

## **REBUILDING CAPACITY FOR EFFECTIVE PUBLIC FINANCE MANAGEMENT: THE CASE OF SOMALIA'S TRANSITION FROM CONFLICT<sup>1</sup>**

### **I. The Economic and Social Costs of Conflict**

**Conflicts have become a major development issue in Africa and many other countries in the world.** Over the last 20 years, nearly half of the member states of the African continent have been involved in one form of conflict or another. In this decade, over one-third of Sub-Saharan Africa was involved in conflict—more than any other part of the world. Besides the loss of life, displacement and dislocation caused by conflicts, there have been substantial long-term implications for increased poverty and delayed development, human and physical capital degradation, and institutional capacity destruction. The causes of conflicts in Africa have been varied, and included ethnic strife, weakening economies, exclusionary economic and social policies, and poor governance.

**The human and social toll has been staggering,** and includes loss of tens of millions of human lives and large scale population displacement. In the protracted wars in Angola, the Democratic Republic of Congo (DRC), Liberia, Rwanda, Sierra Leone, Somalia, Sudan and Uganda, millions perished from direct effects of the conflict, while millions more died from associated disease and starvation. Lives lost in the DRC conflict exceeded any other conflict since World War II, and in Rwanda, over a million people perished in the genocide in a very short period is estimated at over a million, with much larger number displaced internally.. The conflict in Somalia has led to in excess of ½ million deaths, millions of refugees outside the country, and about 2 million internally displaced.

**Conflicts have also severely damaged economic and social infrastructure; eroded human and social capital; reduced productive capacity; and increased insecurity leading to disinvestment and capital flight.** Many countries that experienced recent conflicts were low income and had inadequate infrastructure from the start. Intense and protracted conflicts destroyed economic gains built over many years, and thus further impoverished low income countries, in particular the most vulnerable among these societies. More lasting damage arises from depletion of social capital; as cooperation and cohesion break down in organizations and the community at large; and lack of trust in most institutions prevails. In most prolonged conflict settings, public institutions suffer severe loss of credibility and legitimacy.

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**Somalia recently emerged from prolonged civil war and long absence of central authority, to a phase that can be described as transition from conflict, and not quite post-conflict.** The country experienced horrendous destruction of public assets and institutions. Accordingly, lack of effective institutions to formulate and implement sound policies undermines stability and is one of the most serious constraints on economic and social recovery. Besides securing sustainable national security and reconciliation, Somalia needs, first and foremost, to build credible and effective Public Finance Management institutions to promote recovery, reconstruction and poverty reduction. Serious commitment to reforms by the Government and significant financial and technical efforts by the country's development partners (DPs) are required to build Public Finance Management (PFM) urgently, and in general institutional capacity in the medium term.

Although perceptions differ on the factors that have contributed, there is common recognition that the Transitional Federal Government of Somalia (TFG) has made little or no progress to establish PFM institutions that could implement accountable and transparent public finance operations. Broad insecurity in the country for most of the period that the TFG has been in existence played an important role in the lack of effective institutions, but the legacy of the crisis in Somalia PFM predates the TFG and the prolonged conflict years, and needs to be addressed with a fundamental change in the culture of public resource management. The Involvement of the international donor community in rebuilding Somalia's public sector institutions has been feeble, ad-hoc and ill conceived

**Adequate institutional capacity is a precondition for sound public policy making and a country's economic and social development.** Effective institutions are required for markets to function efficiently and the private sector to thrive, to ensure proper management of own resources and donor financial assistance, and to implement home-grown economic policies and reforms. The need for effective domestic institutions particularly for post-conflict African countries is highlighted in the recent reports of the UN Millennium Development Project and the Commission for Africa, which concluded that **developing local capacities to take the lead in solving problems is an essential prerequisite to good governance and sustainable development**"

## **II. PFM legacies in Post-Conflict countries (PCCs)**

**Wide spread institutional damage during conflicts inhibits the ability of PCCs to formulate and execute sound PFM.** The destruction or considerable weakening of the capacity of state institutions in PCCs is manifested in particular in the poor management of public finance during the transition and post-conflict phases. Among the legacies of major conflicts is insecurity that drives people with marketable skills to migrate or be internally displaced. Such a loss of human capital built over many years leads to weak PFM institutions and in some cases, such as Somalia, to complete absence of effective institutions. The challenges facing post-conflict countries in rebuilding a cadre of skilled personnel are particularly severe in the fiscal area. PCCs face urgent multiple demands, with limited public finance institutional capacity, including rebuilding systems, reconstructing procedures, and often reconstituting the legal framework that has fallen in disuse.

In most post-conflict countries, the collapse or considerable weakening of the central authority is accompanied by the considerable damage to domestic revenue administration; and to the public expenditure management system. This is further complicated by loss of skilled personnel, as the civil service often ceases to function effectively. In this context, rebuilding fiscal institutions in PCCs entails creating sound legal and regulatory framework for fiscal management; designing and implementing appropriate revenue administration; and strengthening public expenditure management, as follows:

**Rebuilding PFM institutional capacity commences with reforms to address weaknesses in the legal and regulatory framework.** This involves reinstating tax laws and tax administration procedures to allow for tax enforcement and collection of information from tax payers. It includes legislation and regulations that define legal powers and responsibilities for public expenditure management, and procurement processes. Designing a new budget law or financial Act, as well as procurement regulations and procedures after conflict is important to initiating budget reforms. The legal and regulatory framework sets clear directives and guidelines for budget, establishes a framework for internal controls, and external controls.

**Among the institutional capacities that are often lacking in PCCs is the capacity of the state to mobilize domestic revenue.** Tax and customs administration is often extremely limited after protracted conflicts when the legitimacy of the state has been tested and questioned. In extreme cases including Somalia, extra-legal taxation by combatants or warlords replaces the legitimate state functions to collect tax revenue. The capacity of the state to collect domestic revenue determines not only its ability to deliver much needed services, but also to stand-up institutions that are important for security and proper management of state functions. A major characteristic of post-conflict situations is a very low level of domestic revenue base, as demonstrated by revenue to GDP ratios in the low single digits, even years

after cessation of hostilities. In this context, a key objective of transition from conflict is to raise revenue to cover the most urgent government activities, such as statutory obligations and to provide for basic services and essential recovery needs.

**A major challenge in post-conflict countries is to get the revenue administration up and running** and to rebuild a cost efficient and effective customs collection system. Establishment of basic tax administration infrastructure is an important first step. Key requirements include an updated tax payers list, a basic infrastructure and equipment for a functioning national revenue administration; and provision of requisite skilled tax assessors, collectors and auditors. In this context, recruitment of qualified and well remunerated staff is an essential element of the strategy to reestablish effective tax and customs administration. Upgrading of the skills of local staff and assignment of expatriate technical experts is important in strengthening tax administration in the early transition from conflict.

**A principal challenge of PCCs is ineffective and inefficient public expenditure management.** In view of limited institutional and human capacity, it is difficult to formulate sound budgets, properly allocate scarce public resources, and manage public finances with accountability and transparency. Absence of capable institutions and the rule of law lead to misuse of public resources and often pervasive corruption, where individuals usurp the authority of the state and ignore the public interest. The TFG has failed to formulate and implement a single budget, four years into its mandate, although donor efforts have been constantly directed at this endeavor.

A national budget is imperative to underpin the rebuilding of government credibility, and sound management of scarce that should be allocated to the highest priority public expenditures. The formulation of national budgets that prioritize the allocation of resources to essential needs, and that executes public expenditure with accountability and transparency is important for sound PFM, and for sustaining peace and stability. Another important feature of instituting sound public expenditure is to avoid misuse of public resources for unauthorized and unintended purposes, as is reportedly rampant in Somalia's official circles during the transitional phase

### **III. Building Institutional Capacity for effective PFM.**

**The poor quality of institutions, ineffective systems of services delivery and inadequate human resources have been recognized as some of the key obstacles to recovery and reconstruction in the transitional and post-conflict phase.** After the cessation of hostilities, a country requires support through the establishment of a Governance Reforms through coordinated

donor support for capacity-building, especially in PFM. Ad-hoc attempts to upgrade capacity and restore some measure of competence in some parts of the public service is not sufficient, there is urgent need to build more capacity within the public sector.

During the early transitional and post-conflict years, donor efforts are often focused largely on gap filling by establishing Program Implementation Units in many key government ministries and agencies manned by short-term consultants and with contract workers being engaged to fill strategic staff positions in the civil service. However, as the country transitions from a relief phase, it is imperative for capacity building to be brought into sharper focus with a longer-term perspective. In this context, a country requires a major shift and re-orientation from gap-fill technical assistance to building of an indigenous human and institutional capacity to meet the development challenges faced.

**A country needs to chart a new course to quickly enhance human and institutional capacity in a sustainable manner for the medium and long term.** The successful rebuilding of human and institutional capacity for effective aid management and sound financial governance depends on setting a comprehensive framework and requires substantial support from DPs. The assistance provided by development often suffers, owing to lack of a central organ from the government side to coordinate and prioritize provision of capacity building by donors. Multi-donor coordinated support is quite infrequent and coherent dialogue between government and DPs on a comprehensive program for capacity building has not yet materialized in Somalia. Documenting a clear external assistance policy and providing ownership and leadership in this endeavor will be critical for setting appropriate and enlightened local capacity for effective PFM.

The main obstacles to achieving significant progress include lack of decisive action to guide donor efforts and for the TFG to take ownership. More significantly, addressing the shortages of staff skills and limited capacity of key public institutions, the ministry of finance and economic planning and line ministries, is needed to address the lack of credible PFM in the country.

**There are many international and bilateral agencies that provide technical advice and financial assistance for institutional capacity building.** Unless the government takes a lead role in prioritization and coordination, the delivery of donor assistance is often susceptible to duplication and over-lapping efforts. In this context, donors need to identify key areas within their mandate and competence, where they could offer effective support. Each donor's engagement ought to focus financial and human resources in areas it has a clear comparative advantage that will provide most value for money in creating sustainable capacity. A country that emerges from

conflict with operative institutional capacity demands different set of priority interventions than a state that has damaged central authority and no institutional capacity, as is the case in Somalia.

Among the many challenges in PFM that the TFG of Somalia should focus its efforts and leverage are the following key areas:

- Rebuilding domestic revenue generation and efficient tax and customs administration.
- Establishing effective budget formulation and execution capacity, at the local level, including effective centralized treasury operations.
- Establishing credible external audits and parliamentary scrutiny.
- Providing strong implementation capacity at the line ministries and civil service at large (all government agencies).

**a. Enhancing domestic revenue generation capacity**

At the onset of the reconstruction phase and transition to recovery, a country's financial requirements are greatest on account of the need to revive delivery of social services and to rebuild economic and social infrastructure. Consequently, a first priority in any post conflict setting as in Somalia is the rebuilding of domestic capacity to adopt sound taxation policies and to reestablish an effective and transparent tax and customs administration. Rebuilding a domestic revenue base is vital for ensuring that a government's priority expenditures are adequately met—without exclusive dependence on aid donors. Providing appropriate financial incentives to government staff on a timely basis is important for rebuilding institutional capacity, but most donors are reluctant to support generalized remuneration for public servants that would not be sustained by own resources.

**Rebuilding sustainable capacity at the public service demands foremost an effective and efficient revenue generation and administration.** In view of the specialized skills required for tax assessors, auditors, and administrators, as well as the need to minimize corrupt practices, the process of establishing an effective revenue authority requires major financial resources for training and equipping. Such required assistance comprises skill development of staff, provision of machinery and equipment, adequate premises and transportation facilities, and adequate

remuneration. More significant, changing the culture of tax administrators and instilling honesty and financial discipline could only be developed over time.

Among the basic functions of effective and strong revenue administration is to assist with formulation of tax policy, estimation of annual and medium-term revenue forecasting and its effective collection and administration. In post-conflict settings, including Somalia, the revenue management capacity is non-existent or extremely weak and DPs should address that immediate urgency, while focusing on sustainable capacity strengthening over the longer term. Donors ought to assist proactively in building capacity to deliver on essential responsibilities, and avoid tendencies to monopolize decision making at the critical transitional phase.

#### **b. Establishing local capacity for sound budget management**

A first step toward rebuilding local institutions for sound PFM is to address critical shortage of qualified staff. Government and DPs should endeavor to set up mechanisms to strengthen policy development and fiscal execution capacity at the Ministry of Finance and at other relevant domestic institutions, and to create the nucleus of rebuilding sound budget formulation and execution. Besides the urgent requirement to maintain macroeconomic stability immediately after a protracted conflict, a country in transition needs to put great emphasis on aggregate expenditure controls, in order to keep budget units within authorized limits, and to avoid unsustainable fiscal outcomes and the accumulation of payments arrears or inflationary money printing.

**Weak treasury management is often manifested as lack of financial discipline, and is associated with misuse of scarce public resources and corruption that lead to loss of government legitimacy.** Against this background, there is a need to set-up a treasury department and external finance management system, which properly staffed and managed. An effective Ministry of Finance with requisite institutional capacity enhances execution of public expenditure consistent with national priorities; improves analysis and reporting, assures monitoring and evaluation of budget performance. The setting up of an effective Ministry of Finance in a post-conflict setting demands large resources to be committed to the effort in a predictable manner.

#### **c. Ensuring credible external controls**

**Rebuilding local capacity for effective external audits and parliamentary scrutiny of government fiscal operations is important for sound PFM in Somalia and all post-conflict settings.** Generally, inadequate external audits and controls are a common feature of low income

countries. A key challenge in PFM that faces the TFG of Somalia in the current circumstances is to rebuild local institutional capacity for the external audit offices and to strengthen legislative oversight. Accordingly, a key feature of the integrity of PFM is the role played by the Auditor General and the legislative branch of government. Parliamentary approval of the budget is a prerequisite for the executive branch to use public money for authorized purposes only. It is therefore necessary for the country's parliament members to have the competence to scrutinize the national budget, so as to discharge their responsibilities for informed consent. In addition, once the audited accounts are presented to the public accounts or other pertinent organs of Parliament, proper oversight and scrutiny should be assured. There is clear evidence that strong ex-post controls accompanied by predictable and assured sanctions promote effective public expenditure management, and Somalia clearly needs external controls to enhance public resource management with accountability and transparency.

#### **d. Providing for strong civil service capacity**

Reconstituting the country's civil service after the protracted and brutal civil conflict that destroyed it is a most important requirement for strengthening PFM in Somalia. What is left of the civil service is plagued with very low incentive structure and inadequate institutional and other support. The vision should be to create a leaner, well-motivated and efficient civil service to implement national development strategies and maximize efficiency in the public service generally. This requires a comprehensive civil service reform program, retraining, and enhancing competences at all levels to be implemented in the medium and long term. In the near term, the strategy should involve the filling of critical gaps in key government ministries and agencies through implementation of competitive recruitment and performance-based retention. .

**Rebuilding implementation capacity in the line ministries should be a high priority**, in order to achieve sound execution of national programs and projects. Providing strong systems and processes at the line Ministries is imperative over the short to medium term to coordinate and achieve the necessary capacity building requirements. Key measures to enhance the effectiveness of line Ministries of government include: determining their skilled staffing and training needs; and providing the necessary administrative, technical and logistical support. A comprehensive civil service program will involve improving the legal and institutional framework of human resource management, creating an environment of attractive remuneration, and sustained training to develop the full capacity of the service.



#### **e. Technical assistance in capacity building**

Technical assistance (TA) provided to TFG in PFM in recent years was faced with complexities often confronted in post-conflict settings with inadequate human and institutional capacities. In such settings, a principal challenge of TA providers is reconciling the need to cover urgent gaps while providing for rebuilding of sustainable institutional capacity. In aiming to meet immediate gaps to restart the operations of the central authority, the tendency is to “buy or build temporary capacity” and be less mindful of the need for sustainable capacity building. The urgency to respond to immediate government requirements often leads to lack of coordination and duplication in TA provision. In some instances, the need to respond could result in over-lapping responsibilities that lead to unhealthy competition for influence among DPs.

The TFG needs to strive for proper ownership and leadership of TA coordination, if progress were to be made in building sustainable institutional capacity. A main characteristic of the “gap-fill” TA is “to get the job done” and to ensure accountability. Accordingly, a common approach is to put expatriate experts in place to perform desired tasks, with no adequate search if the desired skills and competence could be procured in the local market. There are frequent indictments of supply driven TA as often leading to assignment of “ill-suited or incompetent experts” to tasks better delivered by local staff and at much less exorbitant costs at that.

**TFG guidance, and to the extent possible ownership, of TA and its coordination with development partners could have more lasting impact on imparting skills to local staff and building sustainable institutional capacity.** Among the many limitations of the supply-oriented TA is that it leads to significant share of technical assistance being at the discretion of the respective donors and being earmarked to own nationals, regardless of their competence to deliver lasting impact. A first order for improving the impact of available TA is to de-link it from specific projects and supporting donors. Clearly, by pooling the resources expended on TA and addressing the specific capacity requirements of key sectors and institutions would lead to more value for money and ensure that utilization is demand-driven. Pooled TA resources and coordinated sector-wide implementation, within an agreed framework among stakeholders, have been adopted in some countries with success.

The TFG should move to pooling of TA resources, to the extent possible and feasible, as pooling of resources puts the government to “pilot or co-pilot” the execution of technical assistance in all

forms. A general pool of TA resources also allows for competitive recruitment of experts on account of the fact such facility provides flexibility to seek best value for money from all sources. A classical complaint of the lack of effectiveness of traditional TA is that expatriate personnel and consultants confront adjustment and communication difficulties that contribute to a steep learning curve when they arrive, and that limits their overall impact.

Establishing of a Trust Fund for TA or pooling of resources would permit the government to seek highly qualified locals and permit the country's Diaspora to contribute to building sustainable public sector capacity. There is evidence in every region of the world " that members of Diasporas have contributed valuable management skills to their countries of origin, both public and private sectors, while also bringing financial resources, external contacts, and demand for a higher overall standard of performance".

#### **IV. Findings and Recommendations**

##### **Principal findings and conclusions**

- Somalia's confronted with institutional capacity challenges faced by most post-conflict countries, attribute to losses of critical human skills needed for sound management of public resources and broad depletion of the competence of the civil service. The damage caused by the protracted conflict to economic infrastructure and institutional capacity that depleted the country of many critical assets that can not be reversed through uncoordinated efforts and lack of coherence.
- Somalia has made no progress in strengthening public finance management, notwithstanding some support from DPs. The process of budget formulation has yet to be initiated and alignment with national policies and poverty reduction strategies, is urgently required. Among the principal areas of concern to be addressed is the lack of credibility and legitimacy.
- Some donor practices have also inhibited effective capacity to formulate and execute a national budget. Donors have been unwilling or unable to assist national institutions essential for the purpose. Financial assistance for programs and projects is through direct donor disbursements and considerable share of development assistance is channeled outside the government's mandate.
- Another principal weakness of PFM in Somalia is the high dependence on donor assistance, manifested by the fact that nearly 100 percent of the national expenditure is financed by grants from donors. Domestic revenue remains lacking or misappropriated through quest official shears, and hence the dependence is absolute.

- The TFG has no vision of a PFM strategy, and based on current information, has no explicit aid management policy to guide the process and to ensure external resources are used effectively. Government should recognize the imperative need for developing an aid policy, and realize that coordination of assistance provided to the country is a daunting task that should commence forthwith.
- Inadequate accountability and pervasive corruption are major challenges hampering reliability of the country's fiduciary systems. Somalia has a very low score in the corruption perceptions index compiled by Transparency International, and was ranked bottom among the 175 countries in the 2007 survey. The suspect credibility of the effectiveness of national systems and procedures leads DPs to rely on parallel implementation units independent from government involvement and scrutiny.
- Poor quality of institutions, ineffective systems of services delivery, and inadequate human resources are some of the key obstacles to significant progress in rebuilding the country's major institutions. Somalia needs to chart a new course to quickly enhance human and institutional capacity in a sustainable manner for the medium and long term. A review of progress made in rebuilding sustainable capacity, particularly in the area of effective aid management, indicates that much work needs to be done. TFG's lack of achievements in every measure of improving effective aid management, in comparison with other fragile and post-conflict states, is attributed to both mis-governance and lack of vision.

### **Reforms Government Should Undertake**

- The TFG should take ownership and leadership in setting a framework for rebuilding the country's institutional and human capacity so as to ensure sound management of public resources, domestic and foreign alike.
- A competent and efficient Ministry of Finance should be given a first priority, in view of the need to strengthen domestic revenue mobilization, ensure an effective treasury department, and to reestablish internal and external controls in budget execution. Enhanced local capacity in the Ministry of Finance and other relevant government agencies, in turn will provide assurance to development partners of strengthened accountability and transparency in the management of public finances.
- An overhaul of the civil service rebuilt on merit-based recruitment, adequate remuneration and effective retention, and provision of essential skills is important for strengthening institutional capacity, and is a complex and long-term process that requires, among other changes, business culture re-orientation and "demand for excellence".

- The rebuilding of the competencies of specific “centers of excellence” and in general the civil service requires adequate funding of a comprehensive program with targets and objectives set for the medium and long term. Accelerated strengthening of core ministries and other government agencies responsible for aid management should be used in the transitional phase, while the civil service is being upgraded.
- In the transitional from conflict phase, the government should focus its efforts on rebuilding a domestic revenue generation capacity and efficient tax and customs administration; establishing effective budget formulation and execution capacity including centralized treasury operations; ensuring credible external audits and parliamentary scrutiny; and providing strong implementation capacity at the line Ministries.
- The Government should strive for proper ownership and leadership of Technical Assistance (TA) coordination, if progress were to be made in building sustainable institutional capacity. A first order for improving the impact of TA is to de-link it from specific projects and supporting donors. Pooling the resources earmarked for TA and addressing the specific capacity requirements of key sectors and institutions would provide flexibility in use of resources and improved value for money.
- The Government should move to establishing a multi-donor capacity building and TA support Trust Fund. Such facility provides flexibility to competitively seek desired skills, including local staffing and Diaspora contributions in building sustainable public sector capacity. Sound management of a TA Trust Fund together with participating donors allows for mapping out coherent capacity building in the medium and long term, and promotes prioritization and proper sequencing.

### **Measures Development Partners should support**

- Assist the development of a policy framework for capacity building; in view of the fact that Somalia has yet to formulate a coherent public finance management, and adopt a program for building sustainable capacity for effective aid management. A joint capacity needs assessment by government and DPs is necessary to define the current constraints on PFM and to develop short-term interventions and longer-term programs to address the principal staffing and institutional capacity limitations.
- Provide effective support for government institutions responsible for PFM, and allow sufficient room for such institutions to deliver on their mandates. The use of outside government channels of aid delivery should be phased out, and Development Partners should strive to work with and through relevant government ministries and agencies, allowing them to gain essential experience and sustainable capacity. They should also avoid to undermine “nascent or dormant capacity” in government institutions, by working with non-state actors that are unwilling to cede back such functions

- Promote and facilitate the creation of capacity building Trust Funds for pooling TA resources, in order to allow for government guidance and direction in the prioritization, sequencing and execution of technical assistance. Government and donor joint management of pooled TA resources allows for competitive procurement of required services, improved monitoring of performance, joint accountability for outcomes, and more flexibility in utilization of local expertise and Diaspora skills.
- Support the development of effective training programs and skill development in the civil service. In order to strengthen the sound management of public resources, government requires competent accountants, financial officers, fiscal economists, auditors and many other professionals to manage state finances. Targeted training programs could meet such urgent requirements, but sustainable capacity rebuilding in the public sector requires on-going training through civil service academies or other institutions.
- Encourage the creation of a lean and efficient civil service, with merit-based recruitment and retention. A comprehensive rebuilding of the civil service is necessary, and positive incentives in the form of adequate remuneration and an enabling work environment are essential first steps. As a complete rebuilding requires time and resources, what are required are transitional entry points to strengthen the performance of the civil service through building of the capacity of “centers of excellence”.

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