



# Public expenditure and financial management in fragile states

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Overseas Development Institute**

Development Policy Centre, ANU  
5 March 2013



## What is ODI?

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- The Overseas Development Institute is...
  - Europe’s leading independent think tank on international development and humanitarian issues (ranked 2<sup>nd</sup> in the world)
  - Over 50 years old
- ODI’s mission is...
  - “to inspire and inform policy and practice which leads to the reduction of poverty, the alleviation of suffering and the achievement of sustainable livelihoods in developing countries”



## What is ODI?

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- ODI comprises 12 thematic research programmes and a total of 200 staff
  - Major research programmes:
    - Centre for Aid and Public Expenditure (20+ staff)
    - Climate Change, Environment and Forests programme (20+ staff)
    - Politics and Governance programme (10+ staff)
    - Humanitarian Policy Group (18 staff)
  - Flagship initiatives:
    - Budget Strengthening Initiative for fragile states (BSI)
    - Development Progress Stories
  - ODI Fellowship Scheme
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# ODI Budget Strengthening Initiative for fragile states

Marcus Manuel, Alastair McKechnie



# Effective, transparent & accountable budgeting

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## **What we do**

- Policy advice, Implementation & Research

## **Three pilots to date**

- South Sudan, Liberia & DRC

## **Under consideration**

- Myanmar
- Afghanistan
- Somaliland

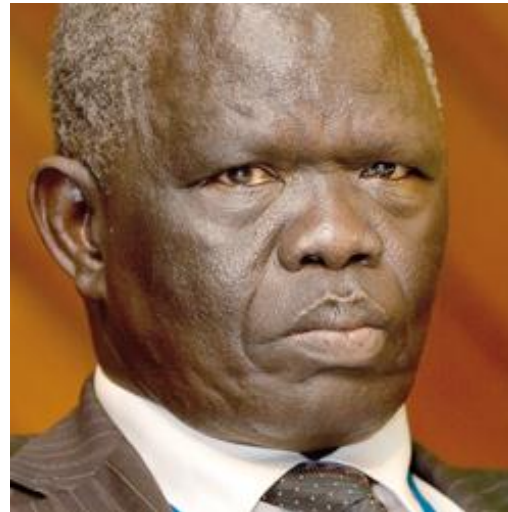


## Provide support to reformers

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Brian d'Silva

Minister's adviser



Aggrey Tisa Sabuni

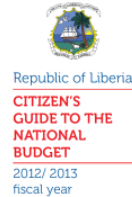
Economic Advisor to  
President of South  
Sudan

Sheila Kigozi

Ugandan "ODI  
fellow"





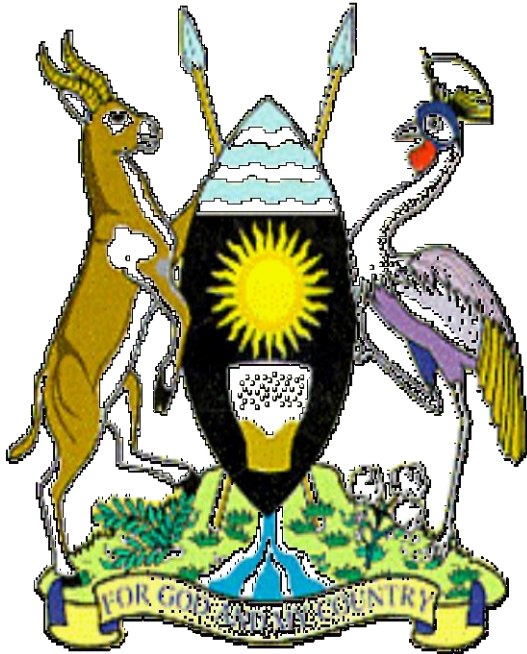


- Supporting Uganda's **Parliamentary Budget Office**
- Improving the reporting and **transparency of budget formulation** in South Sudan
- Assisting with the production of a **citizen's guide to the budget** in Liberia
- Exploring how to use **mobile phones** to disseminate information on the budget in Uganda

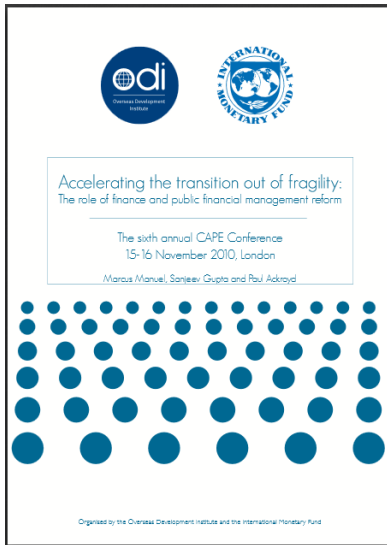


# Peer to peer learning: Uganda & South Sudan (& ODI)

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**Budget  
strengthening  
Initiative**





## New Deal: One year on at UNGA

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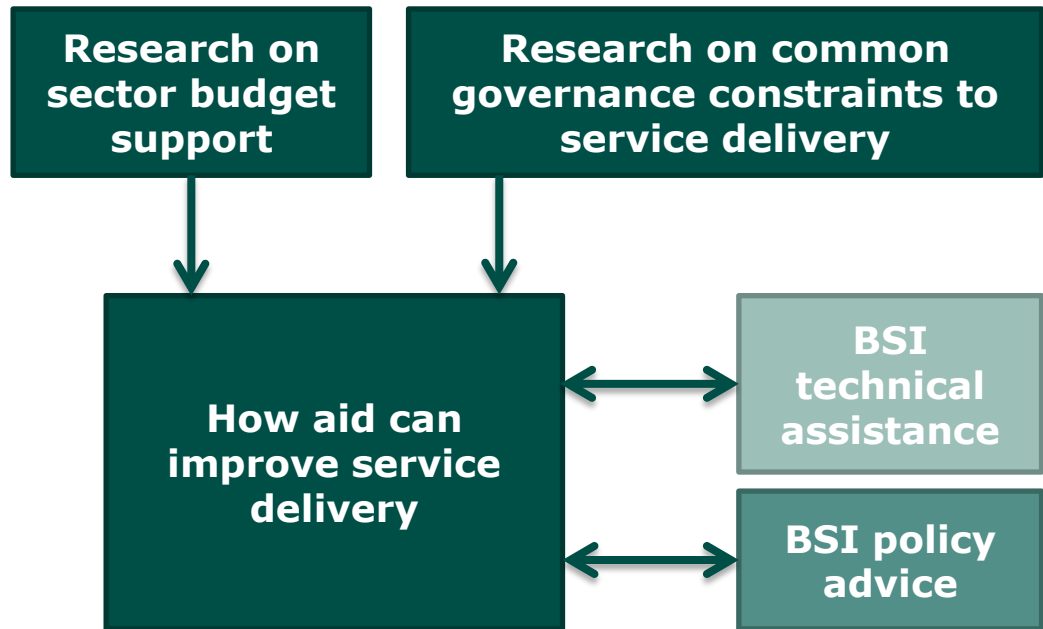




# Research & policy - feedback loop

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- BSI's Tim Williamson and Catherine Dom publish papers on sector budget support, concluding '*service quality at the front line will not happen automatically*'
- BSI supports improvement in service delivery in South Sudan
- BSI/CAPE/POGO launch research stream on how aid can help overcome governance constraints to service delivery





## What is the model & what is valued

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### **Independent**

- Neutral – not one of the donors
- Not for profit, not a consultancy

### **Demand-led**

- “No TORs” – have to respond to most pressing issue
- Implementation not ideas



## What is the model & what is valued (2)

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**Speed**

**Catalytic**

**Style**

- High level advice “without egos” “invisible”
- “Think like us”
- Confidential
- Collaborative – IMF MOU

## ARMS LENGTH SUPPORT

*“Overall, we think the way ahead is to liberate the positive potential of external assistance by disconnecting it as far as possible from supply-side pressures that render it irrelevant, if not harmful, as a factor in the political economy of African development”*

The political economy of development in Africa:  
A joint statement from five research programmes  
March 2012

# The power of stories of Development Progress

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## Cambodia's progress in education

Re-establishing a more inclusive primary and secondary education system.



## Vietnam's progress in economic development

Joining the ranks of middle income countries.







# Prioritise Peace and State building goals

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- Politics for all
- Security for all
- Justice for all
- Jobs for all
- Resources for all



**Implementation of Investments,  
On-Budget by Governments**



## Implementation: A key challenge

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- BSI found that capacity to implement investments was a major constraint to executing public expenditure for results.
  - Major issues include:
    - Decisions on what should be built where – an investment planning problem.
    - Decision making process in divided Cabinets & neo-patrimonial settings – a collective action problem.
    - Procurement decisions – includes complexity of process for FCAS.
    - Project management capacity – bring back The Engineer & qualified problem solvers in donors.
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## Implementation : Some ways forward

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- Targeted TA to assist government plan and take decisions – strengthen the technocratic element to focus political choices.
- De-fragment: consolidate small projects into national programs.
- Streamline procurement rules & shift rapidly to country systems. Issue is how to manage & mitigate risks, not whether to use country systems.
- Contract out fiduciary services while building national capacity in parallel.
- Encourage governments to select 5-10 projects/programs for special oversight by inter-ministerial committee with support staff.



## Pooling funds and risks

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- Transaction costs for countries in dealing with multiple donors, fragmented projects, and many donor operational and reporting processes.
  - Donor driven project aid weakens accountability of government budget processes and usually undermines local capacity.
  - Challenge for donors to stay engaged for the decades needed for local institutions to develop.
  - Dominant donor (and recipient countries) might prefer a multilateral face to development assistance.
  - Multi-donor pooled funds can contribute to resolving these problems. (Also well designed sovereign wealth funds).
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## Pooled funds: ... continued

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- Pooled funds also share risks among fund donors and transfer risk to the pooled fund administrator.
  - Pooled funds usually use country PFM systems, reinforced where necessary by special controls, e.g. contracting out procurement & accounting, monitoring agents, e.g. Liberia health, Afghanistan ARTF.
  - Pooled funds, including MDTFs, need to be designed well with clear responsibilities and accountabilities.
  - Administrator needs to be held accountable for delivery and for putting right staff in country.
  - Better process needed for selecting administrators when crisis ends, e.g. competitive proposals.
  - Delivery of development services by humanitarian agencies (including UN) needs a new approach, including more competition, stronger contractual frameworks with clear obligations and responsibilities to governments, in return for more predictable funding that can cover their core costs.
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## Implementation & Procurement Lessons from Afghanistan



## Program implementation in Afghanistan: General lessons

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1. International partners were willing to take risks, because of geopolitical implications of failure in Afghanistan, but not always the case.
2. Some partner organizations aligned behind government program, e.g. World Bank, but many others bypassed government to deliver services through humanitarian channels that were not sustainable.
3. Possible to selectively support reforming ministers with strategic vision committed to development.
4. Build on institutional capacity that exists & use community based approaches & non-state actors.
5. Design programs for both short term results, e.g. rehabilitation using emergency procedures, and longer gestation capacity & investment, e.g. infrastructure.
6. Defragment – consolidate projects into national programs.
7. Support grant coordination & management units in key ministries to manage all donor funds flowing on budget & to become permanent departments.
8. Put high quality people into country offices and decentralize decision making from HQ.
9. Question sector ideologies – be heterodox and pragmatic.



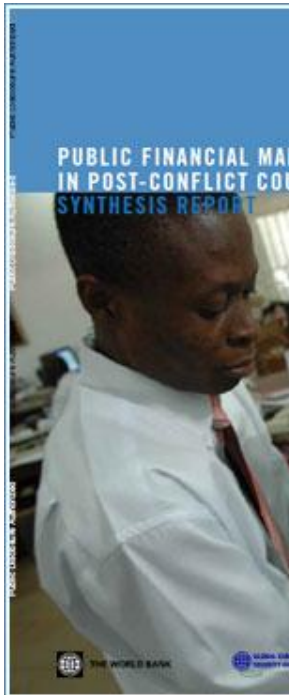
## Program implementation in Afghanistan: Belling the public procurement cat

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1. Government central focus and buying-in of temporary procurement capacity.
2. But build permanent procurement capacity in parallel with different advisors from transaction processing.
3. Exploit flexibility which exists in donor procurement rules, e.g. for natural disasters.
4. Don't waste effort initially on new procurement laws and rules unless capacity to implement them exists and they are necessary for results, and donor ready to use them itself.
5. Package procurement to allow for local competitive rather than international bidding. Adapt to local commercial conditions and help build local private sector).
6. Build related institutions that strengthen good procurement, e.g. financial reporting, auditing, parliamentary oversight.
7. Differentiate & manage corruption risks, including for non-donor funds which can erode the legitimacy of the state.
8. Balance & manage fiduciary, program delivery & security risks, e.g. recurrent cost financing & ineligible expenditures.
9. Contracting (including tendering) for NGOs and UN Agencies. Controversial but helped humanitarian to development transition.

**Public Finance  
Reform in Post-  
Conflict Countries**  
*Evidence from Cross-  
Country Research*

Edward Hedger



## Briefing Paper 77

October 2012

### Public financial management reform in fragile states

Grounds for cautious optimism?

**Key points**

- Fragile states with very low income and capacity can make substantial progress with public financial management reform
- New research suggests that efforts to strengthen budget execution out-perform work on other dimensions of public financial management
- But we still need to know more about how public financial management reforms can contribute to better service delivery and state-building

Overseas Development Institute ODI is the UK's leading independent think tank on international development and humanitarian issues. ODI Briefing Papers present information, analysis and key policy recommendations on important development and humanitarian topics. This and other ODI Briefing Papers are available from [www.odi.org.uk](http://www.odi.org.uk)

**Public financial management (PFM) reform is a priority for fragile states. If a state can't tax reasonably or spend responsibly a key element of statehood is missing. The guidelines on state-building in situations of fragility and conflict established by the Development Assistance Committee of the OECD (DAC) emphasize PFM (OECD, 2011). Yet, the evidence on what works and what doesn't is limited. Andrew's study of PFM reform in Africa points out that six fragile states in a sample of 31 countries perform far worse on PFM, including budget execution, with Sierra Leone the only exception (Andrews, 2010).**

This Briefing Paper outlines the findings of a recent study by the World Bank and ODI (World Bank, 2012), which sheds new light on PFM reforms in fragile states. It suggests that even though fragile states may perform less well than non-fragile states overall, substantial progress is still possible. More surprising is the evidence that, of the different dimensions of PFM, the most progress has been made on budget execution. However, there are critical gaps in our knowledge of the relationship between PFM, statehood and development progress.

**Country comparisons of PFM reform**

New evidence reveals substantial progress on PFM in certain fragile states – even in countries with low public-sector capacity, legacies of protracted conflict, and low income levels. This finding emerges from a qualitative assessment of eight countries (World Bank, 2012): Afghanistan, Cambodia, the Democratic Republic of the Congo (DRC), Kosovo, Liberia, Sierra Leone, Tajikistan and West Bank and Gaza. In each, it was at least eight years since the start of PFM reforms – usually as part of post-conflict reform efforts. Substantial progress was defined as improvement across all dimensions of public expenditure management (budget preparation, budget execution, accountability and oversight), leading to well-established systems in at least some areas.

Four of the eight countries showed substantial progress, two some progress, and two only limited progress. This finding suggests that state fragility, war and protracted conflict do not automatically prevent the relatively rapid improvement of PFM systems once reconstruction begins. Progress spanned regions, colonial heritage, income level and territorial size. Where progress was substantial, there was always evidence of quite advanced reforms, such as automated financial management information systems. This evidence should, however, be treated with caution. Four cases out of eight do not permit generalisation across all fragile states, and statements based on generalised rates of success alone are not meaningful. It would be better to ask whether the countries in this sample have characteristics in common with other countries that might provide lessons for application elsewhere.

Two of our sample countries are middle income: Kosovo and West Bank and Gaza. They are also the two cases where a central

Money changer at a bazaar in Afghanistan

Shaping policy for development

## Comparative study of eight post-conflict countries

Afghanistan, DR Congo, Cambodia, Kosovo, Liberia, Sierra Leone, Tajikistan, West Bank and Gaza  
 Generally 7-10 year time horizon, Cambodia longer

Focus is on post-conflict countries rather than *fragile* states overall



## Starting years and relative progress on PFM rebuilding and reforms

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Country	Post-conflict 'starting point'	Relative progress by 2010
Afghanistan	2001-02	Substantial
Cambodia	1991-93	Intermediate
DR Congo	2001	Limited
Kosovo	1999	Substantial
Liberia	2003	Intermediate
Sierra Leone	2002	Substantial
Tajikistan	1997	Limited
West Bank & Gaza	1993-2002	Substantial

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# What motivates and enables governments to pursue PFM reforms?

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- Institutional legacies and whether countries saw continuity or a switch to different systems also less relevant than expected
    - Range of institutional legacies represented: variations of communist, Francophone, US- and UK-Anglophone and others
    - Successful reformers included relatively greater continuity (Sierra Leone, Liberia) as well as those embarking on a complete overhaul (Kosovo, Afghanistan)
    - Some problems emerged when different institutional models 'overlap' (Cambodia)
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## Low capacity was not a binding constraint

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- Significant progress has been possible even in environments in which capacity was initially very weak or eroded
  - Significant use of capacity substitution (especially in SL, Liberia, Afghanistan) and supplementation
  - This helped to short-circuit capacity in the short to medium term
    - Problems with transitioning to longer term sustainable capacity
  - Sustained development of local capacity happened primarily in the two middle income cases – Kosovo and WBG
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## Government motivation appears as the decisive factor

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- Governments seeking external support and recognition have tended to facilitate greater progress on PFM reforms
    - HIPC debt relief or seeking international recognition were influential and pushed PFM engagement and results
    - Motivation in response to incentives – not ‘random’ political will
    - Domestic demand side had relatively limited influence on PFM reforms
  - Any reform effort and support to reforms has to contend with the fact that ministerial turn-over tends to be high
    - Especially during early post-conflict years
    - Heads of state appoint ministers of finance strategically
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## Drivers of reform selection and sequencing

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- **Donors and their assessments were dominant (but problematic)**
  - Initial approaches were ad hoc before the emergence of coordinated reform efforts and measures...
    - Comprehensive and integrated PFM reform programmes (SL, Afg)
    - Introduction of formal sequencing methodologies (e.g. 'platform approach' variants) (Cam, SL, Kos)
    - Improvements in donor coordination based on reform plan (SL, Lib)
  - Weakness in the autonomous agenda-setting capability of government for reform boosted the strong external influence on reform measures and approaches (except WBG)
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## Reform coverage: rules and organisation

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- **Legal framework was not critical**
    - Comprehensive reform of legal frameworks did not happen quickly across the cases (up to eight years) (Taj, Lib, DRC), and followed initial reform of systems and practices rather than driving them
    - However, enactment of comprehensive legislation is only a partial measure of progress (drafting laws, government approval, parliamentary assent)
    - Piecemeal legal reforms were sufficient initially, but created some incoherence and gaps (especially for fiscal decentralisation) (DRC)
    - Reform of the legal framework did not ensure changes to actual practice ('de facto' reform), because of capacity constraints and limited 'political will'
  - **Organisational arrangements matter**
    - Some mergers/splits (Lib, DRC), but separate ministries of finance and planning (except SL, Kos) have undermined comprehensiveness
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# Reform coverage: budget cycle (1)

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- **Budget formulation improved in basic terms**
    - Getting the annual budget back up and running was an immediate priority in most countries (Afg, DRC, Lib)
    - Focus on basic MTEF and fiscal aggregates in all cases, with emerging MoF capacity in macro-fiscal forecasting and analysis (Kov, SL)
    - More complex and ambitious budget formulation reforms were tried (especially MTEF), but had limited traction because of technical and political challenges (SL, DRC, Taj)
    - Programme budgeting was attempted (Afg, Cam, Lib, SL) without success in any of the cases
    - Widespread efforts to integrate recurrent and investment budgets were undermined by weak policy linkages, slow procurement processes and substantial off-budget aid
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- **Budget execution showed strong specific progress**

- Restoring basic fiscal control through cash-based expenditure management was a priority (Afg, DRC)
  - Early and consistent attention was given to budget execution issues and produced relatively strong results:
    - Chart of accounts revision, centralisation of cash management through TSA, automation of central treasury system, implementation of commitment controls
    - Sub-national roll-out of FMIS (Kos, Afg)
  - In-year and end-of-year fiscal/financial reporting has shown major gains (SL, WBG, Lib, Taj)
  - Legal, institutional and procedural reforms were prevalent in procurement, but not matched by better procurement practice
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# Reform coverage: budget cycle (3)

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- **Budget accountability and oversight was marginal**
    - Early and sustained attention to external audit in some cases (Afg, SL), but later focus elsewhere (Kos, Lib)
    - Legal framework reform was important for external audit, especially establishing the independence of the Auditor General (SL, Lib)
    - Full or partial outsourcing of external audit compensated for weak capacity and provided additional safeguards to donors
    - Despite parliamentary engagement on budget approval, ex post oversight and audit follow-up were among the weakest areas of PFM
    - Vertical (citizen-state) accountability has emerged selectively (Lib, DRC, WBG), but remains a relatively weak force
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- **Primary focus was on central finance agencies**
    - Strong reform emphasis on strengthening the central finance agency (usually MoF), with the primary objective to (re)establish control and fiscal discipline
    - Central control was also established in some cases by reducing the discretion of line ministries and sub-national governments (e.g. through TSAs) (WBG, Kos)
    - Engagement with line ministries and sub-national tiers started later and targeted only key service delivery line ministries
    - Extending PFM measures to full geographical territory was limited, slow and challenging (Afg)
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## Practical and Policy Implications

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1. There are **no standard reform sequences** and no evidence that reform plans going beyond a small number of years are sensible or realistic
  2. Implications taken from this study need to keep the small sample size in mind
    - Governments should make informed choices about institutional change
  3. It is more sensible to think of **incentives for and against PFM reforms**, rather than monolithic (and elusive) “political commitment”
    - Actors with incentives to pursue reforms seem to be the most critical bottleneck – more so than weak capacity
    - PFM reforms should be calibrated to the available space & avoid excessive or premature recommendations
    - Significant implications for the way donors engage on PFM reforms – in terms of understanding incentives & calibrating PFM support and being strategic in overall engagement
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## Practical and Policy Implications

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4. Evidence suggests that **budget execution reforms** are more likely to gain traction, even if reforms become quite “advanced”
  5. Advanced **budget preparation reforms**, such as MTEFs and PBBs have had little traction and can be costly in terms of effort and attention
    - The inspiration of planning resources beyond single years, and making budgets more informative remain, but more practical solutions needed
  6. Changes to the **legislative framework of PFM** usually come later in the reform process – there does not seem to be a case for early reforms in this area
  7. Attention to capacity includes considering **pay and other civil service reforms** early and in a sustained fashion – every single country in the sample struggles to attract and retain capable staff
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The views presented here are those of the speaker, and do not necessarily represent the views of ODI or our partners.

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