Less can be more when small isn't always beautiful

By Tobias Haque
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Public Financial Management (PFM) systems in Pacific contexts are often very different from the sophisticated and comprehensive systems operating in larger, wealthier countries. Those working on PFM in Pacific contexts must grapple with difficult questions: What needs to be done, when achieving across-the-board "good practice" standards is not feasible? What should be done immediately, and what can wait? How can reforms be implemented and sustained in the context of very small public services and shortages of staff with vital specialized skills (as described in our previous blog post here)?

My new Guidance Note [pdf], produced jointly by the World Bank and IMF/PFTAC, is intended to help government officials and donor agencies answer such questions. Drawing on regional experience, the note emphasizes the importance of: i) prioritizing PFM reform efforts towards specific development problems; and ii) considering a broader range of mechanisms to address capacity constraints.

Prioritize PFM reforms towards specific development problems

With limited capacity and resources available to support improved PFM systems in Pacific Island Countries (PICs), plans to implement the full range of "good practices" seen in developed countries (and measured in PEFA assessments) are seldom feasible.

Prioritization of reforms is therefore vital and should be guided by identification of the PFM reforms that are likely to have the greatest impact in achieving development objectives and policy goals. Development priorities will vary according to country context, and PFM priorities should therefore also vary across countries.

By linking PFM-related development challenges firstly to PFM weaknesses and then to specific reforms to address weaknesses, PFM priorities can be identified that reflect national development priorities. PFM practitioners can begin with the broad problem they wish to address and then target resources towards a small number of specific reforms that might address that problem. A framework to guide this process is presented below and elaborated in the table below:

If… Development Challenge	Because… Secondary problem	Because… PFM weakness causing the problem	Then… Priority reform to address the problem
Budgets lead to unsustainable deficits	• Revenue falls short of forecasts	• Revenue forecasts are unrealistic	• Improve forecasts
	• Revenue forecasts are adequate, but expenditure exceeds sustainable levels	• Upcoming expenditure obligations are not reflected in the budget	• Improve tracking and budgeting for possible liabilities and pressures
		• Allocations are increased to finance new discretionary programs during the year	• Improve transparency and justification of expenditure decisions, and build buy-in to the budget
		• Inadequate controls to prevent aggregate expenditure exceeding allocations	• Ensure controls are appropriate and enforced
Budget allocations do not reflect Government priorities	• Plans are inadequate to inform budget development	• Plans are not prepared, or have weak ownership or do not provide a realistic basis for prioritizing resources	• Improve quality of plans and build ownership through consultation
	• Plans are adequate, but not reflected in budgets	• Administrative problems impede integration of planning and budgeting	• Alignment of budgeting and planning, through shared staff, timelines, and documents
		• The Executive and Parliament have inadequate opportunity to ensure that their priorities are reflected in budgets	• Strengthen processes for Cabinet and Parliament oversight of budget formation and execution
		• There is insufficient flexibility in the budget to give effect to plans	• Provide executive with sufficient information to make substantial reallocation decisions
Budgets are not executed as appropriated	• Cash flow problems disrupt execution	• Expected cash is not available to the Ministry of Finance	• Improve revenue forecasting and build cash reserves
		• Information on line ministry cash needs is inadequate	• Improve forecasting of cash needs and information on flows
		• Additional expenditure during the year forces cash rationing	• Improve processes for authorization and financing of new spending
	• Ministries reallocate resources away from allocations	• Expenditure controls are inadequate, unsuitable, or not enforced	• Improve expenditure controls
	• Allocations are changed throughout the year to meet in-year pressures	• Inadequate allocations to anticipated in-year expenditure pressures	• Ensure anticipated pressures are budgeted for
Inefficiency and ineffectiveness in spending undermine service delivery	• Inadequate systems to ensure good-quality spending	• Weak internal controls lead to low-quality inputs and waste	• Improve the quality of controls
		• Systems provide excessive or inadequate flexibility in input mix	• Achieve balance between control and flexibility in budget systems
	• Inadequate transparency and oversight of spending decisions	• Insufficient information is available to Cabinet and Parliament	• Improve quality and dissemination of budget and service delivery information
		• Available information is not being used	• Ensure processes encourage use of available information by Cabinet and Parliament

Consider a broader range of mechanisms to address capacity constraints

Shortage of staff with required technical skills is one of the primary constraints to PFM reform in PICs. Capacity building is commonly cited as a means to address capacity constraints. But capacity building will not be an adequate solution if there is an absence of specialized technical skills that cannot be acquired through short-term, on-the-job training. Capacity building efforts may also be undermined if there are simply not enough staff available to undertake required tasks or if there is high staff turnover. As a result, advisors formally engaged in capacity building roles often find themselves undertaking capacity supplementation and capacity substitution. Such non-transparent arrangements lead to inadequate accountability and inappropriate reporting arrangements.

In certain contexts, capacity supplementation and capacity substitution can be legitimate alternative mechanisms for filling capacity gaps. "Capacity supplementation" involves the provision of continuing support to staff undertaking certain functions, delivered through advisors, regional institutions, internship schemes, and regional professional bodies. "Capacity substitution" involves "outsourcing" of specific PFM functions on a long-term basis, with external specialist individuals or agencies performing line functions on a long-term or permanent basis.

Claims that such solutions are less sustainable than capacity building need to be carefully tested given the opportunity costs of staff time used in acquiring and applying new PFM skills, and the mixed success of capacity building efforts in the region. The possible benefits and necessary conditions for capacity supplementation and capacity substitution are outlined in the following table:

	Possible benefits	Necessary conditions
Capacity Supplementation	• Allows access to skills that are not available locally • Can be quickly deployed	• Adequate financing required • Need to ensure sustainability, either through certainty that required resources will be available for continued TA assistance, or by ensuring that there is adequate transfer of skills to allow local staff to continue the function once TA is complete • Requires adequate oversight and monitoring to ensure that TA is providing appropriate advice and assistance.
Capacity Substitution	• Allows access to skills that are not available locally • Can reduce burden on existing staff, allowing them to focus on other tasks • Can be quickly deployed with skills accessed only when needed	• Sovereignty concerns must be managed • Adequate resources to finance outsourcing required over the long-term to avoid disruptions in functions due to financing constraints • Sufficient local capacity is required to manage an outsourcing process, including procurement and contract management.

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Tobias Haque has worked on economic development in fragile states for the past decade, and is currently a PhD student at the Department of Pacific Affairs at ANU and the World Bank's Senior Country Economist for Afghanistan. He holds Masters degrees in finance and sociology and undergraduate degrees in economics, political science, and development studies.