Action Fiche for Jordan

1. IDENTIFICATION

Title	Support to the Public Financial Management Reform Programme
Total cost	EU contribution: EUR 45 million.
Aid method / Method of implementation	Sector Budget Support (SBS) Centralised management
DAC-code	15120 Public Sector Financial Management

2. RATIONALE AND COUNTRY CONTEXT

2.1. Country context and rationale for SPSP

2.1.1. Economic situation

Jordan experienced robust economic growth in recent years, underpinned by its strong links with the region and the rest of the world, but the global economic downturn had a significant impact on the domestic economy in 2009. Due to sluggish activity in the finance, trade, and mining sectors, output growth declined from about 8% in 2008 to 3% in 2009. Due to a decline in growth and a shortfall in external grants, pressures on the fiscal position intensified in 2009. Fiscal pressures are likely to continue into 2010 and domestic revenue is forecast to shrink further in 2010; for instance the income tax revenues collected from the banking sector and mining companies reportedly declined further in January 2010 compared to the same month of the previous year. While the underlying deficit (before grants) is expected to narrow by 0.7% of GDP, declining external financing will widen the overall deficit to 7⅓ % of GDP. This widening of fiscal imbalances occurred despite vigorous efforts taken by the authorities to reduce spending in the second half of the year, by limiting current spending and large cuts to capital spending.

The Government of Jordan has taken measures to tighten the fiscal stance in 2010; the State Budget Law for the year 2010 emphasizes increasing revenues and cutting down expenditures to address the high deficit. Taxes on specific products were increased, including a special tax on cellular phone calls which was raised from 4% to 8% in February 2010. In addition all public sector recruitments have been frozen except for the Education and Health Ministries. Although inflation was fuelled by oil and food prices in 2008, it declined sharply due to lower world commodity prices and weak domestic demand. The real effective exchange rate has depreciated by 4% thus far in 2009, partially reversing its sharp appreciation during 2008.

Safeguarding the exchange rate peg remains the lynchpin for the maintenance of financial stability according to the IMF. The peg of the Jordanian dinar to the U.S. dollar has served the country well by anchoring inflation expectations and providing stability in a challenging regional and global environment.

2.2. Sector context: policies and challenges

(1) **Sector context.** The key PFM organizations and stakeholders are: the Ministry of Finance (MoF), with policy and treasury responsibilities; the Income and Sales Tax Directorate (ISTD), with income and sales tax responsibilities; the General budget Department (GBD), with budgeting responsibilities; and the Audit Bureau, with external audit responsibilities and currently also involved in internal audit functions. ISTD and GBD report directly to the MoF, but operate semi autonomously. Analysis of the PFM sector policy and strategy confirms that a well-defined policy and strategy framework that responds to the challenges Jordan faces is under implementation. Thus, the sector policy and strategy is considered appropriate for the provision of Sector Budget Support (SBS). Considerable progress in public financial management reform has been achieved in recent years. The stakeholders' Strategic and Action Plans for 2010–2013 were prepared and discussed with the identification and formulation missions during August–December 2009 and provide evidence of national ownership and commitment to the policy and strategy. The Strategic Plans present clear and coherent statements of policy and strategy that are consistent with the *National Agenda 2006–2015* and the European Commission sector policies and principles.

Concurrent with the development of the *National Agenda* in 2005, the Government launched its aggressive financial reform agenda focused on its identification of its highest priority needs, including tax policy and administration reform, development of a medium-term fiscal framework (MTFF) process, preparation of medium-term expenditure framework (MTEF), installation of a Government Financial Management Information System (GFMIS), introduction and implementation of results-oriented budgeting, reform of commitment control and internal control processes, and institution of a treasury single account (TSA). There has been on-going support from the European Union (EU), USAID, GTZ, the International Monetary Fund (IMF), the World Bank (WB) and others to assist in this massive reform effort. Assessments by the EU, IMF, WB and USAID all confirm that significant progress has been made on all of these fronts.

Below follow the main features of the stakeholders strategies and their accompanying action plans for the period 2010–2013 specifying what the Government aims to achieve in the PFM sector and how. The strategies and actions plans will be attached to the Technical and Administrative Provisions.

- ***Ministry of Finance.*** The *MoF Strategic Plan 2010–2013* sets the following strategic objectives: (i) draw up the public financial policy to enhance financial stability and encourage economic growth; (ii) reduce public indebtedness; (iii) improve the efficiency of control on public funds; (iv) promote the level of transparency and disclosure; (v) improve the level of provided services; and (vi) enhance the capacities of the MoF staff.

- ***Income and Sales Tax Directorate***. The *ISTD Strategic Plan 2010–2014* sets the following objectives to help meet *National Agenda*'s goals: (i) increase revenues; (ii) raise efficiency and effectiveness in managing the tax system to ensure that every taxpayer complies with tax obligations; (iii) raise voluntary compliance of taxpayers by increasing tax awareness, improving transparency, and providing quality taxpayer services; (iv) develop staff capability and competency; and (v) develop modern and effective information technology to raise efficiency in managing tax system processes.

- ***General Budget Department***. No department in the government has undertaken a more sweeping and challenging set of reforms. The *GBD Strategic Plan 2010–2013* includes among its major responsibilities: prepare the general budget; develop manpower tables; allocate funds to implement policy in accordance with national priorities; evaluate the Government's programs, projects, and activities; monitor the execution of the budget; and prepare regular analytical reports.

- ***Audit Bureau.*** The *Audit Bureau Strategic Plan 2010–2014* includes the Audit Bureau's duties: submit an annual report to the House of Representatives; monitor the Government's revenues, expenditures, trust accounts, advances, loans, settlements, and warehouses; provide accounting advice; ensure spending of public funds is legal and effective among others.

(2) **Sector budget and its medium-term financial perspectives.** Unlike traditional sectors such as health, education, or transportation where the budget provides an important indication of the commitment of the sector to its declared priorities, advancing PFM reform by introducing results-oriented budgeting, cash management planning, and consolidating the Treasury Single Account (TSA) do not require a large proportion of the budget. PFM reform requires mainly enough funding to support adequate staffing, training, and a reasonable investment in new technology. As a result, an analysis of funding trends in PFM reform does not reveal the degree of commitment to sector policy priorities.

The best indicator of any government's commitment to PFM reform is its positive track record in making progress against stated goals. The Government meets this test. The September 2009 report of the IMF-WB, *Advancing the PFM*

Reform Agenda, states that "*the authorities have made considerable progress in advancing PFM reforms, actively supported by donor*s."

(3) **Coordination process.** During formulation extensive meetings were held with the leadership of the stakeholder ministries and directorates – MoF, GBD, ISTD, and the Audit Bureau – to discuss their Strategic and Action Plans for 2010–2013. The role of SBS in supporting the objectives of those plans, and the design of the general and specific conditions was fully reviewed. The stakeholders demonstrated their readiness to make adjustments to their plans based on issues that emerged during these consultations. The formulation team met with GTZ advisors, key USAID advisors who led the PFM reform process as well as with the IMF and World Bank.

(4) **Institutional capacity.** The organizational arrangements within which PFM is conducted in Jordan operate fairly well, but some improvements are needed and some of the needed changes have been or are being made. The MoF and ISTD have made changes to their organizational structures in the past few years that have led to greater focus on high priority activities. The September 2009 IMF-WB report, *Advancing the PFM Reform Agenda,* recommended the creation of an expenditure policy division and a dedicated unit to manage the budget preparation process and schedule. These recommendations are included for action in GBD's latest strategic plan. ISTD has already merged the Sales and Income Tax Directorates and created new organizations for handling large, medium, and small taxpayers.

(5) **Performance monitoring.** All stakeholders except the Audit Bureau are accustomed to using performance measurement as a means for determining disbursement of European Commission Sector Budget Support (SBS) funds. European Commission monitoring of performance under the last SBS to PFM Reform found commitment to monitoring and following through on commitments made under earlier strategic plans. Furthermore, there is commitment to monitoring and improving performance. ISTD, for instance, developed its *Strategic Plan 2010–2013* following a thorough assessment of what was achieved under its earlier plans. GBD has an explicit four-point section in its plan entitled "Follow up and Evaluation". MoF developed a new element of its strategic plan entitled "Overarching Financial Management Reform for Jordan's Public Financial Management 2010–2013." Included in this plan are extensive tables of performance indicators covering MoF, GBD, ISTD, and the Audit Bureau that will be monitored based on the PEFA methodology. Individual action plans of the stakeholders also include performance indicators to measure results. Thus, the strategies of the stakeholders have permitted the setting of monitoring indicators that can be used to define tranche conditionalities.

Although performance has been an important part of MoF's cooperation with periodic European Commission missions, the systematic establishment of and reporting on performance measures is a relatively new phenomenon for the stakeholders. The ability of MoF and GBD to monitor performance and program implementation utilizing quality statistical information will get a significant boost when the new GFMIS, now undergoing pilot testing, comes on line. This new system is designed to track and report timely and comprehensively on financial and program performance data from across government. The new results-oriented budgeting process, now government-wide, will further improve the ability to establish and report on performance.

(6) **Macroeconomic framework.** A stability-oriented macroeconomic policy is under implementation and is expected to be in place during the SBS implementation according to the IMF Aide-Mémoire for the Staff Visit Discussions of 13 December 2009.

The IMF expects economic growth to pick up modestly to about 4 percent in 2010, reflecting slowly-recovering global and regional conditions. Export growth is projected to rebound, but will remain below its long-term trend because of still-weak external demand. The impact on the external current account, however, is expected to be offset by increased imports arising from higher food and fuel prices, with the deficit narrowing slightly to about 7½ percent of GDP in 2010 (down from 8 percent in 2009). However, the near-term outlook is subject to considerable uncertainty related to world commodity price developments and the liquidity situation in the region, particularly in the Gulf Cooperative Council countries, which account for a large share of Jordan’s FDI, remittances, grants, and tourism receipts.

The IMF considers that the 2010 Budget envisages substantial fiscal consolidation, which is necessary to support a decline in the external deficit and underpin continued low inflation. The IMF mission agreed with the authorities that there is no room for countercyclical fiscal policy, given the slowdown in flows of external financing and the need to mitigate risks related to Jordan’s already-high public debt and debt servicing. The 2010 Budget is expected to yield a narrowing of the overall deficit to 4¼ percent of GDP. With this, public debt would fall below the legislated public debt-to-GDP ceiling of 60 percent by end-2010, and debt servicing would rise to 11 percent of domestic revenue. The IMF indicated that with inflation muted and output growth below potential, there is scope for further cautious monetary easing, to support fiscal tightening.

The IMF reported that the Jordanian banking system has been little affected by the global financial crisis, and remains sound because of prudent financial oversight and proactive supervision by the CBJ which shielded banks. These policies helped maintain confidence, allowing for a steep build-up of international reserves, even during the global financial crisis. While private sector credit remained essentially flat in 2009, bank deposits continued to grow at a healthy pace. However, underlying vulnerabilities remain —banks could be exposed to higher non-performing loans in light of the projected period of below-potential growth in Jordan and the region— suggesting the need for continued vigilance in bank supervision.

The IMF also noted that banks in Jordan have little exposure to corporate debt in Dubai. At the same time, banks continue to reprice credit risks, closely monitor their exposures, and have built up capital buffers to strengthen their capacity to withstand shocks. The IMF welcomed the measures taken by the CBJ to further enhance its effective banking supervision, including: continuing to implement Basle II regulations (introduced in 2008); regular stress testing of banks; enhanced cross-border bank regulation through consolidated supervision of international branches; publication of financial stability reports; and close monitoring of financial soundness indicators as part of an early warning system.

(7) **Public Financial Management.** The informal review of the Public Expenditure and Financial Accountability (PEFA) based PFM Assessment in February 2009 and the monitoring report of the past SBS to PFM Reform of September 2009 concluded that the PFM system in Jordan is sufficiently well-functioning to ensure the proper utilisation of donor funds, including SBS. Jordan has an integrated and well functioning PFM system that has been strengthened over the last five years through an ongoing reform process.

The September 2009 IMF-WB report, *Advancing the PFM Reform Agenda*, noted Jordan's commitment to the reforms and the considerable progress made in advancing PFM reforms, actively supported by donors. Donors, especially the USAID, EU, and GTZ, have supported the reform process by providing considerable financial resources and technical support to the stakeholders. The main improvements observed by the SBS missions include: strengthened forecasting mechanisms including the adoption of a MTFF, MTEF, results-oriented budgeting, and arrangements for a Treasury Single Account. Weaknesses were mainly identified in some institutional and technical aspects of the budget preparation and management. The trend is very positive as several of the recommendations are currently being implemented or under preparation as part of the reform process.

The stakeholders' Strategic and Action Plans provide a comprehensive strategy for implementing specific actions designed to address pending PFM weaknesses. The stakeholders' commitment to the conditionalities associated with this Action Fiche demonstrates that commitment. The Government adopted the PEFA evaluation process into its objectives and performance monitoring needs in the PFM sector and has requested PEFA training to facilitate its successful implementation.

2.3. Eligibility for budget support

Jordan continues to be eligible for sector budget support and is also expected to maintain these conditions during the SBS implementation. Furthermore, Jordan is a strong candidate for SBS, as it has already received and successfully managed SBS. The risk of non-utilisation of SBS is very limited. The conclusions on the three eligibility criteria for budget support follow:

(1) The analysis of the PFM sector policy and strategy confirms that a well-defined policy and strategy that responds to the challenges faced by Jordan has been under implementation. The stakeholders prepared sound Strategic and Action Plans for 2010-2013 during August-December 2009 and discussed them with the formulation mission. Considerable progress in PFM reform has been achieved in recent years. Thus, the sector policy is considered appropriate for the provision of EU SBS.

(2) It follows from the first eligibility criterion that Jordan also meets the legal requirement on the PFM eligibility criterion to support budget support as indicated in Article 15(2)(e) of ENPI.

(3) The analysis of the macroeconomic framework and the macroeconomic perspective provided by the IMF in the Aide-Mémoire for the Staff Visit Discussions of 13 December 2009 shows that the macroeconomic policy in Jordan is conducive to maintaining macroeconomic stability and is not expected to put at risk sector objectives. Thus, the macroeconomic policy provides an appropriate basis for providing SBS to Jordan.

The eligibility criteria will be set out in the General Conditions contained in the Technical and Administrative Provisions for the proposed programme.

2.4. Lessons learnt

The PFM sector, led by MoF, has made great progress in implementing new systems across all the stakeholder organizations, but new systems and processes alone are insufficient to guarantee progress against the considerable challenges that the government faces. Systems and processes must be implemented by leadership and staff with the analytical skills and judgment to utilize data to inform decisions on strategy and policy. Improvements in PFM need to move outwards from MoF to line ministries. Organizational charts must be redesigned to allow the most efficient and effective use of processes and staff. Personnel policies must support the considerable changes required in human capacities. These further changes would assist the stakeholders in better linking policy to budgets and monitoring results, and fully benefiting from progress made thus far. Donor financial and technical assistance were vital to many of the reforms to date, especially with regards to big projects like GFMIS, results-oriented budgeting, and MTEF. Continuing assistance is necessary to further the reform process, especially during the current world financial crisis.

2.5. Complementary actions

EU actions include: (i) PFM programme (2007- EUR 43.14 million) (ii) a twinning project "Institutional strengthening of the Audit Bureau of the Hashemite Kingdom of Jordan" under the "Programme of Support to the Implementation of the EU-Jordan

Association Agreement" (SAAP), which was completed in June 2008, but is relevant to this SBS as recommendations provided to the Audit Bureau then are included as specific conditions; (iii) sectoral budget support tied to a number of sectoral Government strategic reform initiatives; and (iv) technical assistance in medium-term budget reforms to the Ministry of Education.

USAID has provided resident advisors to the MoF, GBD, and ISTD who worked extensively in helping establish the macro-fiscal unit, tax policy and administration reforms, results-oriented budgeting, and GFMIS. The IMF Fiscal Affairs Department and METAC in Lebanon have provided technical assistance on treasury issues including treasury single account, cash management, and commitment control; the development of a public debt management strategy; and the ISTD re-organization and operations to strengthen capacity and effectiveness. The World Bank has provided a Development Policy Loan for US$300 million to Jordan in October 2009 in support of Government's efforts to address economic and social consequences of the current global financial crisis and economic slowdown while improving resilience of the Jordanian economy to adverse shocks. It has also supported a range of reform initiatives including a broad public expenditure trend review and establishment of MTEF. The IMF and the World Bank provided technical assistance through a joint assessment of the PFM system in August 2009; a joint assessment was also provided in July 2004. GTZ has also supported the macro-fiscal unit and budget reforms including MTEF, sectoral expenditure review, budget classification, chart of accounts, and results-oriented budgeting. GTZ is currently providing advice to the MoF on performance management and internal audit.

2.6. Donor coordination

Responsibility for donor coordination lies with the Ministry of Planning and International Cooperation (MOPIC) and UNDP, in close co-operation with the line ministries. MOPIC created Government-Donor Coordination Working Groups in 10 priority sectors in 2007, which meet as needed. One of the sectors is good governance. MOPIC chairs all the working groups with the aim of establishing a structured and technical level dialogue with donors on Jordan's development needs and priorities.

The EU has been instrumental in establishing the Donors and Lenders Consultation Group (DLCG) in 2000, for which UNDP provides the secretariat. The group is intended to provide coordination among member states, as well as USAID, UNDP, the EU, GTZ, and other active donors. The DLCG has established six thematic sub-groups: governance/public-sector reform, education, social development, private sector development, environment, and water. The EU is very active in the DLCG, was chairman in 2008, and chairs several of the working groups. At times it has led more than half of the working groups. Since the EU is tying its SBS to PFM Reform to the achievement of certain strategic goals and objectives and USAID is the primary donor assisting Jordan in attaining these goals, it is critical that the EU and USAID continue maintaining close coordination and communication. EU coordination with the WB and

European Investment Bank is achieved under the Strategic Partnership Agreement among the three institutions, launched in 2004.

The EU has supported MOPIC in the development of a new donor coordination mechanism called the *Jordan Aid Information Management System* (JAIMS). This database, which is being loaded with data now and will go on-line in 2010, is intended to provide information on ongoing financial assistance, projects, and programs.

3. DESCRIPTION

3.1. Objectives

The overall objective of this programme is to support Jordan's public financial management reform strategy to achieve long-term fiscal sustainability.

3.2. Expected results and main activities

The expected results of this programme include the following:

- Improved debt management;
- Enhanced government leadership in donor coordination;
- Improved public expenditure management and improved allocation of funds;
- Improved tax collection;
- Improved expenditure rationalisation.

In order to achieve the above-mentioned results, the indicative list of activities could include the following:

- Preparing a debt management strategy;
- Establishing an effective mechanism for leading donor coordination on PFM aid;
- Adopt measures to improve budget preparation consistent with the new budget preparation schedule, including a credible Medium Term Fiscal Framework (MTFF);
- Taking the steps necessary to obtain a fully operational Financial Management Information System;
- Strengthening the role of the Audit Bureau;
- Establishing new procedures for writing off old, uncollectible tax debt;
- Implementing the stop-filer program;

- Implementing the audit tracking system for large and medium taxpayers;
- Using risk-based audit selection techniques;
- Introduce a more effective cash-flow mechanism;
- Strengthening the internal control and audit functions exercised by all general government agencies.

In order to achieve the above- mentioned results, the following first activities have been agreed; and others will follow:

- Complete a new Public Expenditure and Financial Accountability Assessment report (PEFA).
- Training on Public Financial Management Assessment based on the PEFA framework.

3.3. Risks and assumptions

The main risks are that**:** (i) the current economic crisis deteriorates sufficiently to disrupt the government's ability to support continued implementation of the reform strategy; (ii) the stakeholders are unable to improve their analytical capability sufficiently to utilize effectively the new technologies and process reforms put in place; (iii) the recent stability in sector leadership does not continue, putting the commitment to reform and its schedule in jeopardy; and (iv) weak capacities in line ministries undermine PFM reform.

The main assumptions are that: (i) MoF, ISTD, GBD, and Audit Bureau will implement their Strategic and Action Plans for 2010–2013 on schedule; and (ii) USAID, GTZ, EU, World Bank, IMF and other technical and financial assistance critical to continued reform progress will continue unabated.

3.4. Crosscutting Issues

This programme contributes to improve governance and accountability by supporting the stakeholders' strategic and action plans. Many of the proposed conditionalities will tie directly to accountability (external audit, GFMIS, results-oriented budgeting, commitment control, internal control, tax administration), transparency (results-oriented budgeting, MTEF, GFMIS, debt management strategy), and anticorruption (external audit, GFMIS, tax administration, internal control).

3.5. Stakeholders

The main stakeholders are: the MoF; the ISTD and GBD as well as the Audit Bureau.

4. IMPLEMENTATION ISSUES

4.1. Method of implementation

The programme will be implemented through centralised management mode. All contracts and payments will be centralised.

4.2. Procurement and grant award procedures

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the European Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

4.3. Budget and Calendar

The total allocation for this programme is EUR 45 million.

The allocation for budget support is estimated at EUR 44 million. Indicatively three tranches are foreseen.

The allocation for complementary support measures for the programme is estimated at EUR 0.4 million for a PEFA study and capacity building activities and at EUR 0.6 million for evaluation, audit and communication and visibility.

The operational duration foreseen is 48 months from the signature of the Financing Agreement.

Indicative Budget (In million of Euros)

Components	Budget
Budget Support	44.0
PEFA study; Capacity building activities (training)	0.4
Evaluation, audit, communication and visibility (service contracts)	0.6
Total	45.0

4.4. Performance monitoring and criteria for disbursement

The performance evaluation preceding the disbursement of the tranches will be undertaken by the European Commission through monitoring missions. Monitoring missions will be mobilised twice-yearly for the disbursement of the tranches. In each year, the first mission will review that the programme is on track ensuring that a common understanding exists among stakeholders of the processes and time-frame of actions required to meet the specific conditions and the second mission will undertake the detailed performance monitoring of the general and specific conditions.

4.5. Evaluation and audit

The EU will carry out a final evaluation of the programme. The EU may also carry out a mid-term evaluation if deemed necessary. Both evaluations will be carried out by independent consultants recruited directly by the Commission under specific Terms of Reference.

4.6. Communication and visibility

The Delegation of the European Commission will monitor that the EU visibility guidelines are respected, ensuring adequate perception of EU efforts among the key stakeholders and beneficiaries. Activities will be defined in close collaboration between the Government and the Delegation. It is envisaged that workshops might be arranged for discussions between stakeholders on the progress of programme implementation.