

Public Financial Management in Fragile States

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Effective Public Financial Management (PFM) in fragile states is a critical foundation for basic economic governance and in establishing the performance, legitimacy and accountability of functional states. Extreme poverty is increasingly located in these countries, which face multiple challenges of ongoing conflict, instability and resource constraints, both financial and human. A June 2015 summary ICAI review¹ noted that three quarters of DFID's priority countries are now affected by conflict and fragility and forward estimates reinforce the notion that fragile states will continue to be the location for those in most need of support and assistance. In addition, the ICAI review identified that one of the most common barriers to progress identified by DFID in its Country Poverty Reduction Diagnostic was weak core state capacity in tax, budgeting, and financial management, and the direct impact of this on the ability to implement policy and deliver public services.

This package of readings therefore builds on those cited in the [Public Financial Management](#) reading pack. While the broad principles of PFM in all countries also apply in fragile states, there are a number of areas which require special attention. This note summarises these areas, highlights case study material that provides specific insights, and identifies areas of focus for those engaged in and supporting PFM reforms in fragile states.



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¹ DFID's approach to delivering impact, ICAI report 45-June 2015. <http://icai.independent.gov.uk/wp-content/uploads/2015/02/ICAI-Report-Assessing-the-Impact-of-the-Scale-up-of-DFID%E2%80%99s-Support-to-Fragile-States.pdf>

Important distinctions

While fragile and conflict affected situations share some broad common characteristics they are all different in their own ways. Context matters and needs to be understood (see Reading 1). This entails an assessment of a country's assets and attributes, the underlying trajectory of development, as well as the overarching political settlement. The cross country case studies highlighted in Readings 3 and 4, which cover a range of post conflict countries, exemplify this particular point.

There are, however, a number of significant factors which are highlighted by Symansky in Reading 2.

These include:

Low levels of human capacity. This will have implications both for the initial deployment of technical assistance (and its form and content) as well as creating an imperative to systematically develop capacity (human/organisational/institutional) in line with systems, processes, and institutions. Low human capacity in fragile settings is due to several causes which include emigration, the absence or deterioration of the education system, distorted incentives and clientilistic appointments, which need to be understood and addressed whenever possible.

Low levels of domestic resource mobilisation in relation to need. While this remains true of many countries it is a particular feature of fragile states. The tax base is narrow and in some countries is highly dependent on natural resources. Government may not be able to collect taxes and duties and rival power centres may levy informal taxes and charges.

Physical capacity, basic operating systems and processes will also require attention. This feature may be heavily dependent on the nature of the conflict and the emerging political settlement. Physical infrastructure may need to be developed or rebuilt, the banking system may have extremely limited reach and basic systems and processes may need to be established or re-established. Irrespective of the quality of institutions at the central level there are likely to be real constraints at the local level, which will have a direct impact on the decentralisation of power and the delivery of local services.

Managing the tension between a short term focus on security and stability and longer development needs. The prioritisation challenge facing many fragile states is an acute one. It applies not only in the assessment of immediate priorities but also in the choice between current consumption and delivering services as well as investment for the future in areas such as basic infrastructure and post-primary education. Understanding the context is critical to helping a country reach the right balance, as stability and peace-building may depend more on factors other than equitable public service delivery. Strengthening PFM in the security sector and moving away from cash based transactions may represent areas where initial attention needs to be focused.

External assistance is likely to be a significant part of the funding landscape, but governments struggle to manage it. Fragile states are typically aid dependent and are challenged in managing and monitoring inflows, ensuring that they are directed and used effectively, as well as by multiple and competing reporting requirements of donors. High levels of donor assistance can have a knock on effect on state capacity as competent staff move from government to the plethora of international agencies. Aid fragmented into small projects is difficult for the government to coordinate and to integrate into its budget processes.

Where has progress been made?

The case study review of eight countries emerging from conflict (see Readings 3 and 4) highlight a number of key messages. They point to the importance of maintaining a focus on the basic functions of the PFM system with a particular focus on budget execution rather than budget formulation.

Some basic reforms can in fact be very challenging. Procurement reform is often at the centre of fiduciary concerns but it can also be at the heart of rent seeking and clientilistic behaviour by elites. Reform in this area is often highly contentious.

In the area of budget formulation, the studies show it is better to focus on some basic reforms, such as addressing budget credibility, rather than more advanced reforms such as multi-year frameworks and program budgeting.

The case studies highlight the progress with accountability and oversight in a number of countries where focused efforts together with political support can make a real impact. Capacity substitution and supplementation approaches supported by international partners in a number of countries were pivotal in the implementation of PFM reforms. However while this often creates a short term dividend it can also create perceptions of inequity within the Ministry and create difficulties in transitioning away from external support.

Where should attention be focused?

The case studies demonstrate that real progress can be made in developing public financial management in difficult fragile settings. The Budget Strengthening Initiative, which is working in South Sudan, Liberia, and Democratic Republic of Congo (DRC), has also been able to demonstrate how PFM can be strengthened in some very fragile environments. The mid-term evaluation of BSI (see Reading 6) points to a number of success factors. Drawing these together with the results of the case studies enables us to identify characteristics of successful interventions in PFM reform in fragile states.

These include the need to:

Maintain a focus on budget execution. Priority should be given to reforms that improve the ability to see what the government is spending its money on across all stages of the budget cycle, improving cash management, and extending and developing relevant systems. Cash Management takes prominence in many countries as it helps specifically at the point where decisions on how resources are allocated are made. The case studies show that there is no standard reform design or sequence for strengthening budget execution. The processes that were chosen depended on what PFM system already existed, country characteristics, and the mobilisation of commitment by the political and technical leadership.

Recognise that the *way systems and processes are developed is more relevant to how they function than their form.* Partners should want to facilitate institutions that deliver impact rather than just mimic good practice. Building local legitimacy, ownership, and capacity needs to happen alongside improving systems and processes.

Address the lack of co-ordination between international partners and government, across and within government, and across development partners that undermines forward momentum. Information is not shared, there is duplication of activity, and governments only have a partial view of how resources are being allocated. This in itself undermines the effectiveness of all expenditure. Working together to capacitate government to co-ordinate can also develop and enhance collaboration and coalition building.

Build flexibility and adaptation into programme design, implementation, and monitoring. An assessment and reporting framework needs to adapt and respond to circumstances on the ground and be used to guide and shape the next stage of reform. The phrase used in Reading 5 is the “importance of solving problems, not selling solutions.”

Apply the precepts set out in the New Deal for engagement in fragile states. This sets out a set of principles to ensure that resources (including aid) can be used effectively for results. The TRUST principles set out key elements of partnership in fragile states and stand for:

Transparency in the use of aid and domestic resources.

Risk-sharing involving the joint identification, monitoring and sharing of risks, especially when peace-building is a priority.

Use of country systems. While this remains challenging to many partners, there are a variety of measures which can be explored to address fiduciary concerns, such as recipient governments contracting in temporary capacity and ex post expenditure monitoring, while PFM systems and capacity are being strengthened.

Strengthen capacities. This principle recognises the imperative to build capacity, to work to reduce programme implementation units and look to ensure that external technical assistance reports to the national authorities.

Timely and predictable aid which in itself will greatly improve budgeting and financial management in recipient countries.

Overall leadership that supports change is needed for PFM reforms to move ahead. BSI has however learnt that change can be driven forward within a department or ministry by senior and middle level managers. The overall environment needs to be permissive but it is not always necessary to wait for ministerial approval before actions and developments are taken forward. Ministers and top level staff within a ministry like Finance often have extremely limited time to focus on specific issues. They also do not usually stay in post long (the tenure of Finance Ministers in the case studies was typically between 2 and 4 years). Political commitment and leadership is important but it is prudent to look for and build a more distributed form of leadership.

PFM reform in fragile states is also seen as an important part of state-building. While other factors obviously play a role, the interim conclusions from the case studies are that the state-building impact of PFM reform is particularly significant when it is associated with greater attention to domestic accountability, the development of sustainable capacity and a clear focus on supporting and delivering services.

Key readings

Reading 1: Porter, D., Andrews, M., Turkewitz, J. & Wescott, C. (2010). *Managing Public Finance and Procurement in Fragile and Conflicted Settings*. World Development Report 2011 Background Paper. Washington, DC: World Bank.

http://web.worldbank.org/archive/website01306/web/pdf/wdr%20background%20paper_pfm.pdf

This paper gives an overview of the performance of fragile and conflict affected states. It highlights the disconnect between the laws, rules and procedures adopted for better public finance and procurement and their actual functionality. The changes in the nature and volumes of resource flows, both domestic and international, have affected the incentives to which governing elites respond in fragile settings. The central challenge in public finance and procurement interventions is to positively influence the incentives to which elites, national as well as local, inside and around public authorities, respond in contexts of fragility.

Reading 2: Symansky, S. (2010). *Donor funding and Public Finance Management (PFM) reform in post-conflict countries: Recommendations derived from personal observations* (Discussion Paper). London: ODI/IMF.

<http://www.odi.org/sites/odi.org.uk/files/odi-assets/events-documents/4518.pdf>

Symansky draws from his extensive practical experience in five post conflict countries and he makes a series of recommendations on how to address PFM reform in these contexts. His conclusions resonate with those in subsequent readings but Symansky's focus on what can be done immediately after a conflict includes some specific data on the use of trust funds, mechanisms of dual signatory arrangements (which were used in the immediate post conflict period in Liberia), as well as the role of international expertise in line management positions.

Reading 3 and 4: PFM in post-conflict countries

Hedger, E., Krause, P. & Tavakoli, H., (2012). *Public financial management reform in fragile states: Grounds for cautious optimism?* (ODI Briefing Paper). London: Overseas Development Institute.

<http://www.odi.org/publications/6852-public-financial-management-conflict-affected-fragile-states-cautious-optimism>

Fritz, V. (2012). *Strengthening PFM in Postconflict Countries: Lessons for PFM Practitioners and Country Programming Staff*. Washington, DC: World Bank.

http://siteresources.worldbank.org/PUBLICSECTORANDGOVERNANCE/Resources/285741-1361973400317/GPSM1_v1.pdf

These readings summarise a cross-country study (the country cases include Afghanistan, Cambodia, DRC, Kosovo, Liberia, Sierra Leone, Tajikistan, and West Bank and Gaza) of PFM reforms in post-conflict situations. They show that substantial progress is possible even in difficult circumstances. Post-conflict environments can offer real opportunities but implementation needs to proceed with caution and with attention to the specific country environment and dynamics. The reform experiences across countries suggest that there is no single best practice in sequencing or approach that can be applied. Rather, support to strengthen PFM in post-conflict situations should be based on three essential components: drawing relevant lessons from other post-conflict trajectories, a sufficient understanding of the (evolving) status quo and of current key bottlenecks in PFM, and attention to calibrating reforms to existing windows of opportunity and evolving capacity.

Reading 5: Andrews, M., Pritchett, L. and Woolcock, M. (2012). *Escaping Capability Traps through Problem Driven Iterative Adaptation* (Working Paper 299). Washington, DC: Centre for Global Development (CGD).

<http://www.cgdev.org/publication/escaping-capability-traps-through-problem-driven-iterative-adaptation-pdia-working-paper>

Many reform initiatives in developing countries fail to achieve sustained improvements in performance because they are merely ‘isomorphic mimicry’—that is, governments and organisations pretend to reform by changing what policies or organisations look like rather than what they actually do. In addition, the flow of development resources and legitimacy without demonstrated improvements in performance undermines the impetus for effective action to build state capability or improve performance. This dynamic results in “capability traps”, where state capability stagnates, or even deteriorates, over long periods of time even though governments remain engaged in developmental rhetoric and continue to receive development resources. How can countries escape capability traps? The authors propose an approach, Problem-Driven Iterative Adaptation (PDIA). PDIA focuses on solving locally nominated and prioritised performance problems (instead of transplanting “best practice” solutions). PDIA encourages positive deviance and experimentation (instead of requiring that agents implement policies as designed). PDIA creates feedback loops that facilitate rapid learning (instead of lagged learning from ex post evaluation). PDIA engages many agents to create viable, relevant interventions (instead of depending on external experts).

Reading 6: Cox, M. & Robson, K. (2013). *Mid Term Evaluation of the Budget Strengthening Initiative*. London: Agulhas Applied Knowledge.

<http://www.budgetstrengthening.org/external-evaluation/>

The mid-term evaluation of the BSI programme highlights the way that a programme operating in three fragile states has both worked and the successes it has had in improving budget processes and aid management, as well as taking forward an ambitious programme of localised service delivery. The programme draws on the evidence and experience cited in the earlier readings and illustrates how this can be translated into programme implementation.

Reading 7:

Building Peaceful States (n.d.). *A New Deal for Engagement in Fragile States. International Dialogue on Peacebuilding and Statebuilding*.

<http://www.pbsdialogue.org/documentupload/49151944.pdf>

The New Deal sets out an agreed set of mutual commitments and responsibilities centred around five Peacebuilding and Statebuilding goals, an agreed method of engagement centred on the FOCUS principles together with an internationally endorsed agreement to provide aid and manage resources effectively for results based around the TRUST principles. The new Deal has been agreed by the g7+ group of fragile and conflict affected states together with a broad spectrum of international agencies and bilateral donors.

Questions to guide readings

1. To what extent are the particular problems facing fragile states unique or different from other developing countries? Is there a need to treat them differently?
2. Are there any existing systems and processes which are now inhibiting or restricting further reforms? Are there any donor practices militating against improved PFM in a fragile state?
3. To what extent does a donor you are most familiar with advance the TRUST principles in a country you are most familiar with and what action could be taken to align behaviour and practice with those principles?
4. A significant proportion of expenditure in many countries is taken up with wages and basic procurement. What do the associated readings recommend in this area?
5. How do you ensure that technical interventions in the PFM area are continually informed and aligned with the changes in the political context?
6. The BSI programme (a DFID funded programme) has managed to build flexibility and adaptability into its programme and monitoring framework. The ICAI report quoted earlier says that “they have been consistently concerned that DFID’s programme design and delivery arrangements are not sufficiently flexible to support real time adjustment.” How could you build/introduce flexibility and adaptability into your monitoring frameworks?