Helpdesk Report

Knowledge, evidence and learning for development

Public Financial Management and Transitioning Out of Aid

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Question

How do Public Financial Management (PFM) and governance system strengthening relate to transitioning out of aid in countries moving up the income ladder? Provide any lessons from the literature that may be useful for low-income countries that are moving away from aid.

Contents

1. Summary

This rapid review found an absence of literature focused specifically on measuring the impact of PFM and governance systems in countries that have transitioned from aid, by moving up the income ladder. However, there are a few academic publications and a limited number of studies by multilateral, such as the World Bank, that examine the role of PFM and governance systems in countries that are transitioning or have moved away from aid. However, the importance of public financial management (PFM) and governance systems in development is well established and seen as a pre-requisite for economic growth. To effectively transition from aid, most low-income countries (LICs) need to upgrade their PFM and governance systems to meet the different scale, resources, accountability mechanisms, and capacity-building requirements of a middle-income country (MIC).

The absence of the above empirical evidence may be due to **the complexity of measuring the impact of PFM reforms as the results are non-linear, difficult to isolate from other policies to establish causality, and manifest in a longer time frame.** However, through comparative country studies, the consequences of deficient PFM and governance have been well documented. So impaired budgetary planning, implementation, and reporting, limited fiscal transparency, weak accountability mechanisms, resource leakage, and inefficient service delivery are well recognised as detrimental to economic growth and development.

The literature on transitioning countries focuses predominantly on the impact of aid withdrawal on the social sector, where comparative qualitative data is easier to obtain and the effects are usually more immediate, visible, and may even extend to global health outcomes, such as in AIDS prevention programmes. Thus, **tracking the progress of donor-assisted social sector programmes is relatively easier than for PFM and governance reforms.**

The literature is more abundant on the overall lessons of transitions from aid both for country governments and donors. **The key lessons underscore the importance of PFM and governance systems and mechanisms to a successful transition up the income ladder**:

- Planning for transition should be strategic, detailed and specifically geared to mitigate against risks, explicitly assessing the best mix of finance options to mitigate the impact of aid reduction/withdrawal on national budgets. The plan must be led by a working group or ministry and have timelines and milestones.
- Where PFM and governance is weak transition preparation should include strengthening PFM especially economic and fiscal legislation, administration, and implementation.
- Stakeholders such as donor partners (DPs) and NGOs should participate in the planning process with clear, open, and ongoing communication channels.
- Political and economic assessments in the planning and mid-term phases as well as long-term monitoring and evaluation should be instituted.
- Build financial, technical, and management capacity throughout the plan implementation

This helpdesk report draws on academic, policy, and grey sources from the previous seven years rather than the usual K4D five-year window, to account for the two-year disruption of COVID-19. As cross-country studies on PFM and governance are scarce, a few older studies are also referenced to ensure a comprehensive response to the query. The report focuses on low-income countries transitioning from aid due to a change in status to lower-middle-income countries.

2. Definitions

What is Public Financial Management (PFM)?

“**PFM is the way governments manage public resources, including collecting revenue and controlling expenditure, and the impact such resources have on the economy and society”** (ACCA, 2021).

A robust PFM system improves a government’s ability to meet the key financial management goals of achieving sustainable financial stability, efficient allocation of public resources, and effective (and equitable) provision of public goods and services (ACCA, 2021). Generally, it is thought of as a cycle of six phases, starting with policy creation, budget planning and execution, and concluding with external audit and assessment, encompassing a larger range of activities than financial management (Lawson, 2015, p. 1).

PFM and Governance Indicators

Public Expenditure and Financial Accountability (PEFA), despite some limitations, has become the “gold standard” of PFM assessment frameworks (de Renzio, 2015, p. 2). The following indicators[1] are used to measure the robustness of a country’s governance structure. Country Policy and Institutional Assessment (CPIA) property rights and rule-based governance includes 16 criteria grouped in 4 equally weighted clusters (economic management, structural policies, policies for social inclusion and equity, public sector management & institutions) (Yamey et al., 2019, p. 13). In each criterion, countries are rated on a scale of 1 (low) to 6 (high). The Worldwide Governance Index (WGI) measures perceptions about governance performance where -2.5 is weakest governance with 2.5 being the strongest (Yamey et al., 2019, p. 13).

Transition from Aid

A period when donors begin to scale back their programmes in a recipient country because it is assessed that the country requires less assistance is referred to as the "transition" from aid (Calleja and Prizzon, 2019, p. 12). This report focuses on those countries exiting aid due to an increase in per capita income, which leads to moving up the income ladder, rather than those where aid is withdrawn for political or security concerns.

After reviewing the pertinent literature, Calleja and Prizzon (2019, p. 12) discovered that **very little research has been done on the practical difficulties and problems that nations face** when they move from overseas development aid (ODA) to other sources of funding. There is a **paucity of comparative evidence on** (1) how countries prepare for and manage such a transition process; (2) the types of cooperation countries seek from donors throughout it; and (3) the expectations about the evolution of relations with former donors beyond ODA (Calleja and Prizzon, 2019, p. 12; Gotsadze et al., 2019, p. 260).

Calleja and Prizzon (2019, p. 12) also conclude that there is a **gap in the literature** examining whether and how recipient nations actively create roadmaps for the transition from aid, with discussion mostly on national development plans. Instead of meaningful policy planning aimed at the key goals of sustaining and building upon development results, the objective of reducing aid

[1] Fritz (2016, p. 302) sets out the full range of indicators that are available.

dependency (which is seen as promoting national policy autonomy) frequently takes precedence in transitioning countries (Thomas et al., 2011, as cited in Calleja and Prizzon, 2019, p. 21).

Moving up the Income Ladder

Each donor organisation establishes its own criteria for initiating, assessing, and graduating from aid. The policy set out by the Organisation for Economic Co-operation and Development (OECD) that governs graduation from the list of “ODA-eligible” nations is the only one based purely on per capita income i.e.: when a country's per capita income reaches a certain level for three years in a row it graduates (Calleja and Prizzon, 2019, p. 13).

Low-Income Countries (LICs) and Middle-Income Countries (MICs)

Based on their gross national income (GNI) per capita, the World Bank divides the world's nations into low-income countries (LICs), lower-middle-income countries (LMICs), upper-middle-income countries (UMICs), and high-income countries (HICs). These classifications are useful for analysis, such as when comparing data between groups of countries, but they are not directly related to the terms of loans (Engen and Prizzon, 2019, p. 15, Box 1). “Reclassification” occurs when a nation exceeds the threshold for income per capita and moves up or down the income ladder from one classification to the next (Engen and Prizzon, 2019, p. 15, Box 1).

Although a country's overall economic and social development is only partially reflected in its income per capita, a country's **transition to MIC status can have a significant impact on the mix of financing resources available** to it and can prompt donors to reduce or even phase out financial assistance (Engen and Prizzon, 2019, p. 9).

This report focuses on the experiences of low-income countries (LICs) that have moved or are expected to be moving up the income ladder to lower-middle-income (LMIC) or upper-middle-income (UMIC) status, which will be referred to collectively as (MIC). Countries that are studied in this context include Ethiopia, Nepal, Tanzania, Timor-Leste, Rwanda, and Botswana.

3. The Impact of PFM and Governance Reforms

History of PFM and Governance Reforms

The literature that examines factors influencing PFM quality in developing countries, the effects of foreign aid on governance, and donor support for PFM reforms is sparse (de Renzio et al., 2010, p. 10). To evaluate and compare the quality of PFM systems between nations and over time, there are relatively few reliable sources of data and cross-national statistics (de Renzio et al., 2010, p. 11). It is challenging to locate comprehensive and reliable data on donor assistance for PFM specifically (de Renzio et al., 2010, pp. 16-17) especially due to difficulties in measuring results. There is some literature on the impact of donor support for PFM and governance reforms in low-income (developing) countries but much of it is from older sources[2] (prior to 2010 there had only been two cross-country comparative analyses)[3]. "The evaluation finds that "about two-thirds of all countries that borrowed for financial management showed improvement in this area", with **public financial management being "the most consistent area of improvement in the case studies"** when compared to other aspects of public sector reforms (World Bank 2008:xv). More specifically, using CPIA data as a yardstick for improvements in the quality of budget institutions, the evaluation finds that 64% of countries that received any support for PFM reform programmes saw their CPIA PFM indicator score increase, compared to 32% in countries that did not receive such support (Wescott 2009:147)" as cited in de Renzio et al (2010, p. 10).

PFM reform efforts have been ongoing throughout the world particularly over the past two decades[4] with nearly 150 countries doing at least one PEFA report, which serves to assess PFM progress and usually serves as a basis for future reform design (Fritz et al., 2017, p. xi). "Development partners (DPs) support efforts at PFM strengthening with about US$1.3 billion annually and nearly US$20 billion in total since 2002, based on Organisation for Economic Co-operation and Development (OECD) data" (Fritz et al., 2017, p. xi).

Given this level of interest and investment, it is somewhat perplexing that there is so little data and analysis available on the comparative performance of PFM systems over time and across countries, on the elements that support successful PFM reforms, and on the potential contribution of DPs to PFM reform efforts in developing nations (de Renzio et al., 2010, p. 7). Lack of comparison data is one of the main causes of this (de Renzio et al., 2010, p. 7).

Results of PFM and Governance Reforms

The findings of a cross-country study covering 100 countries using PEFA assessments looked at the broader literature on aid effectiveness, particularly at cross-country studies assessing the impact of donor aid on recipient country governance (de Renzio et al., 2010, pp. 3-4) and sought to answer:

a) Where do PFM reform initiatives succeed, and why? b) Where and how does outside assistance for PFM reform initiatives work best to ensure success? (de Renzio et al., 2010, p. 5)

- Key economic factors have a major role in explaining variations in PFM system quality with aid-related factors having a lower level of explanatory power. As a result, rather than donor initiatives, **PFM systems are more likely to improve in response to shifting economic conditions.** Compared to absolute income level, the economic growth rate is more strongly associated with higher quality PFM. So, **a few low-income but rapidly**

[2] "At present, there are no comprehensive studies looking at the impact of donor support for PFM reforms on the quality of PFM systems. The only existing comprehensive evaluation of this kind of support is included in the World Bank evaluation mentioned above (World Bank 2008, Wescott 2009)" as cited in de Renzio et al (2010, p. 10).

[3] "The bulk of the analysis draws on data from PEFA assessments in 100 countries, data on donor support to PFM reforms directly collected from some of the donor agencies most active in this area, and a large dataset on other economic/social, political/institutional and aid-related variables that were identified as relevant from previous research" de Renzio et al (2010, p. 3).

[4] As of 2017

developing African nations are among the greatest PFM performers (Andrews[5], 2010, as cited in de Renzio et al., 2010, p. 8).

- **Superior PFM systems are a hallmark of nations with greater per capita incomes, larger populations, and better recent records of economic growth** (de Renzio et al., 2010, p. 32). On the other side, the strength of PFM systems is adversely impacted by state fragility, which is characterised as being in a conflict or post-conflict environment (de Renzio et al., 2010, p. 32).
- **The effectiveness of PFM systems is also strongly and favourably correlated with donor PFM support.** In general, PFM systems are better in nations that received more **technical support relating to PFM** (de Renzio et al., 2010, p. 24). The correlation, however, is quite weak: an extra 40–50 million US dollars annually would be comparable to a 0.5-point rise in the average PEFA score. In reality, the positive correlation with assistance dependence may indicate a **reverse causality** as "it could merely reflect the fact that donors tend to provide more PFM-related assistance to countries that have already achieved a certain success in improving the quality of their PFM systems" (de Renzio et al., 2010, p. 24). **Longer-term donor-assisted PFM programmes are positively associated** with measurable PFM results (Westcott, 2008, p. 44 as cited in Omollo, 2018, p. 173).
- Numerous robustness tests and model adjustments did not modify these results. Using more current data or concentrating on **low-income nations only**, produces interesting additional results. In these situations, there is also a **positive and substantial correlation between greater PFM quality and the proportion of overall aid supplied as general budget support.** "It indicates that in low-income countries it is not just PFM support, among donor interventions, that is significantly associated with changes in the quality of PFM systems. Aid modalities also count" (de Renzio et al., 2010, p. 27).
- Finally, **the link between various components of donor support and more specific PFM processes varies**. For instance, a longer term of donor participation is linked to greater results in upstream, de jure[6], and focused processes (de Renzio et al., 2010, pp. 28-29). This may be because donors have historically tended to focus more on these easier reform areas, but it may also be a result of the longer time it takes to strengthen downstream, de facto, and deconcentrated processes (de Renzio et al., 2010, pp. 28-29).
- Demonstrating how **donor PFM support appears to focus more on rules, procedures, and particular players within government**, the degree of donor PFM support is also more strongly related with ratings for de jure and concentrated[7] PFM processes (de Renzio et al., 2010, p. 28). "Confirming the results of past research that countries make budgets better than they execute them, pass laws better than they

[5] Andrews, M. (2010) How Far Have Public Financial Management Reforms Come in Africa? RWP10- 018 Faculty Research Working Paper Series. Cambridge, MA: Harvard Kennedy School. http://nrs.harvard.edu/urn-3:HUL.InstRepos:4448885

[6] PFM reforms that are linked to legislation, institutional processes, and procedures (i.e., de jure reforms) vs. those interventions focused on the implementation or establishment of new practices (i.e., de facto reforms) (de Renzio et al., 2010, p. 8).

[7] "PFM process areas involving small groups of 'concentrated' actors such as budget departments vs. processes which engage broader sets of 'de-concentrated' actors, such as line ministries" (de Renzio et al., 2010, p. 8).

implement them, and progress further when responsibility for reforms lies within core groups in the Ministry of Finance" (de Renzio et al., 2010, p. 26).

- Some limitations and difficulties highlight the **need for extreme caution when interpreting the analysis' findings**, which are provided in this study. The association between income levels, donor PFM aid, and the quality of PFM systems—which is large, positive, and resilient to a number of variables—**cannot be construed as causative**, as was stated above (de Renzio et al., 2010, p. 27). Instead, **it could reflect the tendency of donor organisations to invest more money in nations that have already demonstrated the ability and willingness to reform their PFM systems**, have moved past simpler initial reforms, and are beginning to engage in more complex (and expensive) reforms (de Renzio et al., 2010, p. 27).
- One of the major drawbacks of the research done so far using solely PEFA data is that it compares nations at a certain period, presuming that improved PFM systems in place now reflect successful PFM reforms in the past (de Renzio et al., 2010, p. 29).
- It is necessary to combine quantitative findings with in-depth qualitative country-level research **that explains not only if and when donor PFM funding affected PFM systems, but also why and how it did** (de Renzio et al., 2010, p. 34). De Renzio's 2011 study of 16 aid-dependent countries found that "**among domestic factors, economic and political stability are preconditions for successful budget reforms**[8]". This approach was adopted in the Fritz et al (2017) study where the research, which draws on five case studies[9], focuses on numerous important aspects of the how and why of PFM changes: first, levels and longevity of political commitment, broad policy objectives, and fiscal trends; second, institutional and legal starting points and conditions, including the relationship between the executive and the legislature with regard to their roles in PFM as well as whether citizens are calling for such reforms; third, it examines the specific reform intentions as stated in the PFM reform plans, and one by one at how these were pursued over a period of 10 to 15 years (Fritz et al., 2017, p. xi).

Fritz et al's study of five country cases for the World Bank Group in 2017 found:

- "**The country characteristics that are statistically relevant explain some of the specific cases' individual status and trajectories, while also leaving a number of puzzles**" (Fritz et al., 2017, p. xii).
- "Change in Georgia was exceptionally rapid and has gone farther than regional and income group comparators on average. Tanzania's regressing trend would not have been predicted, given its continued growth and political stability. Nepal and the Philippines both achieved some progress with Nepal's progression being stronger than would be expected given its post-conflict[10] situation and still low per capita incomes. For

[8] Burkina Faso and Ethiopia are two countries where leadership and commitment contributed to successful budget reforms (de Renzio, 2011, p. 20).

[9] Five countries (with country classification in 2002-2017): Nepal (LIC), Tanzania (LIC), Philippines (MIC), Georgia and Nigeria (both moved from LIC to MIC) (Fritz et al., 2017, p. xii

[10] Nepal was listed on the World Bank's list of fragile and conflict situation (FCS) countries until FY2014 (Fritz et al., 2017, p. xii)

> the Philippines, the overall observed strengthening of PFM systems has been broadly in line with the country's characteristics" (Fritz et al., 2017, p. xii).

There are favourable correlations between the effectiveness of PFM systems, overall fiscal discipline, and budget credibility, according to research and empirical data, which also reflects that countries may not be able to fully realise the potential of their public investments if their PFM system is flawed (Robinson et al., 2021, p. 7). However, it is challenging to establish a direct link between PFM system reforms and improvements in infrastructure and service delivery results since these changes are not usually linear (Robinson et al., 2021, p. 10).

Fritz (2016, p. 303) **concludes that the evidence on whether governance reforms have been successful gives a "fuzzy picture" as there are many different sets of indicators and questions persist as to how comparable and accurate the ratings are**. Fritz et al (2017, p. xi) reiterate this conclusion regarding **PFM strengthening efforts** "following nearly two decades of intensive effort, what has been achieved, where, and why is not very clear". **However, there are some countries where progress has been significant** (Fritz, 2016, p. 303). Despite mixed evidence on the success of public sector reforms in general, such as anti-corruption and civil service initiatives, **PFM reforms have a better track record** (Blum, 2014; DfID, Irish Aid, and SIDA, 2013; World Bank, 2008 as cited in Fritz, 2016, p. 300).

Recommendations for PFM & Governance Reforms in LICs

Although significant governance improvements have been infrequent, nonetheless there is **encouraging evidence of some LICs** and LMICs that **have advanced significantly over the previous decade (up to 2016) such as Ethiopia, Rwanda, and Lao PDR despite relatively scarce fiscal resources as well as some countries in Eastern Europe** (Fritz, 2016, p. 303-304; Omollo, 2018).

However, a key finding is that **successful reforms depend on strong political will and commitment** to achieving change, as evidenced by Rwanda's successful PFM programme (Omollo, 2019, p. 185), so reforms are implemented fully, more so than the type of reform approach taken (Fritz, 2016, p. 308; Omollo, 2018, p. 187).

Robinson et al (2021) found that efforts to enhance PFM that are focused on obtaining **quantifiable intermediate results** (such as increasing adherence to authorised budgets) are more likely to produce visible improvements in public investment and service delivery outcomes and offer a more precise basis for comparison when attempting to connect PFM reforms to public investment results.

Robinson et al's (2021) analysis gave recommendations for future PFM progress measurements including that: PFM performance areas should be connected to **quantitative, interim measurements** where causality is proved; PFM-strengthening initiatives should pinpoint the **complementarity of reforms and generate measurable instant results** for such initiatives; evidence of their effect on certain PFM performance objectives should serve as the foundation for future PFM-strengthening reforms (Robinson et al., 2021. p. 8; Omollo, 2018, p. 185).

Studies mainly focusing on the health and education sectors indicate that **a robust PFM system can significantly improve sectoral spending especially by increasing allocative efficiency** and lowering budget deviations (Robinson et al., 2021. p. 14).

The majority of studies on sustainability and national ownership (in the health sector) have emphasised the requirement for **improved management capabilities**. Local partners may require additional training in important management areas including health planning, M&E, procurement, performance management, and financial management (Vogus and Graff, 2015, p. 280).

However, economic downturns force governments to make challenging judgments about the allocation of funds between and within sectors. Priorities for health can also be impacted by changes in government and policy (Vogus and Graff, 2015, p. 280).

How successfully programmes have been incorporated into current organisational processes and practices and the extent to which institutional norms serve as a guide for programme management are two important areas of evaluation. “The evaluation framework assumes that institutionalization and standardization create processes to ensure programme quality in activities that will be transitioned from the NGO to the government” (Vogus and Graff, 2015, p. 280).

Building the ability of local stakeholders to take charge of forecasting, monitoring, and managing logistics and using different procurement systems as well as ensuring sufficient cash flow is provided by the Ministries of Finance in transitioning countries for sustainable procurement and supply chain management (Vogus and Graff, 2015, pp. 281-282).

Vogus and Graff (2015, p. 283) stress that more work needs to be done to ensure that civil society has a seat at the policymaking table, particularly to reflect the needs of marginalised or underrepresented groups which can seriously undermine health policy outcomes if not addressed. **In systems where PFM is strong, equity and transparency of policymaking are usually protected**.[11]

Yamey et al., (2019, pp. 14-15) underscore **the importance of PFM and governance indicators in assessing whether a country is ready for transitioning to another category**.

Yamey and Hecht (2018) include **“a robust economy, strong governance, adequate domestic finances” amongst their five sets of indicators** reflecting their hypothesis that these factors assist successful transitions from aid. They conclude that higher debt servicing without greater domestic resource mobilisation can negatively impact a country’s transition. Furthermore, the less efficient use of government funding, and “weaker governance and public institutions” undermine a country’s capacity to successfully transition from aid.

Yamey and Hecht (2018) ask: whether weaker countries should **prepare earlier for the transition** by, for example**, investing more in further strengthening their PFM systems, especially for budgeting, procurement, and key functions**; whether donors should allocate more resources to countries to facilitate domestic commitment to health outcomes and ensure better governance is in place.

[11] Author’s own conclusion. Also refer to Khan, M. (2022). *Public Financial Management, Corruption, Transparency, and Accountability*. K4D Helpdesk Report 1197. Institute of Development Studies.

4. Lessons for Countries Transitioning from Aid

Donor transition management is a difficult journey where many factors, from a recipient country's political will, ability to access alternative foreign and domestic financial resources, enhance fiscal policies, tax administration and revenue collection, information systems, governance, accountability, institutional capacity, and service delivery can potentially hamper country transitions from aid (Gotsadze et al., 2019, p. 260).

Engen and Prizzon (2019) list **key findings from their study of countries exiting aid**:

1) **Increased Debt**: The transition from LIC to LMIC status for most of the countries studied saw **an increase in official development assistance (ODA),** so factors other than the country's GDP per capita influenced future development aid (Engen and Prizzon, 2019, p. 9). **Most of the countries studied showed a rise in their percentage of loans vs grants after becoming LMICs with the terms and conditions of such loans also becoming less concessionary and more stringent** (Engen and Prizzon, 2019, pp. 10-11).

2) **Resource Allocation Shift**: As loans have a financing cost, they tend to be spent on infrastructure projects which potentially generate revenue as opposed to the social sector (health and education), shifting the resource allocation of MICs **towards infrastructure** (Engen and Prizzon, 2019, p. 11).

3) **Tax Revenue**: As they develop, MICs may become trapped in what is dubbed the "missing middle" of development financing, in which a country's total public resources as a proportion of GDP declines after it leaves LIC classification, only increasing once it has fully attained MIC status (Engen and Prizzon, 2019, p. 12). Thus, Vogus and Graff (2015, p. 280) recommend **conducting political and economic assessments** during the planning phase to detect vulnerabilities of the proposed transition strategy. Prizzon (2021) cautions that **tax collection ratios can rise at a slow pace or even fall** creating a serious "missing middle of development finance" with both "official development finance and tax revenues as a share of GDP falling"[12] due to challenges in widening the tax base and increasing tax rates. Therefore, governments should "**prioritise tax revenue mobilisation and tax administration as a key element of national financing strategy**" (Engen and Prizzon, 2019, p. 13).

4) **Lack of Planning to Address Aid Exit**: Countries transitioning from aid usually do not have a plan in place. Many nations have recently undergone reclassification from LIC to LMIC, but Engen and Prizzon (2019, p. 12) were unable to locate any literature specifically discussing transitioning country strategies, let alone any comprehensive studies of their policy decisions[13]. In all the case studies, they discovered that **the governments had trouble articulating their priorities for the kinds of help they wanted from DPs** as they made the shift away from aid and they seldom ever explicitly addressed the evolving conditions linked to LMIC status, such as alternative financing options, instead listing knowledge and government capacity-building as their key needs (Engen and Prizzon, 2019, p. 12).

[12] As in the cases of Nigeria, Papua New Guinea, and Sri Lanka (Engen and Prizzon, 2019, p. 13)

[13] A more recent study (Lopes, 2021) on the graduation of Timor-Leste is covered in Annex 3 of this report

Literature on Transitions & “Beyond Aid”

The methods and effects of transition and exit from ODA have been examined in two detailed studies. Slob and Jerve (2008) investigated the impact of the withdrawal of ODA in five different nations (Botswana, Eritrea, India, Malawi, and South Africa) (Calleja and Prizzon, 2019, p. 13). They discovered that **transitioning from donor-recipient relationships to global partnerships and collaboration requires deliberate and cooperative preparation.** The same study found donor departures that are politically driven and carried out quickly rather than gradually often result in the complete breakdown of ties post-exit as did the second study by the Independent Commission for Aid Impact (ICAI) in 2016 (Calleja and Prizzon, 2019, p. 13). **Explicit strategies for managing transition are used inconsistently by DPs themselves** even varying across ministries within donor governments, with few development partners actively planning for transition and post-ODA relations (Jalles d’Orey and Prizzon, 2019).

Donor cooperation with countries in transition. Only a few contributions have examined and analysed the needs of nations moving away from ODA as well as the methods that donors might aid this transition (Calleja and Prizzon, 2019, p. 14). Instead of focusing on other aspects of project and programme planning and implementation, these studies have largely focused on mapping financing for development, including changes to the scale and types of financial resources available at different stages of the transition process, in both cross-country and country studies (Calleja and Prizzon, 2019, p. 14).

The literature is generally devoid of additional study of alternative partnership models, strategies, and venues for ongoing participation beyond ODA **and provides little actual guidance for nations shifting away from aid** (Calleja and Prizzon, 2019, p. 14).

In LMICs that have recently graduated, institutional capacity development has not kept up with economic growth, and various analyses urge continuous "soft" support (technical assistance), based on an analysis of country studies (Prizzon and Rabinowitz, 2015, as cited in Engen and Prizzon, 2019, p. 21). Thus, many nations continue to request technical support from their development partners, especially for knowledge transfer and skill development, including technical vocational education and training. Government officials in Botswana, and even countries that have not relied on ODA for many years, such as Chile and Mexico, **cited technical assistance as an important type of cooperation** from DPs and international institutions that they wished to continue to assist with capacity building and technical assistance (Engen and Prizzon, 2019, p. 31).

An important policy issue for increasing collaboration outside of ODA is climate change. Because of the study participants' high climate change vulnerability, Botswana, Chile, and Mexico specifically requested DP assistance to encourage the adoption of clean and/or green technology (Calleja and Prizzon, 2019, p. 32).

“Beyond Aid” Cooperation

The study of data from various nations and the assessment of the literature supported the **predictable finding that aid decreased after achieving LMIC status** (Engen and Prizzon, 2019, p. 29). Countries have found certain methods, such as joint funds for development cooperation and creative funding arrangements, effective for transforming donor-recipient ties into development partnerships (Calleja and Prizzon, 2019, p. 32).

Beyond-aid relations are expected to encompass economic involvement, technical and scientific collaboration, and support for "global public goods" such as climate change and migration policies, by countries in transition (Calleja and Prizzon, 2019, p. 33). Countries continued to prioritize technical support for planning, implementation, monitoring, and evaluation throughout the transition period, which assists sustainable development in the longer term (Calleja and Prizzon, 2019, p. 36-37).

Calleja and Prizzon (2019, p. 34) observe that: "At the bilateral level, however, countries that donors consider less geostrategic may see less space for policy dialogue in the absence of aid." In Botswana, as ODA flows continued to fall donors lacked the motivation to extend their engagement as the swift departure of the Scandinavian DPs illustrates (Calleja and Prizzon, 2019, p. 34). Contrarily, in Mexico, a country with a substantial economy and strategic importance, DPs were extremely motivated to maintain development cooperation beyond the transition period (Calleja and Prizzon, 2019, p. 34).

Planning for the Transition

"**Transition and graduation from aid are not linear paths**" stresses Prizzon (2021) and thus **require careful preparation and management by both governments and donors**. Engen and Prizzon (2019, p. 12) emphasise that **transitioning countries should establish goals** for external development financing, be explicit about them, and **create a plan** for managing the shift away from aid.

However, **most nations lack a transition strategy** to deal with potential problems and explicitly prepare for the withdrawal of assistance (Prizzon, 2021). Most of the country plans Calleja and Prizzon (2019) studied served as the nation's implicit transition strategy, focusing on economic growth and high-income status as final goals, with only Chile's plan specifically catering to the possibility of diminishing ODA resources due to the transition (Calleja and Prizzon, 2019, p. 35).

Lopes (2021, p. 42) agrees that "**preparing for a smooth graduation with proper planning and strategies is important**" but notes that Timor-Leste's LDC graduation preparations were not adequately managed, and **no specific government ministry had taken the reins** to oversee the transition compared to Governments in a variety of graduated and graduating nations[14] that **established national committees or working groups**. A working group or national transition committee would not only prepare the strategy in line with national goals but also explore international finance options, negotiate with relevant trading partners and donors to get beneficial terms for the transition period and beyond, as well as monitor post-aid impacts (Lopes, 2021, p. 42).

Vogus and Graff (2015, p. 280) further recommend **conducting political and economic assessments** during the planning phase to detect internal and external vulnerabilities of the proposed transition strategy.

To reduce financial risks and escalating costs, countries need to plan for **changes in the makeup of development financing**, especially when a nation has constraints on its external

[14] Includes Bangladesh, the Maldives, and Vanuatu (Lopes, 2021, p. 42)

borrowing (Engen and Prizzon, 2019, p. 13) as the transition to LMIC does not automatically result in lower levels of official development finance but can mean **more stringent and less concessionary terms** (Prizzon, 2021).

Governments can **protect social progress by "ring-fencing" health and education budgets**, as sectoral allocations can change post-transition with emphasis often shifting away from perceived low revenue producing social sectors towards higher revenue generation sectors such as infrastructure (Engen and Prizzon, 2019, p. 13; Prizzon, 2021).

In order to mobilise external resources (grants and loans), it is also necessary to alter and enhance the current **structures of coordination and communication** between the government and development partners. Engen and Prizzon (2019, p. 13) advise transitioning countries to prepare and "**invest in coordination mechanisms" so coordination between their governments and development partners is improved** including sharing information regarding development partners' plans, such as the timeline of when they want to alter the focus of their programmes or phase them out.

Quarterly dialogues are suggested by Lopes (2021, p. 35) for Timor-Leste's upcoming graduation from a least-developed country (LDC) as a **new forum for cooperation** that will increase trust and confidence to increase private sector investments: meetings between the government, the private sector, and financial institutions to address policies, regulations, opportunities, and difficulties, facilitated by the International Finance Corporation (IFC).

Avoiding Income Traps

UNCTAD's 2016 Information Note posits that **income traps emerge when the structural improvements required to accelerate and maintain economic growth as nations move up the income ladder prove to be more difficult to implement.** The experience of East Asian economies like Hong Kong (China) and the Republic of Korea, as well as more recently (and at lower income levels) China and Malaysia, demonstrate that **income traps are avoidable** (UNCTAD, 2016). This was achieved with policies for new production and export capacity being incrementally developed in high "connectivity" industries paving the way for a gradual shift to more complex and high-value activities that finally narrowed productivity differences thus avoiding the income trap (UNCTAD, 2016).

Other Lessons for Governments

Governments should think about utilising joint funds and creative funding methods. When typical bilateral programmes are curtailed, joint funds with DPs offer an alternative (Calleja and Prizzon, 2019, p. 36). Mexico demonstrated how joint funds may be a useful instrument offering shared accountability and ownership over programming (Calleja and Prizzon, 2019, p. 36).

Multilateral forums could support the development of more mature partnerships, based on cooperation rather than the donor-recipient dynamic, for transitioning nations (Calleja and Prizzon, 2019, p. 38). The instances from Chile and Mexico demonstrated the benefits of **triangular collaboration** for maintaining relationships with donors, building technical know-how, and establishing the transitioning country as a regional hub (Calleja and Prizzon, 2019, p. 38).

NGOs should be looked after by nations or their DPs since their transition from aid is more severe and frequently begins earlier than that of governments, but further investigation is required on NGO sustainability post-aid and what other financing alternatives could be available in such circumstances (Calleja and Prizzon, 2019, p. 36).

Governments should assign management of inbound and outbound flows to a single unit or agency during the transformation phase as some evidence suggests that this can “foster learning” (Calleja and Prizzon, 2019, p. 36).

Box 1: Timor-Leste’s PFM and Governance Reforms

The case study of Timor-Leste’s graduation from LDC status reflects **the critical role of PFM and governance reforms in the economic growth and structural changes required for transitioning countries to sustain and build upon their upgraded country status**.[15]

Infrastructure, Economic, Social Capital, and Institutional Development are the four sectors included in the **Sectoral Working Group to help Timor-Leste prepare for LDC graduation**, as detailed by Lopes (2021, p. 35). DPs and the private sector are assigned to each of these sectors depending on their expertise (i.e., ADB for the infrastructure sector and the World Bank to support the economic sector) as per Lopes (2021, p. 35).

Including the private sector and DPs in the government's ongoing reforms, such as in public administration, law-making, PFM and fiscal management is also recommended for Timor-Leste (Lopes, 2021, p. 36). These changes all have the goal of **addressing structural issues to enhance public service delivery for economic diversification and inclusive, sustainable growth** (Lopes, 2021, p. 36).

To reach the post-graduation goal of 15% of domestic revenue to GDP by 2023, **the Fiscal and PFM Reform Agenda must be implemented consistently** (in Timor-Leste) under all political conditions including **legislation for tax amendments and implementation**, the **diversification of revenue sources**, and **the improvement of the tax and revenue collection authorities' capacity to improve compliance** (Lopes, 2021, p. 36-37).

Modernising the IT infrastructure and guaranteeing e-services for all tax and customs services, to speed up the nation's tax procedures, as well as **technical and legal frameworks for e-services implementation** should be established and enforced as quickly as possible (Lopes, 2021, p. 38). The **implementation of financial regulations ensures fiscal sustainability and macroeconomic stability that are prerequisites for growth and diversification of the economy** which in turn are necessary for graduating countries to progress (Lopes, 2021, p. 38).

E-government is one of the essential components of the ongoing PFM reform, making it the ideal policy framework to assist the government in modernising and enhancing the

[15] Author’s own conclusion

effectiveness, openness, and accountability of public service delivery (Lopes, 2021, p.41). Additionally, it will increase competitiveness since the time and financial expenses of conducting business in Timor-Leste would decrease (Lopes, 2021, p.41).

Annex 1: Lessons for Specific Sectors

Climate Change Assistance

The climate change agenda was frequently mentioned as one area in which donor participation and assistance were appreciated throughout the case study nations. Government representatives were specifically looking for technical and scientific exchanges to develop clean technologies, renewable energy projects, or preserve biodiversity, as well as technical expertise to support drafting applications for funding for climate-related projects to important international organisations like the Green Climate Fund (Calleja and Prizzon, 2019, p. 37).

In the case of Chile, scientific and technological collaboration was seen as a crucial means of maintaining ties with developing partners in the absence of assistance initiatives, particularly in the areas of sustainable energy and the environment (Calleja and Prizzon, 2019, p. 33).

Impact on the Health Sector

Development assistance for health (DAH) has significantly risen over the past few decades and has aided in the advancement of global health objectives (Gotsadze, et al., 2019, p. 258). DAH funds were distributed through bilateral and international organisations as well as global health programmes (Gotsadze, et al., 2019, p. 258).

"**There have been a lot of exits but not many successful transitions**" from donor support in development work, including public health, therefore, unless the transition from donor funding is carefully planned and carried out, public health improvements made by recipient nations can be undermined (Gotsadze, et al., 2019, p. 259).

A nation's ability for national budgeting is determined by its economy, so **the macroeconomic performance of a country post-transition directly impacts its ability to use domestic funding to replace withdrawn aid in the health sector** (Gotsadze, et al., 2019, p. 262). Research findings that show effective transition involves continuous monitoring of a country's macroeconomic performance and fiscal space, as well as present and anticipated spending demands for the health sector (Gotsadze, et al., 2019, p. 267).

Economic development is not always accompanied by good governance, strong institutions, and the capacity to collect taxes and reliably distribute government funds in accordance with budgets so the actual ability and political will to finance health initiatives may lag behind economic expansion and growth (Resch and Hecht, 2018). This also underscores the important role and impact of PFM and governance systems on the health sector post-transition[16].

Huffstetler et al., provide the most recent literature review, in July 2022, of nations' transition journeys where they find that countries **experience reductions in development aid for the health sector when they shift from low-income to lower-middle-income status and must "transition" to more domestic funding for their health programmes.** They observe that the literature thus far lacks thorough assessment of the impact of donor exits on such countries' health systems (Huffstetler et al., 2022).

The activities of both donors and national governments have an impact on aid transitions and impact every limb of the health system (Huffstetler et al., 2022). Leadership, planning, and pre-transition investments in a country's financial, technological, and logistical capability are crucial to achieving a seamless transition, as per evidence from successful transition cases (Huffstetler et al., 2022).

Because programmes grow via complex adaptive systems and respond to shifting environments, the **transition is increasingly treated as a process rather than an end**. Therefore, in order to achieve sustainability after donor funding has ended and to maintain or expand the public health gains made during donor support, **the activities and policies put in place during transition must adapt to changing demands** (Gotsadze, et al., 2019, p. 260).

Six key steps for an effective transition to country ownership of healthcare are highlighted by Vogus and Graff (2015, pp. 277-279):

(1) develop a clear plan; (2) include stakeholder participation; (3) communicate the plan including potential challenges; (4) ensure midterm assessments to enable adaptability; (5) strengthen financial, technical, and management capacity throughout the implementation of the plan; and (6) support long term monitoring and evaluation to provide data.

Resch and Hecht (2018) and Gotsadze, et al., (2019, p. 267) also **suggest similar key strategies and tools to assist** in a successful transition from donor funding:

a) Using a collaborative and coordinated method for managing transitions with pre-transition readiness assessments.

b) A transition strategy that proactively mitigates identified risks.

c) A framework for monitoring the transition process.

d) A method for ensuring mutual accountability.

[16] Author's own observation

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Key websites

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