlap in time, but each would tackle a subset of the identified problems. The first phase should address the issue of the high level of recurrent expenditures, to reduce the various risks of destabilization presented by the large overall budget deficit and the uncertainty offered by the importance of foreign funding. This phase would also try to achieve a quick redressing of the low level of funding for primary education and primary health care. Moreover, several steps would be taken concurrently to address the institutional weaknesses in the areas of budgeting, expenditure control, aid coordination, accounting and auditing.

7. A second, overlapping, phase would: (a) include a comprehensive reform of the civil service; (b) continue with the process of rationalizing budget preparation; (c) initiate an effort to rationalize project preparation; (d) improve coordination among the institutions involved; and e) continue with the process of streamlining public sector employment and pay. A final phase would continue with the efforts mentioned above, and introduce important institutional reforms in the education, transport, energy and water sectors.

8. The latter phases are called second or third only in the sense that the actions have been prioritized according to urgency, but there is no reason why some of the actions under them cannot begin at the same time as those under the first phase. In particular, preparatory work for many of these reforms need to start immediately.

A. Issues that Need to Be addressed Most Urgently:

(a) Reduce and restructure the Central Government current expenditures:
(i) reduce the size of the wage bill while increasing wages for professionals;
(ii) reduce expenditures in Goods and Services, while increasing allocations for O&M; and (iii) reduce expenditures for defense.

(b) Strengthen and restructure budgetary management: The borderlines among the core units which deal with budgetary practices and expenditure control need to be carefully defined. In order to allow for the orderly and comprehensive handling of budgeting and accounting, it is recommended that an accounting system (based on Budgeting and Accounting units -BAUs- placed in each ministry) be established.

(c) Establish a new expenditure control mechanism: Most importantly,
(i) revitalize expenditure control by the Auditor General; and (ii) extend overall budgetary practices and expenditure control to the Ministries of Defense and Police and the item "Unforeseen Expenditures".

(d) Improve the mechanism for coordination and control of external aid: The establishment of an External Aid Coordination Committee is recommended.

The primary function of this Committee would be to regulate the aid flows, but not the assessment of needs or daily bureaucratic details of aid use. Auditing principles and procedures for external aid would be the same as the system in force for normal budget revenues and expenditures. If an institution acts in non-conformance to the norms, administrative sanctions would be taken.

(e) **Establish a government-wide accounting system:** The proposed Budgeting and Accounting Units in each institution, would be headed by a MIFIN appointed Accountant, and would bear key responsibility for bookkeeping and preparing year-end final accounts of the institutions. Each institution must submit its year-end final accounts to the Auditor General via MIFIN for legality and veracity clearance.

(f) **Prepare and implement a Technical Assistance program:** In order to expedite the above restructuring efforts, short-term three-pronged technical assistance needs to be provided to MIFIN consisting of: (i) training seminars for MIFIN staff on improved budget preparation, implementation and control issues, and some academic training abroad for Budget Directorate staff; (ii) technical assistance for the formulation of an overall government accounting system; and (iii) several short-term consultants in ex-post expenditure control, revision of the auditing mechanism by the Auditor General, and mid-term expenditure planning.

(g) **Reallocate funds toward primary health care:** Reallocate funds from curative care to preventive care; introduce a targeted fee system for both consultations and drugs, to improve efficiency and signal to users the cost of the different kinds of treatment. The funds generated in this way should be allocated to primary health care.

(h) **Reallocate funds towards primary education:** i) reduce subsidies to higher education; ii) develop cost-recovery options (in particular in higher education); iii) charge Universities for the use of public utilities; and iv) reform the retirement provisions of the Ley de Carrera Docente in line with INSSBI's national rules. The funds generated in this way should be allocated to primary education.

(i) **Produce a sectoral strategy in the agricultural sector:** Define the short and medium-term sectoral objectives, and the roles of the different institutions in meeting those objectives. The possible areas of concentration would be extension, research, irrigation, institutional development, coordination of technical assistance and training. Once this is done, a Committee should be set up to assist in the coordination of the overall sector policy.

B. Issues to Be Addressed Subsequently:

9. The issues mentioned below are a continuation of the efforts to streamline the public sector, and increase its accountability and transparency, and the onset of an effort to improve public investment planning and implementation, and to address the structural issues in public sector pay and employment.

(a) **Establish the accountability of government institutions:** The Auditor General of the Republic should audit all government expenditures and institutions on behalf of the National Assembly as a superior organization and officially inform that body of its findings. A reorganization and redistribution of tasks should clear the limited and unclear control conducted by several organizations.

(b) **Improve the mechanism for elaboration of the Public Investment Program:** MEDE needs a clear mandate to coordinate the elaboration of national and sectoral strategies. The PIP should then translate these global and sectoral strategies into specific investment projects. MEDE also needs a clear mandate to enforce agreed upon priorities and allocate domestic and external resources to the priority projects, to prevent the PIP to be driven by donor interests.

(c) **Strengthen institutional capacity for PIP elaboration:** Efficient PIP elaboration requires technical assistance to the core ministries, the line ministries, and the public utilities.

(d) **Restructure the civil service system:** The civil service system needs to be restructured and a sound salary scale established. This is a prerequisite for an effective control mechanism for personnel emoluments. To achieve this, the GON needs to: (i) establish a separate Civil Service organization; (ii) set up a system of establishments and payroll lists; (iii) prepare position tables for each institution; and (iv) forbid institutions to appoint staff without having a position authorized by MIFIN.

(d) **Reduce personnel in public enterprises:** INE, INAA and TELCOR should devise programs to reduce staffing levels and adapt staffing patterns to their revised functions.

(e) **Monetize fringe benefits:** The worker's benefits, now in the form of fringe benefits, should be monetized and a percentage added to the salary. This is particularly relevant in Health. Savings should be assigned to improve patient services and increase expenditures on patient nutrition, sheets, etc.

(f) **Privatize or close all firms producing goods, that are now operating under the Ministries.**

C. Final Phase

10. The final phase of the reforms includes an emphasis in reforming sectoral policies and strengthening sectoral institutions.

(a) **Reduce expenditures on the Item "General Services":** (i) reduce the number of independent institutes; (ii) restructure the urban transport subsidy; and (iii) reform the Law earmarking funds for the University.

(b) **Reduce the size of central administration:** A study should be performed to assess where and by how much the ratio of service to administrative personnel should be increased. As a result of this study, the

Government should restructure staffing patterns in the public sector as a whole (possibly through the restructured Civil Service).

(c) **Set up a preliminary model for mid-term expenditure planning:** It is necessary to start with preliminary mid-term expenditure planning to establish consistency between revenues and expenditures as well as with expenditure prioritization.

(d) **Change teacher training, accreditation and reward alternatives:** In the long run, "professionalization" (i.e. in-house full-time training for untitled teachers), should be abolished. The organizational structure should recognize different career paths for accredited and non-accredited teachers and the salary structure should recognize larger differences between them, as established in the Career Law. MED should consider establishing an examination for teachers, and give high points according to performance in this test and not to previously acquired degrees.

(e) **Promote private sector investment in the energy sector:** The existing institutional setup imposes serious constraints on sector performance and should be reformed. This reform should consider: (i) the creation of an autonomous regulatory entity designed to promote an efficient development and use of energy resources; and (ii) promoting private sector participation, particularly in power generation and distribution and commercialization. This policy implies a modification of INE's organic law which guarantees a public monopoly in power.

(f) **Improve operational and financial performance of INE:**
(i) undertake further reductions of personnel; (ii) undertake an effective power losses reduction program; and (iii) undertake a short term institutional strengthening program focussing in improved budgeting, a managerial information system, auditing and control systems. This program should include the strengthening of INE's planning capability (demand and expansion optimization), power systems maintenance and loss control.

(g) **Develop institutions for the rural water sector:** Plans should be elaborated in coordination with donors (that provide most of the services in rural areas), to determine how their technical and financial assistance will be phased out and operations and maintenance handed over to municipal water companies, communities or private water companies, regulated by an autonomous regulatory entity.

(h) **Improve INAA's (and other sectoral institutions') management capacity to execute and supervise more projects:** A key problem to address in the medium to long run is the low coverage, in particular in rural areas. The objectives of an increased investment program should be to: (i) repair the existing network to prevent filtration; (ii) provide hygiene education; (iii) implement low cost sanitation and improve waste disposal; and (iv) install latrines in rural communities with existing or proposed water systems.

NICARAGUA

PUBLIC SECTOR EXPENDITURE REVIEW MAIN FINDINGS AND RECOMMENDATIONS

I. OVERVIEW OF THE ECONOMY AND GOVERNMENT FINANCES

1. Nicaragua is among the poorest countries in Latin America, with a per capita GDP of around US\$400 in 1991. Population growth is the fastest in Latin America (3.4% per annum), and is expected to create severe pressures on the Government's ability to provide the growing population with basic services, including water and sanitation, primary education and primary health care.

2. During the 1980s, the Frente Sandinista de Liberacion Nacional (FSLN) tried to establish a centrally controlled economy. The combined impact of these institutional changes, inappropriate economic policies, the Contra war and the US trade embargo, led productive capacity into a downward spiral. By the end of the decade, total production was well below the 1970 level, exports were running at about half of the pre-1980 level, hyperinflation had reached 33,700 percent in 1988, international reserves were depleted and there was an extremely high debt accumulation.

3. In less than two years, the Chamorro Administration, which took office in April 1990, has been able to reverse most of these macroeconomic trends. The key to stabilization has been an impressive adjustment in fiscal policy, together with the support from the donor community. Looking into the future, one of the most important challenges the Government faces is to restructure the public sector, focusing its efforts on efficiently delivering a reduced number of services; and strengthening the public sector management capacity.

4. The main purpose of this review is to help the authorities to improve the allocation and management of public sector resources. At present, the system leading to expenditure decisions is inadequate and has important deficiencies. Most ministries are institutionally very weak, with poor methods of planning and control. Budgetary processes and procedures need a great deal of improvement. Moreover, the entire system of expenditure management and control needs to be strengthened. Institutional weakness is particularly worrisome in the management of external aid, as the Government is, and will be for some time, dependent on external resources.

5. The quality of services provided by the Government needs to be improved. The deterioration is mostly due to inappropriate policies and poor management. The situation has worsened in recent years, as public employees' wages and fringe benefits remained at a relatively high level, while expenditures in goods and services, vital to providing the much needed services, declined. Services of the public sector can be improved in a major way by modifying government policies and restructuring expenditures.

II. THE STRUCTURE OF CENTRAL GOVERNMENT EXPENDITURES

6. Over the last twenty years, with each change of Government, the size and structure of public expenditures have changed substantially. From the early seventies to the eighties, under the Sandinista Government, expenditures in percentage of GDP more than tripled. Since 1990, total Central Government expenditures declined to about half in real terms. Nevertheless, in 1991 and 1992, Nicaragua's total Central Government expenditures as a percentage of GDP has remained significantly above the Latin American historical average (28% vs. 18% of GDP, respectively). Moreover, per capita expenditures are at the same level as 1970, while GDP per capita has decreased to a third of the 1970 level.

7. Central Government's capital expenditures increased from 4.3% (average of 1970-79) to 9.7% (average of 1980-86) of GDP. However, in the late eighties and early nineties it fell drastically, reaching 1.9% of GDP in 1991. In 1992, this trend is expected to change. Programmed investments of the Central Government amount to 7.1% of GDP.

8. The strategy followed by the Government of Nicaragua to reduce current expenditures has been to lay off employees under the Plan de Conversion Ocupacional --financed by USAID grants-- and reduction in military personnel which are also financed by foreign grants. Although there is some room to continue this program, the necessary adjustment in current expenditures will require an additional effort in other areas. Hence, there is an urgent need to determine global and sectoral strategies in order to determine priorities that could be used to cut entire programs, which is the only way to decrease and restructure expenditures substantially.

9. Reductions in current expenditures have been a key ingredient in the success of the stabilization program. Central Government current expenditures decreased from 44% in 1990^{1/} to 25.7% in 1991^{2/}. Most of the adjustment fell on the Ministry of Defense and the Ministry of Police and Internal Affairs (Ministerio de Gobernacion).

10. Larger efforts are required on the current expenditure side to, among other things, accommodate the required investment program without generating macroeconomic problems. The following risks will be faced if no further adjustment occurs: i) deterioration in the mid-term financial position of the Central Government; ii) crowding out of private sector activities; and iii) downward pressure on the real exchange rate which would hinder Nicaragua's export-led growth.

1/ Including extra-budgetary military expenses.

2/ Including cash payment of interest obligations to the multilateral lending organizations.

11. Furthermore, there are several risks on both the financing and expenditure side: i) external aid (in particular grants) will diminish over time; ii) debt service will increase gradually in the following years; iii) the large investment effort will require a substantial increase in operations and maintenance expenditures; and iv) expenditures in social security should be expected to rise in the future.

12. With respect to structure, sectoral distribution has traditionally been biased toward defense and general government services. These expenditures make up about half of the 1992 total current expenditures. On the other hand, the social sectors (predominantly education and health) will account for 30 percent of 1992 total current expenditures. This level is slightly above the region's and the country's historical average. Meanwhile, expenditures in ministries involved in production and infrastructure have significantly declined in relative terms.

13. The average wage in the public sector, including all non-wage fringe benefits, appears to be high. The ratio of average public sector wage to GDP per capita is approximately 5, while in other Latin American countries the level is, on average, 3. Although Nicaragua is paying high public sector wages on average, with respect to the country's resources, it is not paying enough to attract and retain the most able personnel.

14. Expenditures in social sectors should receive special attention from the Government. The main problem with social sector expenditures is the allocation, rather than the lack, of resources, even excluding the substantial amounts of money that donors are contributing to the social sectors. Resources in education are not adequately distributed. Too much funding is allocated to higher education, adult education and central administration, rather than to primary education. Moreover, there is a non-discriminatory transport subsidy to students and teachers. With respect to the health sector, expenditure per capita is at a similar level to that of the seventies. However, strong emphasis on higher cost programs causes resources to appear scarce (see Chapter V).

15. With respect to intrasectoral distribution of expenditures, the size of the Central Administration in several ministries is too big. Some of them, consequently, do not have enough money to actually perform their job. Other items in which nearly all ministries show excessive expenditures are water and vehicles. In sum, there are several areas in which a reduction in expenditures can be achieved without affecting the quality of services. An improved management of existing resources would go a long way toward achieving the Government's objectives, in particular in the social sectors.

III. SECTORAL ISSUES

16. Sector ministries and other public sector institutions are afflicted by similar problems, such as the lack of planning of expenditures, the inadequate funding for recurrent expenditures, the influence of foreign aid on project selection, and the weakness of management and institutional

structure. Also of concern, is the divergence between stated sectoral priorities and the actual allocation of resources, in particular within the education and health sectors.

A. AGRICULTURE

17. There are three institutions responsible for carrying out the agriculture sector policies: the Ministry of Agriculture and Livestock (MAG), the Natural Resources Institute (IRENA) and the Agrarian Reform Institute (INRA). Each institution defines its own strategy and action plan without coordinating with the others. From the information that is available on these preliminary strategies, there are large areas of overlap, conflicting objectives and priorities, and a vast number of small investment and technical assistance projects whose impact and effectiveness is unclear.

18. As a result of the lack of a coordinated strategy, the investment program for 1992 has only a few projects which address the main sectoral problems, such as the uncoordinated efforts in: i) research and extension, ii) technical assistance and training; iii) irrigation; and iv) measures to overcome institutional weakness. Instead, most projects address the problems on a piecemeal basis, and generally in a non cost-effective manner.

19. The dispersion of efforts is an important source of inefficiency and ineffectiveness. Only a minimum number of new projects aim to organize dispersed efforts into nation-wide programs. IRENA is the only institution to have attempted consolidation (e.g. creating national forestry service rather than implementing a number of small forestry projects)^{3/}. MAG is unaware of all of the projects that are executed regionally, even though preliminary figures show that the external cooperation budget is over two times MAG's total 1992 budget. Consequently, it lacks control over the sectoral investment program.

B. HEALTH

20. Throughout the 1980s, Nicaragua experienced declining infant mortality rates and increased life expectancy. Gains were achieved through the expansion of free health care coverage. In recent years, however, the gains are being reversed. Nicaragua's 1991 infant mortality rate of 72 per thousand compares poorly with other countries in the region. The major cause of death is acute diarrheal disease.

21. The model used by MINSA to expand health services has been strongly biased toward costly curative interventions, neglecting preventive care, sanitation and maintenance of facilities and equipment. As resources have become increasingly limited, problems associated with this unbalanced strategy are now apparent: i) hospitals are overwhelmed by the number of patients and

^{3/} The Bank is at present performing an environmental assessment to assist Nicaragua in designing a National Environment Strategy.

are deteriorating due to excess demand from cases with preventable diseases and from inadequate maintenance; and ii) the failure to change health, nutrition and sanitation habits leaves the population unable to protect itself from preventable diseases, while the quality of government-financed care declines.

22. Priorities for spending have been inappropriate, emphasizing:

- (a) operational expenditures over maintenance;
- (b) curative over preventive and hospital over primary care;
- (c) administration over medical care (administration costs, mostly at the regional level, comprise 17% of total current expenditures, and approximately 30% of doctors in the Ministry of Health (MINSA) hold administrative positions that remove them from service);
- (d) full-time specialists rather than generalists, doctors rather than nurses;
- (e) expenditures for medicine and drugs (for example, MINSA has estimated that US\$42 million, or US\$10.75/person, is necessary for the public sector alone, which is more than four times what would usually be considered necessary to meet basic needs); and
- (f) sector personnel over patients (under conditions of budgetary constraint, expenditures for workers' goods and services have taken precedence over those of patients; thus, about two thirds of the budget goes to employees).

23. Sector financing is characterized by the divergence between financial allocations and sector priorities. The policy of free service has resulted in excess demand on and premature deterioration of facilities and equipment. Not enough revenues are being allocated to maintain facilities nor to primary health care (PHC). In addition, the failure to charge for curative care limits the incentive to use less expensive preventive measures and results in the appearance of unmet demand at the hospital level, while at the same time the PHC (primary health care) system is underused. The sector could recover several million dollars with minimal fees for certain services without discriminating against the poor. An appropriate fees structure would encourage the use of less expensive methods of treatment, and free up resources to improve PHC.

24. Recurrent Costs. Estimates indicate recurrent maintenance costs in the amount of US\$1.37 million each year are needed for the maintenance of health care equipment and facilities. In 1991, however, only US\$418,000 was budgeted for maintaining equipment and vehicles, and much of this was diverted to other uses.

25. Pharmaceuticals. The need for more medicine has been stressed by the authorities, although it is known that a large amount of donor financing

is being channeled to provide medicines for public health facilities. The problem is not a lack of resources, but inappropriate policies and inadequate management. Drugs are being over-prescribed and are overused by the population. Moreover, there is waste and misuse of medicines because of the looseness of controls in the system of drugs selection, procurement and distribution.

C. EDUCATION

26. The Nicaraguan education sector has traditionally been inefficient. Net enrollment rates are low, while dropout and repetition rates remain exceptionally high. Thus, retention and completion rates continue to be extremely low. Factors that cause this are: i) low teacher quality because of a lack of appropriate training; and ii) an inadequate school environment, in particular lack of books and adequate equipment (desks, toilets, etc.).

27. Teacher training, has been an ongoing concern of the Ministry of Education (MED). The Ministry is now spending a substantial percentage of its budget in what appears to be an ineffective teaching program. The new Teacher's Career Law (Ley de Carrera Docente), approved in 1990, provides an incentive for training that could be very costly and ineffective in increasing quality, if applied under the present structure. The Law emphasizes credentials rather than performance. This is so because the system lacks methods for measuring performance. The "Ley de Carrera Docente" also establishes a retirement system whose effects on MED's finances and human resources have not been thoroughly evaluated.

28. The education budget is distributed approximately one third to primary education and one third to higher education (Universities), with the rest distributed mostly between secondary and General Administration. This structure is inadequate to address the problems referred to above, most importantly, the low retention rates at the primary level. Also, it does not allocate resources to where social returns are highest and more equitably distributed, i.e., primary education. Public education is practically free at all levels, replicating the financial problems addressed above in the case of the Health sector. Universities, moreover, benefit from a system of urban transport subsidies and do not pay for public utilities.

29. Central Administration is oversized and ineffective. MED has started to address this issue by reorganizing the ministry and reducing personnel and costs at the central and regional levels.

30. Private schools are currently being subsidized. Subsidies are given as a proportion of the wage bill. In turn, MED regulates and controls the private sector. In particular, it decides on the curricula and texts that will be used.

31. Technical education has been assigned to a newly created institute, the Instituto Nicaragüense de Tecnología (INATEC), which has also taken over the Vocational Training function from the Ministry of Labor. This institution

is receiving much more foreign assistance in relation to its budget than MED. It also receives earmarked payroll tax revenues, collected by the Social Security Institute (INSSBI), which are credited directly to INATEC without going through the Budget. The internal efficiency of the system appears to be low and the number of administrative personnel in INATEC appears too high. No information is available with respect to the external efficiency of the system or the linkages with the private sector.

D. TRANSPORTATION

32. The Ministry of Construction and Transport (MCT) is responsible for providing and maintaining most of the transport infrastructure and for regulating transport operations. It has a highly bureaucratic structure and a duplication of activities between its central and regional offices. Its present organic structure appears costly and inefficient.

33. Current expenditure of MCT is dominated by staff costs, both because it has an inefficient structure and because it is not spending sufficient amounts on maintenance activities. Capital expenditure over the last ten years has been a fraction of what was needed to maintain the existing infrastructure.

34. Much of the transport infrastructure --roads, bridges, ports, and airports-- is now in urgent need of rehabilitation or reconstruction. In addition to the needs of restoring existing infrastructure, there are pressing demands for new facilities and improvements to existing ones. These demands are mostly to provide improved infrastructure to stimulate increased agricultural production and foreign trade.

35. Faced with these demands, it is not surprising that MCT's investment plan looks overly ambitious. However, it is unlikely that there will be sufficient domestic or foreign funding for all of the projects. Moreover, in the short term it is improbable that MCT could improve its administrative capacity or that the national construction industry can raise its productive capacity. Possibly only half of the total investment planned can be managed.

E. ENERGY

36. Nicaragua's energy sector faces a serious crisis. The power service has deteriorated severely in recent years, with frequent service supply interruptions and low reliability. Currently, power rationing in the National Interconnected System (NIS) reaches an average of 10% daily while energy deficit amounts from 10% to 15% of consumption. Another problem that depicts the current crisis is the increasing level of energy losses, which are currently 24%. This amounts to an increment of more than 5% during the last three years.

37. A significant portion of the power sub-sector problems stem from its legal and institutional framework. The existing public organization imposes serious constraints for better sector performance. It is necessary,

therefore, to study the best arrangements for legal and institutional reform in Nicaragua's energy sector.

38. Generally speaking, the Energy Institute's (INE's) investment program is well designed. Its components are all necessary, and many of them are urgent. Most of the projects are emergency and/or rehabilitation projects, aimed at improving power service quality in the short term. Only three of the 13 projects imply an expansion of the system. Nevertheless, this limited focus is prudent in the short term, as INE's technical and managerial capability for undertaking large expansion projects is weak.

F. WATER AND SANITATION

39. The highest cause of death in Nicaragua is associated with water-borne diseases. This is due to the fact that existing water and sanitation facilities reach a low percentage of the population. Even where these facilities do reach, service quality is poor due to a long period of neglect to facilities maintenance. These two problems will be difficult to address. On the one hand, even though the sector's public investment program (PIP) is ambitious, if fully implemented it would rehabilitate only the existing systems but would not expand service. On the other hand, even where piped water and sewer systems exist, contaminated supplies and poor waste disposal controls contribute to disease transmission. Therefore, investments in urban water, sewer or treatment facilities, without first removing the sources of existing contamination and altering the conditions that create it, will not provide the expected health benefits.

40. The rural areas and the needs of the poor have been given very low priority. Most of the population presently neglected resides in small rural villages of dispersed houses. Although the quality of implementation and maintenance is improving, investment and the rate of implementation are so low that new coverage is hardly keeping pace with population growth. Virtually all assistance to the rural areas is financed by external sources. The level of dependence on donors --implementing programs and providing finances-- is very high, and the domestic institutions, such as Dirección de Agua Rural, are being replaced instead of developed. There is an urgent need to increase investment in the sector, in particular in hygiene education, quality control of water supply and low cost sanitation.

IV. THE PUBLIC INVESTMENT PROGRAM

A. INSTITUTIONAL FRAMEWORK FOR PUBLIC INVESTMENT

41. During 1991, the Ministry of the Economy and Development (MEDE) initiated a formal process for the definition of the PIP for 1992. The elaboration of the 1992 PIP was conducted in an ad-hoc manner, however. The task of following the formal process was hampered due to: i) the existence of direct links between donors/creditors and executing agencies and consequently the availability of finance without the need for clearance by MEDE; ii) the

need to subject the executing agencies to a prioritization process which they had not been accustomed to; and iii) the lack of definition of the roles of the Ministry of Finance (MIFIN), the Ministry of External Cooperation (MCE) and the Central Bank (BCN) in the process of elaborating and supervising the execution of the PIP.

42. The coordination effort is particularly difficult. MCE is a new institution with no clearly established role in the area. Most importantly, MEDE (also a new institution) had to assume a leading role in the process without being able to affect the funding of projects directly, as it does not control either domestic or external financing of the investment projects (domestic financing is controlled by MIFIN; while BCN and MCE jointly administer external financing). This circumstance deprives MEDE the power to enforce its decisions for the PIP without the collaboration of MIFIN, MCE and BCN. Furthermore, MEDE's role would be curtailed until it can provide a framework for the prioritization of projects on which to base its decisions. MEDE has been slow, mainly due to institutional weaknesses, to produce a national development strategy and sectoral strategies which should serve as guidelines for PIP prioritization.

43. MEDE, in joint meetings with sectoral agencies, selected the projects that: i) were for rehabilitation of infrastructure (social and physical); ii) have secured external financing or are in the final stage of securing it; and iii) were carry-on projects from previous years. The Economic Cabinet, based on optimistic projections of the availability of foreign funds and of the 1991 budget surplus of the Central Government, agreed on a PIP of about US\$240 million.

44. The procedures for supervising the implementation and evaluation of the PIP are being developed. The unit of physical and financial control of projects operates under the General Directorate of the Budget in MIFIN. MCE is planning to develop a similar unit, to monitor progress under external cooperation agreements, which would need to coordinate its work program with MIFIN. MIFIN's units are poorly endowed, able to capture only a fraction of the projects in the PIP, and perform only a superficial follow-up of project implementation.

45. Funding for just above half of the PIP will be available from external aid. Based on the experience of 1991, the Government will have difficulties using all the available financing. MCE estimated that out of a total of US\$355 million in programmed funding for 1991 for all purposes (balance of payments support, investments, technical assistance and general aid), roughly US\$226 million (64% of programmed assistance funding) remained undisbursed as of November 1991.

46. With respect to Technical Assistance (TA), about US\$34 million (or 2% of GDP) of external funding was available in 1991. TA in terms of number of projects was concentrated in the agricultural sector and related areas (natural resources). Assistance in the form of cash support went predominantly to the social sectors. The lack of coordination of these projects with sectoral strategies is severely reducing their effectiveness.

B. THE PUBLIC INVESTMENT PROGRAM

47. The main issues are the size and distribution of the 1992 PIP. The Government selected energy, agriculture, transport, water, and telecommunications (in that order) as the main areas for investment. Despite the ad-hoc manner of defining the PIP described in paras. 41 and 42, the Nicaraguan Government put together a reasonably solid investment program, with an appropriate sectoral distribution. The judgement is based on the urgency of investments and the government's objectives.

48. Faced with the enormous needs of the country, it is not surprising that the initial exercise resulted in a very ambitious program. The US\$242 million 1992 PIP (including the Social Investment Fund, FISE) appears to be on the high side, at 13% of the estimated 1992 GDP. Historically, only two years (1983 and 1984) had a higher investment program as a share of GDP. Furthermore, financing problems may be encountered when implementing such a sizeable program, as projections about the available resources seem overly optimistic.

49. Another important issue is the implementation capacity of the different institutions. Most probably the proposed size of the PIP will spread scarce resources --management capacity, skilled manpower, and counterpart funds-- too thinly over many projects. Given the many urgent needs faced by the Government of Nicaragua (GON), it seems advisable to encourage the private sector to take over some of the proposed project areas. Some prioritization is required to assure that key projects are implemented in a timely fashion. Moreover, it is possible that the overall investment program is in fact even bigger than mentioned above, as the PIP exercise may not have captured all of the public sector investment projects in execution or to be executed in 1992. In particular, this is the case for donor-financed projects which do not require counterpart funds.

50. With respect to sectoral distribution, the 1992 PIP focuses on energy (28%), transport (25%), agriculture (14%), telecommunications (11%), and water (9%). This is an appropriate distribution which will restore the seventy's structure, with three quarters of the program going to infrastructure and power. However, over one-half of the program depends on the implementing capacity of INE and MCT, and this capacity is untried, as both institutions have managed very small investment programs in the last five years.

51. The Nicaragua Public Sector Expenditure Review examines in detail the energy, transport, agriculture, water, education and health sectors, or over four-fifths of the Investment Program. The overall distribution of resources appears adequate, especially given the critical situation inherited in the energy, roads, water, and communications sectors. As mentioned previously, however, resources earmarked to the agricultural sector appear to be excessive.

52. The 1992 program is reasonably solid in the selection of projects by the sectoral institutions, telecommunications (TELCOR), energy (INE), and

water and sewage (INAA). However, several of the big projects have an overly optimistic time schedule (for example, the gas turbines project of INE). The Central Government's selection of projects is not as solid, however, and some projects should be postponed, such as MCT's biggest projected investments in highways.

53. With regard to financing, 55% of the investment program will be financed by donors, 5% by institutional resources (principally from TELCOR and INAA) and for the remaining 40%, no financing has been identified. Of the sectors with large investment programs, transport stands out with 61% of its program lacking financing. MCT has a large number of projects (18) with no financing at all. Agriculture, INE and INAA have projects with high percentages of foreign financing (74%, 64% and 75%, respectively).

V. STRENGTHENING AND RESTRUCTURING THE PUBLIC EXPENDITURE MANAGEMENT SYSTEM

54. Nicaragua is attempting an ambitious reform of its economic structure and institutional organization. Among the prerequisites for the successful conclusion of these reforms are efficiency in public expenditures and avoiding the misuse of public funds. These prerequisites are not assured under the existing institutional setup, however. As outlined below, the operation of the public expenditure management system needs to be restructured and/or strengthened. Moreover, the Ministry of Finance (MIFIN), which will play a leading role in this process, is presently undergoing organizational and procedural changes. This process of change has created structural gaps and operational difficulties.

A. THE BUDGETARY PROCESS

55. The key to improving public expenditure management, and in particular, the budgetary process, lies in an efficient and effective operation of the Ministry of Finance, together with the Office of the Auditor General - Contraloria General. To this end, it is essential to revise the general framework of the Ministry's units, to clarify the borderlines of their duties and responsibilities and to assess the functions of some important units which have not worked efficiently during recent years, i.e., the General Directorate of Government Accounting.

56. Budget Preparation and Budget Calendar. MIFIN prepares a detailed calendar for budget preparation, called The Work Chronology, which is basically a budget cycle. This gives a working plan for the General Directorate of the Budget. According to the calendar, budget preparation begins in June, with meetings by central financial and planning organizations to determine macro-economic revenue and expenditure forecasts. These activities end with the preparation and submission of a proposed budget to the President for approval in early October and submission to the National Assembly. The new budget year and financial year start January 1st.

57. Monitoring Expenditures. It is indicated in Article 7 of the Budget Law that all Central Government organizations are obliged to submit to

MIFIN a quarterly report of results of implementation. These reports are to be submitted prior to the subsequent quarter's allocation release. Although these quarterly expenditure returns represent the most important tool of expenditure monitoring and control, the process has not yet been implemented. Expenditure monitoring is being done on a cash basis via control of checks being issued by the General Directorate of the Treasury. This allows for macro-level analysis, but is not sufficient for expenditure control. Expenditure monitoring is also done by examining the supporting documents that the institutions submit to the Directorate of Execution.

58. Inter-/Intra-Program Allocation Transfers. After budget allocations, divided into programs and item lines, are approved by the National Assembly, transfers among them during the course of the year, are made. As set out in the 1991 Budget Law and the Budget Norms, authority to approve these transfers, depending on the type, is given to the President, the Ministry of Finance, and the concerned agency. Based on this authority, the composition of budgetary expenditures can be changed considerably during the year. This practice, together with the habit of resorting to unforeseen expenditure funds, promotes the concept of fluidity, which does not accord with the goals of proper budgeting. Only in the context of a results oriented system, together with effective ex-post controls, would this practice be acceptable.

59. "Unforeseen Expenditures." There is a separate section entitled "Unforeseen Expenditures" ("Imprevistos") in the Budget Document, which amounted to 1.5% of the budget in 1991. The presence of such a contingency fund, separate from the National Budget, does not conform with standard budgetary procedures, since it is counter to the concepts of budgetary unity, expenditure classification and the practices of expenditure control. Given the characteristics of Nicaragua, exposed to many potential natural hazards, the contingency fund would be a reasonable strategy to deal with the risks implied by these hazards (volcanoes, earthquakes, cyclones, etc.) if it were included in the budget of a ministry, and its use narrowed down to those unforeseen natural hazards.

60. The Budgets of the Ministries of Defense and of Police. The budgets of the Ministry of Defense and the Ministry of Police are especially important, both because of their volumes --one-fourth of the total national budget-- and the fact that their budgeting procedures are conducted outside of the norms of general budgetary principles. The budgets of both of these Ministries have been indicated in the past as only a one-line entry in the Budget Document. By 1992, expenditure breakdowns are going to be placed into the Budget Document, based on a request by the National Assembly. However, there will still not be any program breakdown.

61. Budgetary Monitoring of Autonomous Entities. The funding of Autonomous Entities is managed via budgets separate from the Central Budget under MIFIN. Currently, autonomous entities receive allocations in the form of block transfers registered in the Transfers section of the Budget. These transfers represented 12% of the total 1991 budget. The Directorate of Autonomous Entities was established in March 1991 in the General Directorate

of the Budget to monitor the Treasury transfers granted to these entities and to provide the entities with technical assistance.

B. GOVERNMENT ACCOUNTING AND ACCOUNTABILITY OF THE SPENDING INSTITUTIONS

62. The Government of Nicaragua lacks a comprehensive accounting system. In Nicaragua each ministry handles its own bookkeeping through its Financial Director, who is an officer of the institution in charge of financial and administrative affairs and is attached to the Vice Minister. Final accounts are not prepared in accordance with the usual procedures and the Auditor General's Office has not assumed any responsibility to audit the final accounts of the Ministries on behalf of the National Assembly. Therefore, spending institutions are not held accountable for the way they spend funds and the Minister, in effect, clears his own accounts.

63. In addition, problems have occurred due to the lack of a responsible unit for government accounting. The General Directorate of Accounting has not performed its functions in recent years, nor has it prepared final accounts. As a result, the accounting function was partially assumed by the Directorate of Execution of the General Directorate of the Budget and partly by the General Directorate of the Treasury, via ad hoc decisions. MIFIN is planning to abolish the General Directorate of Accounting and explicitly reassign its tasks.

C. EX-POST EXPENDITURE CONTROL

64. One of the most important issues in public expenditure management in Nicaragua, along with the need to revise organizational duties and responsibilities, is the lack of expenditure monitoring and control. Ex-post expenditure control in Nicaragua must be institutionalized in order for it to be effective, particularly in regard to legal and veracity control.

65. The implementation of expenditure monitoring and control is considered to consist of three separate concepts: i) monitor the macro-level revenue/expenditure balance and control the overall budget deficit (or surplus); ii) monitor the use of allocations given to institutions by the Parliament to ensure that they stay within the limits and not resort to overdrafts; and iii) control the legality and veracity of each individual payment made from the Government Budget to determine if the actual expenditures are in conformance to the laws, regulations and norms. At a later stage, the more complicated but more sensible control by results, instead of by inputs, should be incorporated. In Nicaragua the two first tasks are being efficiently performed by the Ministry of Finance. The weak point of the control system is the legality and veracity control of individual payments, both while payments are being made and after they are completed.

66. Under the existing system, the following units share the responsibility for ex-post expenditure control: i) the Financial Officer and Vice-Minister in charge of administration in each institution; ii) the Internal Auditor of the concerned ministry, if there is one; iii) the Director of Execution of the General Directorate of the Budget; iv) the Director

Delegates who have recently been assigned to selected ministries by the General Directorate of the Budget; v) the General Directorate of the Treasury; and vi) the Auditor General's Auditors.

67. Administrative changes have given rise to considerable functional gaps and problems in the expenditure control system. The borderline between the core units which are concerned with budgetary practices and expenditure control, such as the Directorate of Execution, the Director Delegates to the Ministries, the General Directorate of the Treasury (which is assuming the function of the G.D. of Accounting), the financial sections of the spending Ministries, and the Auditor General's Office, have to be identified carefully. Otherwise overlaps, gaps and vagueness will be inevitable.

Control of Personnel Emoluments

68. As in most developing countries, personnel emoluments comprise a large share of budget expenditures in Nicaragua (between one quarter and two-fifths; the exact amount is difficult to assess, see para. 67 in Vol. II). Therefore, it is very important to exercise effective control over personnel emoluments.

69. The 1991 Budget Law states that the administration of the central registry of positions and personnel of the General Government is given to MIFIN. In other words, MIFIN is the authority for granting new positions to the Ministries and making necessary modifications.

70. Since new employment positions are authorized by the General Directorate of the Budget, not by a special law, it is easy to create new positions or abolish them. This flexibility makes it difficult to keep track of the number of positions by institution and by grade, because there is no regulated and formatted system. Within the General Directorate of the Budget, the duty of creating and abolishing Government positions is currently being assumed by the Directorate of Policies.

71. No distinction is being made between Establishment ("cargo" or position) and Staff (individuals). This is a serious drawback to the Budget system and for the system of civil service management. MIFIN is prevented from keeping track of the distribution of positions among institutions and, consequently, from preventing organizations from using unauthorized positions on their own initiative. As a consequence of the lack of an inventory of positions, there is no norm for salary scales. For example, in the payroll table, there are 335 different salary scales for 550 secretarial positions.

D. COORDINATION AND CONTROL OF EXTERNAL AID

72. Given the current and expected size of the flow of foreign aid, its adequate administration is central to the efficiency of public expenditure management. Moreover, a good administration will probably secure the continuity of the flow, a key to the sustainability of the current macroeconomic program.

73. Currently, if donors do not voluntarily go through MCE and MIFIN, MIFIN has no control over the use of funds as there is no central accounting system for external aid. This has led to abuse, with some Government officials receiving double salaries. Based on experiences of other countries, it can be said that problems may increase to serious proportions unless corrective measures are taken.

74. Legal status. A Presidential Decree regarding the organization and duties of MCE (dated October 30, 1990) is the main legal regulation governing the mechanism of external aid. This Decree sets out MCE's primary duties in general terms: obtaining, contracting, coordinating and channeling economic, technical, and material external cooperation. However, it does not stipulate how aid will be handled and channeled through MCE, nor does it set out which administrative and legal measures and/or punishments will be enforced in the event of non-conformance.

75. Budgeting, Accounting and Auditing. When donor aid comes through MCE, the purpose of the assistance and the way it is to be used is clarified through an agreement. Such earmarked aid is recorded by the Directorate of Execution of the General Directorate of the Budget in the revenue budget, on the one hand, and in the expenditure budget of the concerned ministry on the other. The funds are audited in the same way as other expenditures.

76. If cash or commodity aid is not notified to MIFIN, no budget procedure applies. In these cases, MIFIN will ignore the real dimension of the institution's budget or the current expenditure needs being generated by the aid-funded projects. Of course, aid outside of the budget is subject to no auditing whatsoever.

E. MEDIUM-TERM EXPENDITURE PLANNING

77. Budget cuts and expenditure allocation decisions are based on negotiating incremental changes over the previous year's figures. The Government lacks an instrument to prioritize expenditures and plan reallocation in the medium term, however, a prioritized expenditure planning instrument would greatly facilitate the process of allocating resources, and would be a useful guide to budget cuts. Such a medium-term expenditure plan would establish objectives for both recurrent and investment expenditure over a three-year horizon, consistent with over-all Government policies.

78. The expenditure plan would allow synchronization between the Investment and Recurrent Budgets that is not possible today, by insuring that all projects in the annual investment program are included in the investment budget, and that their effects on recurrent costs are reflected in the recurrent budget.

VI. PUBLIC SECTOR RESOURCE ENVELOPE AND PROJECTED EXPENDITURES

A. BASE CASE

79. The base projections assume a positive scenario which is based on the consolidation of stabilization, the deepening of structural adjustment, the development of market institutions, and a satisfactory solution to the external debt overhang. Nicaragua's economic recovery and medium-term growth will crucially depend on adequate external financing, further debt stock reductions to solve its enormous debt overhang and a continuation of the flow of external aid.

80. Under the above-mentioned assumptions, GDP growth would turn positive in 1992, and from then on, it would grow steadily to reach stable levels (5%) by 1994. Consumption per capita takes a longer time to recuperate, however, because Nicaragua needs to reduce public consumption further. With this growth performance, GDP per capita would reach 1950s levels around the year 2000.

81. Tax revenues are the most important source of funds for the Government and are projected to remain at about 19% of GDP during the projection years. Foreign grants to the Central Government are projected at approximately 4.1% of GDP, on average, for the next five years. Overall Central Government expenditure is projected to decline from 28% of GDP in 1991 to 21% in 1996, but interest payments will increase from 1.5 % of GDP to 4% of GDP.

82. The balance on the current account of the Central Government reaches equilibrium in 1993, and a surplus of about 0.4% of GDP, on average, for the projection period. Adding capital expenditures, the overall surplus turns into a deficit before grants. This deficit averages 2.7% during the projection period. Projected grants average more than this, but they will contribute to finance the overall non-financial public sector (NFPS) deficit.

83. Overall NFPS expenditure is projected to decline from 34% of GDP in 1991 to 30% in 1996, and capital expenditure is projected to increase from 5% of GDP to 8.5% in the same period. The balance on the current account of the NFPS reaches equilibrium in 1991 and a surplus of about 4% of GDP, on average, for the projection period. Adding capital expenditures, which are programmed to be substantial, the overall surplus turns into a deficit before grants that averages 6.4% during the projection period. As projected grants to the NFPS average about 5.3%, there will be a need for additional funds to finance the public investment program.

B. LOW CASE

84. Some risks exist that could delay or impede the implementation of the Government's current reform program. First, the implementation capacity of the Government is very weak. Second, the levels of external aid may fall and could result in reduced external flows to finance the significant resource

balance deficit, programmed to average 22.6% of GDP for the period 1992-1996.

85. The low case scenario assumes that stabilization fails, and foreign external assistance is assumed to fall to half of its current level. As a consequence, the overall fiscal deficit after grants grows (from 2% of GDP in 1995 under the base case assumptions to 10% of GDP under the low case assumptions) and public investment is halved with respect to the base case (8.6% vs. 4.4% of GDP under the base and low case, respectively). The main result is an increase in inflation to three digit level and no recovery of GDP.

C. CONCLUSION

86. The macroeconomic conditions and the tightness of the fiscal budget constraint will crucially depend on the flow of foreign aid and the arrangements to be made regarding external debt. Given the risks involved, the Government of Nicaragua should not assume that the present soft-budget conditions, resulting from the existence of ample foreign resources, are a permanent situation. It should make the necessary adjustments in expenditures to assure financial viability in the medium to long-term.

87. The long-term goal of a sound fiscal policy should be to finance all current expenditures and a substantial portion of public investment with domestic revenues. The average projected domestic financing of the PIP is 40 percent for the period 1992-96. A goal of 70 percent by the turn of the century should be considered. The extent of dependence on external assistance currently limits the Government's ability to be fully in charge of resource allocation.

VII. AGENDA FOR REFORM

88. This agenda presents the policy recommendations of the report in a prioritized manner. The recommendations are separated into three phases. Phase I should be addressed without delay; Phase II should follow immediately after; and Phase III should be addressed in the medium run, as it would take more time to implement and register results. These recommendations are organized by topic in the matrices that are attached to the summary.

A. PHASE I

1. Size and Distribution of Expenditures

89. Reduce and restructure the Central Government current expenditures:
- (a) restructure the pay schedule, by eliminating fringe benefits and collective agreement benefits and including a percentage of their monetary value in the salary;

- (b) reduce expenditures in Goods and Services, in particular, by:
 - i) rationalizing water consumption and water tariff;
 - ii) rationalizing the procurement and distribution of medicines;
 - and iii) overhauling the system of road maintenance;
- (c) reduce expenditures in defense, by reducing equipment in line with personnel reduction and continuing with personnel reduction;
- (d) increase allocations for O&M, and monitoring that they are appropriately used; and
- (e) produce a study of the area of social security, with recommendations for reforming the system and reducing its potential effect on public expenditures.

2. Public Sector Management

90. To strengthen the public expenditure management system, the Government should:

91. **Strengthen and Restructure Budgetary Management.** The designated roles for the core units which deal with budgetary practices and expenditure control need to be carefully identified in order to preclude overlap of responsibilities and ensure that all duties are performed effectively. In order to allow for the orderly and comprehensive handling of budgeting and accounting affairs, it is recommended that an accounting system (based on Budgeting and Accounting units -BAUs- that are placed in each ministry) be established in the shortest possible time. With the existing representatives of MIFIN in the Ministries, a body of Inspectors should be created.

92. **Establish a New Expenditure Control Mechanism.** This would involve:

- i) revitalizing auditing by the Auditor General;
- ii) limiting the flexibility to make modifications among allocations;
- iii) extending operations of the Directorate of Autonomous Entities;
- and iv) extending overall budgetary practices and expenditure control to the Ministries of Defense and Police and the item of "Unforeseen Expenditures".

93. **Improve the Mechanism for Coordination and Control of External Aid.** Within the existing organizational framework, MEDE and MIFIN should share the overall decision-making responsibilities for contracting and directing external aid, assessing initial requests from the institutions, as well as the offers from donors. MCE should conduct external aid negotiations and handle the bureaucratic execution of the external aid process as a secretariat.

94. In addition, the establishment of an External Aid Coordination Committee is recommended. The External Aid Coordination Committee, would be composed of one representative from each Ministry involved (MCE, MIFIN, MEDE and the Central Bank). The committee would make the final decisions on distribution of aid to the institutions. The primary function of this

committee would be to regulate aid flows rather than to assess the needs or daily bureaucratic details of aid use.

95. Auditing principles and procedures for external aid would be the same as the system in force for normal budget revenues and expenditures. If it is determined that the institution has acted in non-conformance with the related laws and norms, administrative sanctions would be taken against the offender.

96. **Establish a Preliminary Model for Mid-Term Expenditure Planning.** It is necessary to start with preliminary mid-term expenditure planning using a planning model consistent with expenditure prioritization. For this purpose, a one-year preliminary action plan should be prepared. This action plan should identify the targets, parameters and procedures of the mid-term expenditure planning model, and also should design the preliminary formats for forward budgeting.

97. **Prepare and Implement a Technical Assistance Program.** In order to expedite the above restructuring efforts, short-term technical assistance needs to be provided to MIFIN. The technical assistance would consist of: i) workshops for General Directors to gain an understanding of the necessity for strengthening and reforming public expenditure management; ii) training seminars for MIFIN staff on improved budget preparation, implementation and control issues; and some academic training abroad for Budget Directorate staff; iii) short-term technical assistance for basic budgetary issues; iv) technical assistance for the formulation of an overall government accounting system, possibly by the IMF; and v) several short-term consultants in ex-post expenditure control, revision of the auditing mechanism by Auditor General, mid-term expenditure planning and expenditure prioritization.

3. Sectoral Strategies

Health

98. **Modify the health care strategy.** An action plan to reallocate funds from curative to preventive care should be created. The Government should also introduce a targeted fee system for both consultations and drugs, to improve efficiency and to signal to people the different costs of the different kinds of treatment.

99. **Improve the effectiveness and efficiency of financial resource use.** The Government should revise the budgetary process in line with the recommendations of the previous section, and rationalize MINSA's expenditures for water, medicines, food, clothing, per diem for workers, and overtime pay. Some services should be contracted out. This would save several million dollars a year and permit increased allocations for fuel, maintenance and supplies.

100. **Reform personnel management policies.** More outreach is needed for remote areas and the payment of per diem should be contingent on leaving the

office. A percentage of specialists should be placed on a retainer basis, committed to provide certain services when needed. The urban-rural distribution of hospital doctors should also be reviewed, and incentives should be devised to reduce the concentration of doctors in urban areas. Reforms should also restrict the entry of general physicians into specialties and repeal the hiring guarantee for medical school graduates.

101. **Reform the system of procuring, distributing, prescribing, and pricing medicines.**

Education

102. **Reallocate funds towards primary education.** Education sector reforms should include: i) reducing non-teaching personnel; ii) reducing subsidies to higher education; iii) reevaluating the costs and objectives of adult education; iv) assessing who benefits from subsidized schools to improve targeting; v) changing the system of granting subsidies, in order to promote quality; vi) developing cost-recovery options (particularly higher education); vii) changing the transport subsidy system to a partial subsidy; viii) accounting for INATEC's payroll tax revenues and adjusting its budget accordingly; ix) charging universities for the use of public utilities; x) reforming the retirement provisions of the Ley de Carrera Docente in line with INSSBI's national rules; and xi) increasing the student-teacher ratio, in order to eliminate the practice of using unqualified teachers^{4/}; the funds generated in this way should be allocated to primary education.

Agriculture

103. **Produce a sectoral strategy.** It is necessary to define the short and medium-term sectoral objectives, and the roles of the different institutions in meeting those objectives. The elements of the strategies should be matched with the investment and technical assistance programs. To improve coordination between MAG, INRA and IRENA, the Government should set up a coordinating Committee in charge of developing a sectoral policy and defining sectoral short and medium run objectives. The possible areas of concentration would be extension, research, irrigation, institutional development, coordination of technical assistance and training. This Committee should be created after the roles of the different institutions in attaining sectoral objectives are defined, specializing the institutions in specific areas.

104. **Reduce the size of the investment program.** A major overhaul of the investment program is necessary once the sectoral strategy is agreed up on. Given the poor selection of projects, combined with the historically high financing for the sector, the agricultural investment program should be reduced.

^{4/} It should be noted that a recent survey found the student-teacher ratio to be 32.

Transport

105. Reduce the size of the investment program. Given its administrative capacity and financing, MCT should: i) reduce the current PIP by one third; and ii) postpone projects without financing and no assured benefits. In particular, the two most expensive single road projects in the Plan (Nejapa-Izapa and San Francisco-Camoapa, 28% of total investment) should be deferred.

106. Restructure the ministry in line with present responsibilities. The Economics and Planning Division needs to be strengthened; and the Highways Division should evolve into a project management division and undertake little or no project design in house. The staffing structure should be changed accordingly.

Public Enterprises

107. Reduce personnel in public enterprises. INE, INAA and TELCOR should devise programs to reduce staffing levels and adapt staffing patterns to their revised functions.

4. Public Investment Program

108. Give MEDE a clear mandate in the production and supervision of the investment program. MEDE needs to have a clear mandate in order to coordinate the effort of putting together the national and sectoral strategies. MEDE also needs a clear mandate from the Ministry of the Presidency in order to enforce agreed upon priorities and allocate domestic and external resources to the priority projects.

109. Strengthen institutional capacity for PIP elaboration. Efficient PIP elaboration requires technical assistance to the core ministries, the line ministries, and the public utilities. In MIFIN, the weaknesses include financial planning, expenditure prioritization, control of external resources and macroeconomic analysis. Support is needed to strengthen all of these areas. The line ministries have very weak institutional capacity for identifying, preparing, appraising, monitoring and supervising projects. The public utilities have better project preparation, implementation and supervision capacity, however standards need to be improved.

110. Further prioritize the present PIP and reduce it to US\$200-210 million (including FISE).

B. PHASE II

1. Budget

111. Privatize or close the firms operating under the Ministries. Several Ministries engage in entrepreneurial activities that were not

transferred to CORNAP. The number of existing firms, their employment, assets and the amount of implicit subsidies they are receiving need to be determined, and an action plan to divest them should be prepared.

2. Public Sector Management

112. **Establish the Accountability of Government Institutions.** The Auditor General of the Republic should audit all government expenditures and institutions on behalf of the National Assembly, as a superior organization and officially inform that body of its findings. A reorganization and redistribution of tasks should clarify the method of controlling expenditures in several organizations. This would involve activating the Office of the Auditor General, abolishing the internal auditors and eliminating overlapping functions of the Directorate of Execution of the General Directorate of the Budget and the General Directorate of the Treasury.

113. **Restructure the Civil Service System.** The civil service system needs to be completely restructured, and a sound salary scale should be established. This is a prerequisite of an effective control mechanism for personnel emoluments. To achieve this, the Government needs to: i) establish a Civil Service organization; ii) set up a system of establishments and payroll lists; iii) approve the authorized positions as part of the budget law each year and indicate their numbers in the Budget Document, ministry by ministry and grade by grade. No institution should be allowed to appoint staff without having an authorized personnel position. Position tables for each institution should be prepared.

3. Sectoral Strategies

Health

114. **Monetize fringe benefits.** Budget cuts have deteriorated services for patients but preserved workers' benefits. The workers' benefits, now in the form of fringe benefits, should be monetized, and a percentage added to the salary. Fringe benefits should be eliminated for clothing, per-diem (when paid w/o travel), medicines, overtime pay (when paid w/o overtime work) and, possibly, food. The savings from the reform in benefits should be directed toward improving patient services and increasing expenditures on patient nutrition, sheets, etc.

Transport

115. **Reform the system of allocating road maintenance expenditures.** Contracts should be granted to private builders through competitive bidding.

116. **Close or restructure the railway.** A study should be commissioned to decide if the railway should be closed or restructured.

Energy

117. Promote private sector investment in the energy sector. The existing institutional structure imposes serious constraints to sector performance and should be reformed. This reform should consider two main points. First, an autonomous regulatory entity designed to promote the efficient development and use of energy resources should be created. This entity should set electricity tariffs and fuel prices. Its functions could include the approval of the power expansion plan, and the supervision of procurement activities and construction licensing. Second, private sector participation in power generation, distribution and commercialization should be promoted. This policy implies a modification of INE's organic law, which guarantees a public monopoly in power.

Water

118. Develop a systematic approach to project financing for services outside the core urban areas. Plans should be elaborated, in coordination with the donors that provide most of the services in rural areas, for how donor technical and financial assistance will be phased out and operations and maintenance handed over to municipal water companies, communities or private water companies that are regulated by an autonomous regulatory entity. As FISE's investments are off-budget, FISE's water project investments should be treated as donor-financed projects. For these projects, the following information should be supplied: i) annual recurrent operating costs for staff, equipment, materials, pumping, chemicals and other needs; ii) a plan to show how these recurrent costs will be financed or recovered; and iii) the unit that has been given the responsibility for future operation, maintenance and replacement.

C. PHASE III

1. Budget

119. Reduce expenditures on general services. This should be carried out through: i) reducing the number of independent institutes; ii) restructuring the urban transport subsidy; iii) reducing the expenditure in external leases and representation expenses; and iv) reforming the Law earmarking funds for the University.

120. Reduce the size of Central Administration. A study should be performed to assess where and by how much the ratio of service to administrative personnel should be increased. As a result of this study, the Government should restructure staffing patterns in the public sector as a whole, possibly through the restructured Civil Service.

121. Restructure the pay schedule. The wage bill should be reduced, and incentives given to higher level technical and managerial staff.

122. Continue with the staff reduction program.

2. Public sector Management

123. **Strengthen the Government-wide Accounting System.** The concept of a Government-wide, comprehensive accounting system under the responsibility of MIFIN, needs to be adopted. The problems of ineffective, fragmented accounting can be solved with the assistance of the proposed BAU in each institution, headed by a MIFIN-appointed Accountant, who bear key responsibility for bookkeeping and preparing year-end final accounts of the institutions. Each institution must submit its year-end final accounts to the Auditor General via MIFIN for legality and veracity clearance. The Auditor General (Contralor) should determine whether there have been any excesses or violations and apply administrative sanctions, acting as a "court of account" in the event of non-compliance.

3. Sectoral Strategies

Education

124. **Change teacher training alternatives.** In the long run, "professionalization" (i.e. in-house full-time training for untitled teachers), should be abolished. It should probably be changed to some system of distance education (such as distributing the material and taking an exam, as MED is currently considering). A general exam to provide accreditation at different levels should also be introduced. Such procedures would free as much as US\$2.5 million, or 5% of the 1992 Budget. The organizational structure should recognize different career paths for accredited and non-accredited teachers, and the salary structure should recognize larger salary differences between the two career paths, as established in the Career Law. However, MED should consider establishing an examination for teachers, and give high points according to performance in this test, rather than to previously acquired degrees. Such an exam could also provide accreditation for those "empiricos" (untitled teachers) who demonstrate their abilities as teachers and disqualify teachers who do not qualify above a certain level.

125. **Restructure the organization of MED.** Organizational changes should be oriented towards simplifying the structure and reducing personnel and costs at the central level. Managerial changes should focus on improving the management information system, and decision-making and implementation capacities at the central level, prior to any further decentralization. Standardized systems that would simplify monitoring and control of decentralized units, such as achievement tests should be developed. Private sector subcontracting should be promoted in developing and administering tests.

126. **Regulate private schools according to the quality of their output.** Tests will allow the regulation and control of private schools to be based on the quality of their output, and not only on their inputs. A freer curricula will allow users of the system to judge what are the best institutions that fit their needs. For equity and efficiency reasons, the authorities should improve the targeting of the private school subsidies.

Agriculture

127. Improve the administration of the project cycle. In particular, the Government needs to improve monitoring, control and evaluation of expenditure through both institutional strengthening and training and/or recruiting adequate staff.

Transport

128. Reduce staff costs and change the staffing pattern at MCT. To this end reforms should: i) streamline activities that are now duplicated at the central and regional offices; ii) strengthen some Divisions (like Economics and Planning); and iii) change the role of some other Divisions (like Highways), away from project design and execution towards project management and regulation.

Energy

129. Improve the operational and financial performance of INE. Reforms should: i) undertake further reductions of personnel; ii) undertake an effective power losses reduction program; iii) eliminate the existing distortions in electricity tariffs this implies mainly the elimination of the subsidy to municipalities which do not pay for public lights; and iv) undertake a short-term institutional strengthening program focussing in improved budgeting, a managerial information system, auditing and control systems. This program should include the strengthening of INE's planning capability (demand and expansion optimization), power systems maintenance and loss control.

Water

130. Increase INAA's (and other sectoral institutions') management capacity to handle more projects (directly or supervising). A key problem to address in the medium to long run is the low coverage, in particular in rural areas. The objectives of an increased investment program should be to: i) repair the existing network to prevent filtration; ii) provide hygiene education; iii) implement low cost sanitation and improve waste disposal; and iv) install latrines in rural communities with existing or proposed water systems.

POLICY MATRICES^{1/}

1/ The institution(s) named in the first box of each action are the ones that would be responsible for executing the plan of action. Sometimes a second institution, that would have secondary responsibility, is included.

1. Restructuring the Budget

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
PHASE I		
1.1 The average wage (inclusive of fringe benefits) is high and pay schedule is not transparent MIFIN	Restructure the pay schedule	<ol style="list-style-type: none"> 1. Monetize fringe benefits (now included in goods and services) and include a percentage in wages. 2. Include collective agreement benefits (now included in current transfers) in wages. 3. Restructure pay schedule so to reduce average pay and increase pay to high level management staff.
1.2 Expenditures in most "Goods and Services" items is high MIFIN	Reduce expenditures in Goods and Services	<ol style="list-style-type: none"> 1. Audit inventory of vehicles to rationalize expenditures in gasoline and vehicle maintenance. 2. Rationalize water consumption in MINSA and MED. 3. Negotiate present high public sector tariff with INAA. 4. Pay per-diems only when travel occurs. 5. Rationalize food subsidy to MINSA and MED employees. 6. Rationalize procurement and distribution of medicines. 7. Overhaul the system of road maintenance.
1.3 Defense expenditures continue to be too high MIFIN	Reduce equipment in line with personnel reduction; continue with personnel reduction	<ol style="list-style-type: none"> 1. Assess cost-benefit of replacing eastern block vehicles due to high maintenance costs. 2. Reduce the number of vehicles; armament; services, etc. in line with the reduction in personnel.
1.4 Too little is spent in O&M MIFIN	O&M expenditures to be increased and kept in line with new investment	<ol style="list-style-type: none"> 1. Institutions to be assigned O&M expenditures in accordance to size of assets. 2. MIFIN to closely monitor that O&M funds are spent adequately and not diverted.
PHASE II		
1.5 Several Ministries engage in entrepreneurial activities that were not transferred to CORNAP MIPRES	Firms should be privatized	<ol style="list-style-type: none"> 1. The number of existing firms, their employment, assets and amount of implicit subsidies they are receiving need to be determined. 2. Firms should be divested from the Ministries and privatized or closed.
PHASE III		
1.6 General services expenditures are too high MIFIN	General services to be rationalized	<ol style="list-style-type: none"> 1. Reduce number of independent institutes. 2. Restructure urban transport subsidy, targeting better and reducing subsidy to a percentage of total cost. 3. Examine and reduce expenditures on external leases. 4. Reform Law earmarking funds for the University. 5. Eliminate the item 'unforeseen expenditures'.
1.7 Central administration is too big in several ministries MIFIN-C.SERVICE	Increase the ratio of service to administrative personnel	<ol style="list-style-type: none"> 1. Perform a study of ratios of service to administrative staff. 2. Produce an action plan to restructure staffing patterns to reduce administrative staff.

2. Public sector management

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
P H A S E I		
2.1. Weak budget management system MIFIN	Strengthen and restructure budget management	<ol style="list-style-type: none"> 1. Identify the borderlines between core units. 2. Establish Budgeting and Accounting Units in all ministries. 3. Create a body of inspectors (the Director Delegates). 4. Improve content and format of budget documents.
2.2 Weak expenditure control system MIFIN	Establish a new Expenditure Control System	<ol style="list-style-type: none"> 1. Actions listed above will accomplish this goal also. 2. Limit the flexibility to make modifications among allocations. 3. Extend monitoring activities of the Directorate of Autonomous Entities. 4. Extend overall budgetary practices and expenditure control to the Ministries of Defense and Police. 5. Extend budgeting practices, reporting standards and expenditure control procedures to "unforeseen expenditures."
2.3 Lack of a government-wide accounting system Responsible institutions: MIFIN-CONTRALORIA	Establish a government wide accounting system	<ol style="list-style-type: none"> 1. Create a system of accounting units headed by a MIFIN appointed accountant in all ministries. 2. Final accounts to be submitted to Auditor General (Contralor). 3. Auditor General to check legality and veracity of accounts.
2.4 Weak management and coordination of foreign aid MIPRES-MEDE	Establish a new mechanism for the coordination and control of foreign aid	<ol style="list-style-type: none"> 1. Create a committee to coordinate the flow of aid. 2. Pass a law/decrece regulating the procedure for receiving aid, administrative responsibilities and potential sanctions when established procedures are not followed.
2.5 Scarcity of qualified personnel MIFIN-C.SERVICE	Implement a Technical Assistance Program	<ol style="list-style-type: none"> 1. Provide training seminars for MIFIN and sectoral staff on budget preparation, implementation and control issues. 2. Obtain long-term TA for the formulation of the accounting system. 3. Obtain short-term consultants for expenditure control, auditing mechanisms, MTEP, and expenditure prioritization and program analysis.
P H A S E I I		
2.6 Lack of accountability for expenditures CONTRALORIA-MIFIN	Establish the accountability of institutions for actual expenditures	<ol style="list-style-type: none"> 1. Strengthen the operation of Contraloria. 2. Resolve overlapping responsibilities between the Treasury and the Budget Directorate.
2.7 Lack of an adequate Civil Service System MIPRES-MIFIN	Restructure the Civil Service System	<ol style="list-style-type: none"> 1. Produce a plan of action to restructure the Civil Service system. 2. Set up a system of establishments and payroll lists. 3. Prepare position tables for each institution.

<p>2.8 Weak capacity for investment planning</p> <p>MIPRES-MEDE</p>	<p>Strengthen the institutions involved in the design of the Public Investment Program</p>	<p>1. Establish a system to produce the PIP and to enforce decisions with respect to public investment projects.</p> <p>3. Strengthen coordination of TA with development priorities.</p> <p>3. Guide TA to improve planning and strengthen implementation capacity in the line ministries.</p>
<p style="text-align: center;">P H A S E I I I</p>		
<p>2.9 Lack of public finance planning</p> <p>MIFIN</p>	<p>Create a planning system, and a link with the budgeting function</p>	<p>1. Prepare an action plan to identify the targets, parameters and procedures of the MTEP model.</p> <p>2. Establish a mechanism to regularly produce a medium term expenditure plan.</p> <p>3. Prioritize expenditures on the basis of evaluating program profiles and eliminate non priority and least efficient programs.</p>

3. Health Sector

ISSUE	POLICY DIRECTION	RECOMMENDATIONS
P H A S E I		
<p>3.1 Lack of clearly established priority and strategy on primary health care (PHC).</p> <p>MINSA</p>	<p>Strengthen PHC programs</p>	<p>1. MINSA to adopt a PHC policy. 2. Channel most external financing to PHC. 3. Reallocate resources to PHC according to an action plan. 4. Resources can be obtained from: reduction of administrative personnel; reduction in fringe benefits to staff; cost recovery for services and drugs (in particular for hospitals).</p>
<p>3.2 Need to improve financial management.</p> <p>MIFIN</p>	<p>Improve effectiveness and efficiency of financial resource use</p>	<p>1. Revise budgetary process in line with recommendations in matrix 2. 2. Use unit costs as programming and budgeting tool.</p>
<p>3.3 Inappropriate staffing patterns.</p> <p>MIFIN</p>	<p>Review manpower policy</p>	<p>1. Strengthen the personnel function in MINSA. 2. Restrict entry of general physicians into specialties. 3. Repeal hiring agreement of medical school graduates.</p>
<p>3.4 Poor management of pharmaceuticals and medical supplies.</p> <p>MINSA</p>	<p>Develop an adequate system for handling supplies</p>	<p>Design and introduction of regulations for: procurement, disbursement, allocation, storage and inventory and distribution, prescription and utilization by beneficiaries.</p>
<p>3.5 Facilities are maintained poorly.</p> <p>MINSA</p>	<p>Improve funding for maintenance</p>	<p>1. Allocate more resources to operations and maintenance. 2. Reduce excess demand by charging for services.</p>
P H A S E I I		
<p>3.6 Budget cuts preserved worker benefits but deteriorated services for patients</p> <p>MIFIN</p>	<p>Improve services for patients</p>	<p>1. Monetize fringe benefits and add a percentage to the salary. 2. Fringe benefits should be eliminated in the items clothing, per-diems (when paid w/o travel), medicines, overtime pay (when paid w/o overtime work) and possibly food. 3. Assign savings to improve patients services and increase assignment for food, sheets, etc.</p>

4. Education Sector

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
P H A S E I		
4.1 Resources are not allocated according to stated priorities MIFIN-MED	Reallocate funds towards primary education	The following are possible sources of funds to reallocate to primary education: 1. Reduce non-teaching personnel. 2. Reduce subsidies to higher education. 3. Reevaluate costs and objectives of adult education. 4. Assess beneficiaries of subsidized school to improve targeting. 5. Change the system of granting subsidies to promote quality. 6. Development of cost-recovery options (in particular in higher education). 7. Change the transport subsidy system to a partial subsidy. 8. Take account of INATEC's payroll tax revenues and adjust its budget accordingly. 9. Charge Universities for the use of public utilities. 10. Reform the retirement provisions of the Ley de Carrera Docente in line with INSSBI's national rules. 11. Increase the teacher-student ratio.
P H A S E I I I		
4.2 Low quality of teachers MED	Improve teaching practice	1. Develop and enforce general examinations as accreditation vehicle. 2. Create salary and career incentives for accredited teachers (reform Ley de Carrera Docente to reward performance rather than seniority or titles). 3. Reform Teachers Training program (change nature of professionalization program; grant credit through examinations and not just attendance; reduce cost).
4.3 Institutional weakness of MED MED	Improve management practices	1. Improve flow of information in MED. 2. Improve personnel management. 3. Improve inventory management. 4. Improve programming and budgeting. 5. Improve expenditure control.
4.4 High repetition and dropout rates in primary school MIFIN-MED	Reduce repetition and dropout rates in the first two grades	Reallocate resources towards primary education: 1. Assign best teachers. 2. Reduce multi-grade teaching. 3. Increase supply of learning materials. 4. Introduce student standardized testing to provide feedback on service quality. 5. Design a salary structure in the public system and a subsidy structure in the private sector that rewards high quality of education. 6. Cost/benefit evaluation of a targeted school feeding program.
4.5 Lack of an Education sector policy MED	Definition of Education sector policy	MED to draft and approve education sector policies, strategies and priorities.

5. Agriculture

ISSUE	PCLICY DIRECTION	RECOMMENDED ACTIONS
P H A S E I		
5.1 Lack of a sectoral policy; lack of coordination among sectoral institutions MIPRES	Improve coordination between MAG, INRA and IRENA	<ol style="list-style-type: none"> 1. Set up a coordinating Committee in charge of developing a sectoral policy. 2. Define sectoral short and medium run objectives; concentrating efforts in extension, research, irrigation, institutional development, coordinating technical assistance and training. 3. Define the roles of the different institutions in attaining sectoral objectives. 4. Organize and coordinate dispersed efforts in extension and research. 5. Study the possibility of contracting out services (like extension, certain research, training).
5.2 Poor Investment Program MEDE	Overhaul Investment Program	Revise Investment Program in line with sectoral strategy.
P H A S E I I I		
5.3 Weak administration of the project cycle SECTOR	Improve the capacity to implement projects	Improve the monitoring, control and evaluation of expenditure through institutional strengthening (see ...) and training/recruiting of adequate staff.
5.4 Internal allocation of current expenditures do not correspond to the sector's problems and priorities MIFIN	Reallocate expenditures in the sector	<ol style="list-style-type: none"> 1. Reduce Central Administration expenditures. 2. Increase funds to travel for extension activities. 3. Redirect funds from direct or indirect productive activities that should be left to the private sector.

6. Water and Sanitation

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
PHASE II		
<p>6.1 Complete dependence on donors in the rural areas, both financially and institutionally</p> <p>MIFIN</p>	<p>Develop local institutions to handle water and sanitation projects, and operations and maintenance</p>	<ol style="list-style-type: none"> 1. Develop plans on how donors technical and financial assistance will be phased out. 2. Determine the institutions that will take over the management of the projects (municipal water companies, the communities, or private water companies). 3. FISE projects (given that FISE is temporary) should be treated as donor projects and stages 1 and 2 above followed. 4. All projects should include provisions for cost recovery, to fund O&M expenditures.
<p>6.2 Low coverage, in particular in rural areas</p> <p>INAA</p>	<p>Assign high investment priority to the sector</p>	<ol style="list-style-type: none"> 1. Increase management capacity of INAA to handle more projects (be it directly or supervising the projects). 2. Assign priority to rural areas.
PHASE III		
<p>6.3 Poor quality of service due to lack of maintenance; supplies are often contaminated</p> <p>INAA</p>	<p>Remove sources of existing contamination; reevaluate, and increase, priority assigned to sanitation with respect to water systems</p>	<ol style="list-style-type: none"> 1. Repair existing network to prevent filtration. 2. Hygiene education. 3. Implement low cost sanitation and improve waste disposal. 4. Install latrines in rural communities with existing or proposed water systems.

7. Energy

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
P H A S E I I		
7.1 Existing institutional setup imposes serious constraints on sector performance MIPRES	Reform the sector's legal framework and institutional setup	<ol style="list-style-type: none"> 1. Create an autonomous regulatory entity. 2. Reform INE's organic law to promote private sector participation.
P H A S E I I I		
7.2 INE's operational and financial administration needs to be improved INE	INE should be institutionally strengthened	<ol style="list-style-type: none"> 1. Improve accounting, budget control and auditing. 2. Improve information systems. 3. Reduce personnel and reform staffing patterns in favor of professional staff.
7.3 INE's capacity to undertake expansion projects and maintain the existing is weak INE	INE's planning and implementation capacity to be improved	<ol style="list-style-type: none"> 1. Strengthen planning capability. 2. Improve capacity to maintain the power system and control losses. 3. Strengthen engineering and supervision of projects.

8. Transport

ISSUE	POLICY DIRECTION	RECOMMENDED ACTIONS
P H A S E I		
8.1 MCT's PIP is overly ambitious, given its administrative capacity and lack of funds MEDE-MCT	MCT's capacity for planning, selecting, regulating and controlling project execution should be strengthened	<ol style="list-style-type: none"> 1. Reduce current PIP by one third. 2. Postpone projects without financing and no assured benefits. 3. Staff restructuring should strengthen the management of the project cycle. 4. TA and training for concerned staff.
P H A S E I I		
8.2 Not enough is spent in maintenance activities MIFIN	Reallocate resources and improve cost-effectiveness in road maintenance	Road maintenance should be allocated by a bidding process, and not to the Regional state enterprises, that should be privatized.
8.3 The railway is receiving a substantial subsidy MCT-MIFIN	Close or restructure the railway	Cost/benefit evaluation of the railway and alternatives for restructuring
P H A S E I I I		
8.4 The Ministry of Construction and Transport is highly bureaucratized MCT	Staff costs need to be reduced and the staffing structure changed	<ol style="list-style-type: none"> 1. Activities that are now duplicated at the central and regional offices should be streamlined. 2. Some Divisions (like Economics and Planning) need to be strengthened. 3. Some Divisions (like Highways) need to change their role, away from project design and execution towards project management and regulation.