Accelerating the transition out of fragility:
The role of finance and public financial management reform

The sixth annual CAPE Conference
15-16 November 2010, London

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Organised by the Overseas Development Institute and the International Monetary Fund

ISBN 978-1-907288-33-3

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Abbreviations

CAPE	Centre for Aid and Public Expenditure
DFID	UK Department for International Development
GIZ	Deutsche Gesellschaft für Technische Zusammenarbeit (formerly known as GTZ)
IFI	International Financial Institution
IMF	International Monetary Fund
ODI	Overseas Development Institute
PFM	Public Financial Management
TA	Technical Assistance

Acknowledgements

The sixth annual CAPE conference was jointly organised with the IMF. The Conference and this Conference Report were made possible by funding from DFID (as part of the Budget Strengthening Initiative programme), GIZ (formerly known as GTZ) and the IMF. Thanks are due to Steve Symansky, who created the Conference discussion paper that informed the debate, and to Greg Smith, Samuel Moon, Heidi Tavakoli and Paul Ackroyd, who provided papers on specific issues. This Conference Report presents summaries of the speakers' presentations and a flavour of the discussion from each of the sessions captured by Alasdair McWilliam. We would like to thank all of those who helped to organise the Conference especially Gareth Thomas, Mafalda Marchioro and Eniola Yussuf and, of course, all participants. The conference was co chaired by Marcus Manuel (Head of CAPE, ODI) and Sanjeev Gupta (Deputy Director of Fiscal Affairs Department, IMF) and was facilitated by Paul Ackroyd (who also co-authored this report).

Further information about the Conference can be found online at:
http://bit.ly/capeconference2010

Conference conclusions

In November 2010, around 100 of the world's leading experts in public financial management (PFM) met in London to debate why more progress is not being made in fragile states. Gathered at the sixth annual CAPE Conference, entitled Accelerating the transition out of fragility, these experts focused on the practical and policy aspects of using finance to support fragile states as they make the transition from fragility to stability, and the implications for Public Financial Management (PFM).

The participants included experts who had travelled to London from Afghanistan, Democratic Republic of Congo, Haiti, Liberia, Tajikistan, Timor Leste, Kosovo, Solomon Islands, South Africa and Zimbabwe, with four Ministers of Finance in attendance. They were joined by practitioners with experience of other countries. Despite years of support for reform in fragile states, there were still differences of opinion on many issues. However, the discussions provided clarity on seven key issues:

1. Donors are not respecting government ownership and are micromanaging aid delivery despite commitments to the Paris aid effectiveness agenda in fragile states. We heard accounts from four Ministers of Finance of the difficulties they have had in managing the donor relationship and were struck by the comment that it was only possible to gain control of the reform process once domestic revenues had reached a high enough level to marginalise the influence of donors.

2. Participants recognised that PFM reform in fragile states requires a major change in management practices and buy in from a wide range of stakeholders in the country, with important administrative and political implications. It is not a technocratic fix. Yet there seem to be few country examples of properly designed and applied change management processes.

3. Current procurement procedures required by the international community are too complex and cumbersome for fragile states. While such processes reflect a valid need for accountability, it seems that the balance between accountability and development progress is insufficiently considered.

4. Inadequate pay levels in the public service in fragile states are having a serious effect on the sustainability of reform. In this regard, the policymakers are faced with a difficult choice between retaining qualified staff and ensuring a sustainable fiscal position, without impeding private sector development.

5. As fragile states move towards more democratic structures the role of Parliaments in the budget process would become more important. While there is no unique model for interfacing with Parliament, more attention needs to be paid to it to enhance budget transparency.

6. Too much time can be spent making legislative changes. Often these are not necessary because administrative regulations will do as well and the implementation capacity often does not exist to back up the legislation.

7. Finally, the conference demonstrated that collectively we are not learning as much as we can from the range of fragile state experience. Bringing together representatives from such a diverse group of countries, all of them struggling with the same problems can be enormously productive.

Conference report

The sixth annual CAPE Conference 2010 was jointly organised by the Centre for Aid and Public Expenditure at ODI, and the Fiscal Affairs Department of the International Monetary Fund (IMF). The Conference was held in London on 15 and 16 November, 2010.

This was the sixth conference on development finance and public financial management reform. This conference focussed on the practical and policy aspects of how to use finance to support fragile states in their transition out of fragility and the associated implications for public financial management.

The conference consisted of facilitated panels and plenary discussions across five sessions. Discussion over the two days covered four main themes.

- Delivering effective financial support – joining the dots from Afghanistan to Zimbabwe.
- Developing local financial management capacity – moving from quick fixes to sustained reforms.
- The role of transparency and accountability.
- Public financial management reform in fragile states – what is working and why.

Ahead of the conference, ODI produced issue papers to help stimulate the discussions on the days of the conference itself. The lessons learned were captured in audio recordings, video footage and in this Conference Report.

The context: why this conference, and why now?

Fragile states pose some of the most pressing and complex development challenges. In spite of a growing focus on their situation, there is also growing concern at the perceived lack of progress in their transition from fragility to stability and development.

The organisers of the conference, ODI and the IMF, consider that the role of finance and the related issues around public financial management (PFM) systems are key to advancing progress, but progress remains disappointing, despite an enormous amount of experimentation and discussion.

Marcus Manuel, Head of The Centre for Aid and Public Expenditure (CAPE) at ODI hoped that bringing together representatives of fragile states and donors, as well as academics and practitioners, would help to take stock of present knowledge and shed light on why progress is not fast enough. *'We are being too slow in helping these countries,'* he said. *'We are seeing many of the same problems coming up again and again and we wanted to move beyond a statement of what the problem is to ideas of what we can do to change the situation.'*

In his opening remarks to the Conference, Sanjeev Gupta, Deputy Director of the Fiscal Affairs Department of the International Monetary Fund (IMF) expressed his hope that the conference would identify areas where more needs to be done, areas of lower priority, and areas where things need to be done differently or that need greater understanding. *'We all know what the problems are' he said, 'but not much has happened. So the question is why they have not been acted on'*.

A bridge in Liberia remains unrepaired after five years. '*Why?*' asked Marcus Manuel.

What is different about fragile states?

There are many different definitions of fragility, and some States are sensitive to the 'fragile' label. The conference did not spend time trying to define fragility, but recognised that there were a group of states (or proto-states) that are characterised by:

- Very low human capacity
- Deteriorated or non-existent physical capital and operating systems
- Minimal domestic revenue, and
- The need to move the focus from establishing security and stability towards promoting development.

For these reasons, the provision of finance and the pursuit of PFM reform cannot proceed as they do in more stable and capable developing countries.

Context is everything

Conference participants included representatives from a range of fragile contexts: Afghanistan, Democratic Republic of Congo, Haiti, Kosovo, Liberia, Tajikistan, Timor Leste, and Zimbabwe, as well as practitioners with experience of other contexts, including Cambodia and Iraq. While these exhibit some of the same problems, their administrative systems, political contexts and history vary enormously.

The conference stressed that these differences in context need to be recognised in the design of PFM reform, but too often donors and international experts advocate approaches that have worked elsewhere, including in more stable countries, overlooking specific local circumstances.

There was a tension at the Conference between those who wanted to develop models of strategic change or menus for action, and those who felt it was necessary to do more work to document case studies. Some felt that there was a need to invest more in analysis of the causes of fragility and focus on results that assist the transition out of fragility.

In general, participants felt that *the international community needs to adjust its expectations* on what can be achieved in fragile states. Unless they do so, the gap between intentions and progress will continue to disappoint.

Pace versus sustainability

There is a tension in fragile states between getting development results on the ground and building sustainable systems. Participants had divergent views on how to balance the speed of reform and physical progress versus building sustainable capacity.

Strong feelings were expressed on the need for *more emphasis on getting the money moving to deliver development impact*, and less on the process of PFM reform. It was argued that a paradigm shift is necessary to move towards outcomes rather than processes.

However, given that fragile states have, by definition, very weak capacity, the only way to get the money moving more rapidly to build infrastructure and service delivery is to rely on external resources, be these new accountability software, expatriate advisors, or the use of imported procurement systems. While these may advance progress, the lack of attention to sustainability means that there is no sustainable capacity once the external intervention is withdrawn. Another school of thought, therefore, argues for a stronger emphasis on capacity building and, by implication, a willingness to accept slower development progress.

Delivering effective financial support

The provision of external finance

Reliance on external funding, particularly from donors, is a feature of fragile states. It was noted, however, that the volume of resources devoted to fragile states often falls as they move away from the initial post conflict and humanitarian situation, including funding for security activities through UN peacekeeping forces. The shift towards development programmes supported by multilateral and bilateral donors is thus accompanied by a reduction in total funding. *Some questioned whether donors had a sufficient appetite for risk* in supporting development in fragile states. Taking risks had paid off in Afghanistan and Sierra Leone.

Finance Ministers at the Conference complained about the lack of predictability in the delivery of development aid. They would prefer that development assistance be provided through government systems as much as possible, and preferably in the form of budget support. Donor representatives, however, pointed out that budget support accounts for a relatively small proportion of total aid globally and, for many donors, it seems to be falling out of fashion.

The use of donor conditionality was also criticised. It was felt the conditions rarely recognise the local context and that they should not represent an 'on /off switch'. Some participants wondered why PFM reform should ever be a condition for aid.

Participants strongly supported the delivery of aid through both budget support and other forms of aid using government systems. The conference also noted the innovation of the African Development Bank's Fragile States Facility, and felt that there should be more effort to design innovative financing mechanisms that could support fragile states more effectively than conventional development financing mechanisms.

The need for government ownership and leadership of reform processes is now part of mainstream thinking in development and was reiterated. There was, however, almost universal acknowledgement at the conference that this is not happening in practice in most fragile states.

The amount of aid funding they provide gives donors a dominant role in many fragile states. *Participants felt that there was often a mismatch between the reform priorities of donors and recipient governments*. Donors were not observing their own rhetoric about respecting country leadership. The Ministers of Finance, in particular, were critical of the role of donors in micromanaging reform efforts.

> *'Some donors came with a prescription and did the reform for us.... the context was not considered, the preconditions were not considered and did not have a good link with other systems in the country.'*
>
> *Mustafa Mastoor, Deputy Minister of Finance, Afghanistan*

This generated discussion around two major issues: how to increase government leadership of PFM reforms and how to place donors in a supportive rather than a driving role.

Government leadership

While the conference recognised the need for greater government leadership and ownership, the complexities were not underestimated. It was stressed that the budget is a political process and that PFM is not just a technical fix.

To be effective PFM reform needs the buy in of politicians, but it is unlikely to be the main priority, even for the Minister of Finance. Furthermore, the Ministry of Finance is just one part of a government, and more effort is needed to obtain buy in from other agents such as parliamentarians and other line ministries. It is important to think about incentives for PFM reform and how it can operate in systems where informal norms take precedence over formal rules. In Liberia, for example, there have been serious issues with the implementation of reforms as a result of the lack of cooperation from former warlords.

> *'Reforms initiated by donors are difficult to implement and reforms initiated by countries are difficult to get financed. Reforms are then much better developed and implemented in the context of a partnership between donors and host countries.'*
>
> *Mustafa Mastoor, Deputy Minister of Finance, Afghanistan*

Government ownership cannot be forced. Donors should try not to undermine government leadership and *should be prepared to enter into more flexible agreements, with aid resources linked to the delivery of results*. The Minister of Finance for Timor Leste made a persuasive case, pointing out that her ability to provide leadership increased as domestic resources increased, and as the resulting influence of donors decreased.

Donor behaviour

Donors were characterised as being uncoordinated and competitive in fragile states, with a large number of donors using different systems and proffering different advice seen as a major problem. The additional burden often placed by donors on fragile states was characterised as sometimes violating the OECD-DAC principle of 'do no harm'.

> *'It seems to me (from hearing the ministerial presentations) that a great deal of harm is, in fact, being done.'*
>
> *Alison Evans, Director of ODI and Chair of Ministerial Panel*

Traditional donors were seen as being guilty of micromanagement, while the emerging donors such as China and India were thought by some to offer a better model, even though they tended to show less interest in PFM reform. Some at the conference advocated greater use of multilateral channels to reduce the proliferation of donors. The use of multi-donor trust funds had been found to be useful in some instances. Participants felt that donors were not sufficiently aware of PFM issues. It was also noted that few fragile states had a PFM coordination group and their establishment was recommended by participants.

> *'Most donors at the beginning would prefer to use a lot of parallel systems or project implementation units and project financial management units… there is not enough emphasis on transfer of knowledge.'*
>
> *Augustine Ngafuan, Minister of Finance, Liberia*

Donor representatives cautioned that local government ownership needed to be addressed alongside the increased emphasis on accountability within donor countries and the increasing demand for attribution of results to donor efforts. Some participants, however, questioned whether results-oriented aid was suitable to post conflict and fragile states where the risk of failure is higher.

Participants noted that efforts by donors to coordinate themselves had been disappointing and some recommended that *government leadership was essential to provide the framework within which donors can work*. Others felt that donors should take greater responsibility for their collective actions.

> *'Donor coordination has to be a process led by the country itself.'*
>
> *Patricia Alonso Gamo, Senior Adviser IMF*

> *'Donors should take on the responsibility to coordinate and not play games.'*
>
> *Emilia Pires, Minister of Finance, Timor-Leste*

Procurement

There was a surprising amount of discussion on the issue of procurement, particularly the role of the International Financial Institutions (IFIs). It was widely felt that *the rigid application of complex procurement processes was a major contributor to slow disbursement of aid* with serious consequences for the implementation of development programmes.

Augustine Ngafuan, the Minister of Finance from Liberia, explained the major problems he had encountered with IFI procurement regulations, which made it very difficult to integrate domestic business into contracting relationships. It was suggested that more simple and flexible rules could be introduced for lower value contracts.

> *'Procurement is a major challenge in a post conflict country…. we need to find some rules that tally with post conflict realities.'*
>
> *Augustine Ngafuan, Minister of Finance, Liberia*

Procurement laws developed by international organisations are designed to meet a very high standard of fiduciary control, but it is difficult for fragile states to manage their complexity. It was recognised that IFI procurement practices were designed to provide accountability to their shareholders and that changing them would be difficult. Some participants were concerned that the abandonment of the standards without caution could make bad procurement practice the norm. Good procurement practice, they argued, is necessary to ensure good use of scarce resources as well as to reduce corruption.

It was pointed out that the intensive scrutiny of procurement contracts was resource intensive and that there could be a trade-off between procurement scrutiny and development impact if procurement processes are slowing the release of funds. What is needed is a simpler process that maintains good standards of procurement control without overloading countries with systems that are too complex.

The conference recognised that there are no easy answers to this dilemma. There is a need to *balance the fiduciary and development aspects of procurement* and the majority feeling at the conference seemed to be that the fiduciary concerns had become too dominant, to the detriment of development. The conference considered this an issue that the development community needs to address as a matter of urgency.

> *'Procurement systems and guidelines seem to be a major issue in fragile states... the Fragile States Unit has not been able to convince colleagues in the procurement department that we should make it simpler.'*
>
> *Barbara Barungi, Fragile States Unit, African Development Bank*

Developing local financial management capacity

Some of the most stringent criticism at the CAPE Conference was directed at the way in which donors supply technical assistance (TA) to support PFM reform. TA was characterised as uncoordinated and ad hoc. Participants felt that TA too often consists of providing external experts who are insufficiently qualified, and who try to introduce systems with which they are familiar and that may well have worked elsewhere, but are inappropriate in the local context.

It was stressed that capacity substitution is not the same thing as capacity building. Sometimes expatriate TA was not even good at filling gaps. In South Sudan, for example, it took a year for the international community to find the procurement experts that were needed. Most participants characterised capacity building efforts as inadequate, with one panellist estimating that less than 5% of the TA being provided in fragile states is really building capacity.

Opinions were divided, however, on the role of long-term TA. Some argued that this is valuable and indeed essential in the early stages of the movement out of fragility and that it is quite appropriate for expatriates to fill line management tasks. Others argued that this is rarely, if ever, appropriate, leading to distortions and a lack of sustainability. They felt that outsiders can create tensions and lower morale among local staff. The expertise of some "experts" is often felt to be quite shallow, leading them to try to implement best practice reforms without an understanding of the local context and a focus on form rather than function. Some felt that the donor agencies providing TA do not work closely enough with governments and domestic political actors to understand the all-important context.

Training, it was agreed, is not necessarily the same as capacity building. Training is often conducted in an ad-hoc manner and many contractors brought into fragile states have little idea how to build sustainable capacity. It was felt that training needs to be incorporated into agreements with international contractors to build capacity. Some thought that the emphasis on individual training is misplaced and that more effort should be put into training cadres of staff or setting up specialised training institutes.

Some participants argued that the functions of post-filling should be separated from those of training, while others argued that the most effective training was mentoring of local staff on-the-job by expatriate staff. Most participants agreed, however, that more thought needs to be given to *drawing up technical assistance strategies* with an appropriate balance of long-term and short-term assistance, international and local experts, and an exit strategy from long-term technical assistance. The National Economic and Fiscal Commission in Papua New Guinea was thought to be a good example of a mix of local and international staff in line management positions.

The effort donors put into capacity building was thought to be inadequate in almost all cases. Some participants argued that it is best to work with existing institutions on the ground as a starting point for building capacity, rather than wholesale institutional reform. There are very few circumstances in which there is no capacity and the first priority should be to make best use of the capacity that does exist. Capacity building is a long term activity and needs sustained support. In this area, as in others, participants agreed that government leadership was essential.

Good examples of domestic capacity building initiatives were cited, including Uganda's Economic Analysis Unit and the Afghan Treasury, where a number of international experts have worked alongside a cadre of locals paid only a little more than standard local salaries scales to provide training on the computerised system and have left behind a functioning and sustainable system praised by the international community.

> *'Capacity building is one the most difficult issues; you have to know what you're doing, be committed to doing it and have the resources to commit to it over time.'*
>
> *Abdi Ali Issa, Horn Economic and Social Policy Institute*

Civil service reform and pay

The conference recognised the close links between PFM reform and wider civil service reform, agreeing that it is rarely possible to consider PFM reform without placing it in this wider context. Pay was a particularly difficult issue. In most fragile states, as in many other developing countries, pay levels in the public sector are too low to attract and retain qualified staff. Loss of staff as a result of inadequate pay levels is one of reason why technical assistance is often ineffective. Because many of the same skills are required in the public and private sectors, key public sector jobs need to pay competitive salaries.

Donors and NGOs are often culpable in paying higher salaries to attract government staff away from the public sector. A number of efforts have been made over the years to address pay incentives for key staff through forms of salary supplementation but these have rarely been sustainable. Increasing public service salaries was not only very expensive but also has knock-on effects in the private sector.

Participants agreed that this issue has had too little attention from donors and recipient governments. It was argued, by some, that the solution lies in proper human resource planning and decompression of standard salaries to create the margins for skilled people, although this is often politically difficult.

It was suggested that each ministry should *develop a proper human resource strategy and plan* so that long term advisors could be properly positioned within the ministries, with incentives to transfer skills and leave behind sustainable capacity.

> *'Until such time as governments are able to be competitive employers of their own people we will never be able to build sustainable institutions.'*
>
> *Richard Manning, Chair session 1*

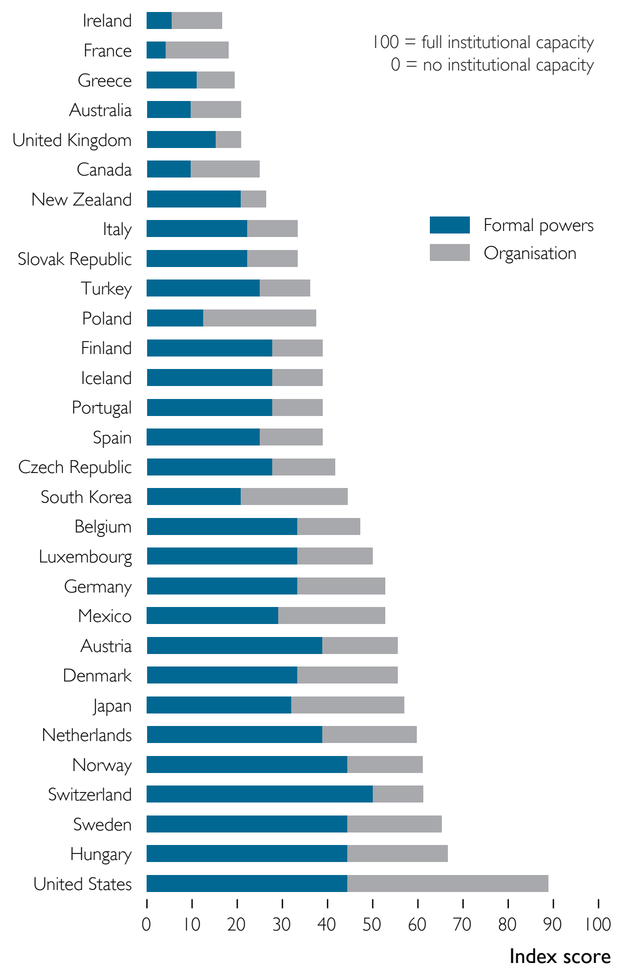
The role of transparency and accountability

The importance of public accountability measures and budget transparency were stressed during the CAPE Conference. It was felt that *accountability and transparency should not be left until later in the PFM reform process but should proceed alongside the 'supply' measures*. Accountability to the Parliament and to the public enhances institution building.

However, establishing accountability is resource intensive and can only take place over the longer term. It requires a solid institutional base and donors should not demand unrealistic accountability up front.

The session on accountability and transparency focused on Parliamentary accountability, which was felt to be crucial in a PFM system. It was pointed out that even within developed countries there is no one model of parliamentary accountability for the budget. As shown in the graph in some countries, such as the US, the legislature has a very strong role in budget preparation and approval. In others, such as the UK, its role in budget approval is much weaker. There is often a trade-off between the effort that a legislature puts into ex ante approval of the budget and accountability scrutiny.

The index of legislative budget institutions



Source: Wehner, 2010.

These institutional roles take a long time to develop. Parliaments are often part of the corruption problem and they need to become partners in the accountability process. Parliamentarians often use budget processes to bargain for personal benefits and the timeframe for budget debate is often limited. Participants agreed that there is a need to *build budget analysis capacity and the understanding of audit procedures in parliaments*.

State audit institutions also have a key role to play. There will, inevitably, be tensions between audit institutions, parliaments and ministries of finance, but the potential role of audit institutions was illustrated by the Auditor Generals from Liberia and Zimbabwe at the conference. Donor finance and support has been essential, for example, in establishing the Audit Commission in Liberia. Its role has been built upon its independence from the President; its operational independence; ability to hire, fire and remunerate staff; and its financial independence. Some participants also stressed the importance of internal audit procedures.

> *'Transparency does not need to wait... some of the countries that have made the most progress in the Open Budget Index in recent years have been fragile states.'*
>
> *Paolo de Renzio, International Budget Partnership*

Transparency forces the government to monitor its own expenditure. *Making Budget information available is a necessary condition for other forms of accountability*, including accountability to the public. Budget data can be made available rapidly at relatively low cost; it may only be a question of making available in the public domain what is already available inside government systems.

Transparency needs to be institutionalised and made irreversible through the involvement of civil society. In Palestine, for example, the Government has responded to pressure from civil society and greater transparency has been achieved by the making available of financial data online and by the regular publication of reports.

International norms for budget transparency are needed to assist the adoption of common standards and measures and empower local actors to lobby and implement reform. The potential impact of exercises such as the Open Budget Index was stressed.

Levels of illiteracy may impede transparency reforms and it may be necessary to invest in institutions that can analyse budget data and disseminate the results in a way that is readily understandable to all citizens. The role of the media, for example, in supporting accountability is often undervalued and unsupported.

Some, however, were concerned that donor pressure to consult extensively on the budget process slows down reform and absorbs capacity that is already limited. There were also concerns on whether uneducated voters could use budget information effectively, and concerns that budget transparency might inhibit the ability of Ministers of Finance to take decisive action.

Aid transparency is also important. The conference felt that *donors should take more seriously their responsibilities for reporting to recipient governments* on the expenditure of aid funds, using the governments' own charts of accounts. Providing enough good quality information at the right time on donor expenditure allows recipient governments to incorporate this information into their own budget processes and documents. One panellist felt that the run-up to the Fourth High Level Forum on Aid Effectiveness in Korea next year was an unparalleled opportunity to push transparency issues.

Building local accountability

Pressure for donor accountability sometimes impedes the building of domestic accountability to local civil society and taxpayers and to parliaments.

One way to resolve the tensions created by the need for donors to demonstrate results and account for their own resources is to *build local accountability mechanisms* that provide domestic controls over the executive and satisfy donor accountability requirements. The conference felt that donors and recipient governments should work more in partnership to build the institutions of local accountability and that donors should be prepared to provide the incentive of greater financing flexibility.

PFM reform in fragile states: what is working and why

The importance of robust public financial management systems was stressed throughout the conference. PFM reforms are essential to plan, budget and account for the resources that underpin the development of the state, build infrastructure and deliver services. Good PFM systems reduce leakages and ensure that money is used for its intended purpose. In the absence of good national PFM systems, donors often resort to parallel and often unsustainable systems.

> *'Apart from security I cannot imagine anything more important for fragile states than how they manage the resources available to them.'*
>
> *Abdi Ali Issa , Horn Economic and Social Policy Institute*

It was stressed that PFM reform is a political process. It is necessary to understand the underlying informal culture of the relevant ministries and how political power and patronage is used. There are a multitude of special interests, and *donors need to understand the political reality without making political choices*. Lack of political buy in is often a consequence of unfeasible or irrelevant reforms that are unsuitable for the local context. Having support from the Ministry of Finance is not enough: PFM reform also requires buy in from other agents such as parliamentarians.

Participants stressed that both *the demand side of transparency and accountability, and the supply side of budget and accounting procedures need to be advanced simultaneously.*

Fragile states are vulnerable to bad advice as they may not have the capacity to judge the quality of the advice they are receiving, and this can lead them to place too much confidence on the advice of the international community and international experts. How reforms are institutionalised and sustained depends upon domestic political processes, and this analysis is often lacking. This can lead to mistakes in the sequencing of reforms. In Rwanda, for example, a Medium Term Expenditure Framework was introduced too early and was, as a result, ineffective and confusing.

There was a lack of consensus at the conference about the best way to build robust PFM systems. One panellist felt that there are no best practice models for PFM reform, and that time and effort are needed to understand the context and to sequence reforms, depending upon the starting point of the country.

The discussion paper for the conference and a number of participants laid emphasis on the need to *keep PFM reform simple and 'do the basics first'*. This was accompanied by the suggestion that the initial emphasis should be on budget execution to establish the credibility of the budget, ensure that development programmes are executed and 'move the money'. This school of thought felt that performance-based budgeting is a bridge too far in most fragile states. But an alternative school argued that the budget planning process is a key policy-making tool and that performance-based project budgeting might have a role in linking allocations to results.

> *'We are too early in the game, perhaps, introducing fairly sophisticated and complicated performance oriented systems.'*
>
> *Marco Cangiano, Assistant Director FAD IMF and Chair of Session 4*

For example, even though there were no PFM systems in Kosovo after the conflict there, rapid progress was made by targeting some basics, such as the establishment of a Treasury single account with no off-budget funds and an integrated financial management system used by all spending agencies at all levels of government using the same chart of accounts.

Lack of capacity in the Ministry of Finance can be a binding constraint and the *pace of reform needs to be matched to often limited capacity*. Conference papers drew attention to the dangers of concentrating exclusively on PFM capacity building in the Ministry of Finance and some participants felt that more attention should be focussed on de-concentrated levels of government.

> *'A budget is meaningless if nothing goes through it.'*
>
> *Steve Symansky, author of the CAPE Conference discussion paper*
> *http://www.odi.org.uk/events/2010/11/15/2513-steve-symansky-discussion-paper.pdf*

There were strong arguments advanced at the conference in favour of the computerisation of accounting systems at an early stage in fragile states, and that this should not be considered 'too sophisticated'. It was pointed out that automated accounting systems could substitute for weak human capacity and could be an effective way to reduce the scope for corruption and the misuse of funds.

There was a feeling that donors often under invest in and misunderstand PFM reform. The Finance Minister from Sierra Leone emphasised that PFM is a complex job that requires focus, long-term commitment and significant financial support. It was emphasised that PFM should be seen not as an end in itself, but as a means to achieve longer term development goals. It was argued that *too often the design of PFM systems seems to prioritise form over function* and it is important to focus on PFM on development outcomes, not just outputs or activities.

'PFM reform represents a complicated complex and difficult agenda … It requires sustained focus, capacity building, institutional setting and above all it requires financing.'

Samura Kamara, Minister of Finance Sierra Leone

The legal framework

A considerable amount of effort is often put into the revision of the legal framework for PFM. This normally involves the introduction or the amendment of a considerable number of laws. Whilst the appropriate legal framework is important, it is necessary to ensure that the implementation capacity exists to back up the legal provisions. Legal reform without institutional capacity is meaningless. In Argentina, according to one panellist, donors press for a new budget law every few years because the previous one has not been implemented.

The adoption of new laws is seldom a straightforward process in a democratic system. There can be a fallacy of composition on legal reform, as numerous suggestions can be made, each of them sensible, but which, taken together, overload the system.

In some post conflict states where there is a complete collapse in the rule of law it is necessary to establish a basic respect for legal procedures and some form of social contract before it is possible to put in place a legal framework. It is unwise to attempt to codify practice before the institutional structure has been determined. In the interim, many problems can be solved without recourse to legal reform. Southern Sudan, for example, has operated without explicit procurement laws. Administrative legislation can often be effective.

Donors sometimes introduce law formation as a performance indicator. Some laws are simply imported from other countries and translated from another language, rather than being drafted to be relevant to the local context. In Afghanistan, for example, a plethora of new laws and regulations have been introduced at the instigation of donors within a short period. Donors, in particular, therefore need to be cautious in recommending new legal instruments and ensure that they pass *a relevance test to ensure that legislation is really necessary and that there is the capacity for its implementation*.

Change management

The final striking conclusion from the conference was that much *more attention needs to be focused on change management* in bringing about PFM reform. Reform is a complicated process, impinging on a range of political and institutional factors. Too often it is approached as if it is a technological fix. The conference felt that a more sophisticated change management approach should be adopted, consulting the whole range of stakeholders that have to be involved in a successful PFM reform programme. Several participants felt that more emphasis should be placed upon *regional lesson learning and peer-to-peer exchange* between fragile states. Marcus Manuel, Head of CAPE, explained that this was to be a focus of the Budget Strengthening Initiative – a new programme at ODI that aims to provide additional, flexible, demand-driven support to fragile states on public financial management reform.

'There is a thread running through these presentations about managing change which is partly about technical difficulties and partly about political difficulties.'

Simon Maxwell, Senior Research Associate, ODI, and Chair of Session 2

Annex i - Conference programme

Day 1 – Monday 15 November

9.30 **Welcome address** - ***Alison Evans***, ODI Director.

9.45 **Introduction to the conference** - ***Marcus Manuel***, Head of CAPE; Director of the ODI Budget Strengthening Initiative and ***Sanjeev Gupta***, Deputy Director, Fiscal Affairs Department, IMF.

10.15 **'Setting the scene'** - ***Steve Symansky***, former staff member IMF Fiscal Affairs Department and ***Edward Hedger***, Senior Research Fellow ODI

11.15 **Keynote session: Country perspectives on finance and financial management reform** - This session will explore the challenges and opportunities for financing and reform from the perspective of current and former Ministers of Finance in 'fragile states'. It will set the agenda from a country standpoint which will then be taken up in subsequent sessions of the conference.

Chair: *Alison Evans*
Panel: ***Augustine Ngafuan***, Minister of Finance, Government of Liberia, ***Samura Kamara***, Vice President and Minister of Finance, Government of Sierra Leone, ***Emilia Pires***, Minister of Finance, Government of the Democratic Republic of Timor-Leste, ***Mustafa Mastoor***, Deputy Minister of Finance, Afghanistan

Plenary discussion

13.30 **Session 1: Delivering effective financial support – joining the dots from Afghanistan to Zimbabwe**

Chair: ***Richard Manning***, Past Chair of OECD Development Assistance Committee.
Panel: ***Mark Lowcock***, Director-General for Country Programmes, DFID, ***Anand Rajaram***, Sector Manager, Public Sector Reform and Capacity Building Unit, Africa Region, World Bank, ***Jon Lomoy***, Director, Development Cooperation Directorate OECD, ***Patricia Alonso-Gamo***, Senior Advisor in the Middle East and Central Asia Department of the International Monetary Fund.

The Ministers of Finance will also act as resource persons for this session.

Plenary and table discussions

15.45 **Session 2: Developing local financial management capacity – moving from quick fixes to sustained reforms**

Chair: ***Simon Maxwell***, Senior Research Fellow ODI.
Panel: ***Graham Scott***, Executive Chairman, Southern Cross Advisers; former Secretary to the Treasury, New Zealand, ***Mark Plant***, Deputy Director, Africa Department, IMF, ***Ephrem Gondha***, President, Reform Committee, Ministry of Finance, Democratic Republic of Congo, ***Matthew Martin***, Director, Development Finance International

16.45 **Plenary and table discussions**

Day 2 – Tuesday 16 November

09.00 **Coffee on arrival**

09.30 **Reflections on first day and Points for meeting conclusions**

10.00 **Session 3: The role of transparency and accountability**

Chair: ***Andy Norton***, Director of Research ODI
Panel: ***John Morlu***, Auditor-General, Liberia, ***Karim Nashashibi***, Advisor to the Prime Minister, Palestinian National Authority, ***Paolo de Renzio***, International Budget Partnership, ***Joachim Wehner***, Lecturer, London School of Economics, ***Gavin Woods***, former Chair of the Parliament Accounts Committee, South Africa.

Plenary and table discussions.

13.00 **Session 4: Public financial management reform in fragile states – what is working and why**

Chair: ***Marco Cangiano***, Assistant Director Fiscal Affairs Dept IMF
Panel: ***Matt Andrews***, Assistant Professor, Harvard Kennedy School, ***Lulzim Ismajli***, Director of Treasury, Ministry of Finance, Kosovo, ***Camille Karamaga***, Regional PFM Adviser for West Africa, IMF; former Director of Budget, Ministry of Finance, Rwanda

Plenary and table discussions

15.00 **Facilitated session: Drawing policy-relevant lessons**

Chairs: ***Marcus Manuel,*** Head of CAPE; Director of the ODI Budget Strengthening Initiative, ***Sanjeev Gupta***, Deputy Director, Fiscal Affairs Department, IMF

Facilitator: ***Paul Ackroyd***, Senior Adviser, ODI

17.00 **Closing remarks and end of Conference**

Annex ii - List of Participants

Ali Issa Abdi, Director, Horn Economic & Social Policy Institute Ethiopia

Stephen Akroyd, Director, Public Sector Finance and Management, OPM

Martin Aldcroft, Governance Advisor, Public Financial Management Workstream, DFID

Patricia Alonso Gamo, Senior Advisor in the Middle East and Central Asia Department, IMF

Matt Andrews, Assistant Professor, Harvard Kennedy School

Barbara Barungi, Lead Economist, African Development Bank

Geraldine Baudienville, Research Associate, ODI

Paul Bernd Spahn, Emeritus Professor of Public Finance, Goethe Business School, Frankfurt

Mary Betley, Principal Consultant, Mokoro

Bella Bird, Head of Governance and Social Development Department, DFID

Martin Bowen, Independent Consultant

Marco Cangiano, Assistant Director, Fiscal Affair Department, IMF

Rebecca Carter, Principal Consultant, Mokoro

Elisa Cavacece, Policy, Planning and Effectiveness Section, Irish Aid

Karin Christiansen, Director, Publish What You Fund

Francisco Da Costa Soares, Ministry of Finance, Timor-Leste

Fiona Davies, Independent Consultant

Inacio De Almeida Liu, Ministry of Finance, Timor-Leste

Paolo De Renzio, Research Fellow, IBP

Catherine Dom, Principal Consultant, Mokoro

Amos Durosier, Anti-Corruption Commission, Haiti

Alison Evans, Director, ODI

Mick Foster, Senior Research Associate, ODI

Tony German, Director, Development Initiatives

Jonathan Glennie, Research Fellow – CAPE, ODI

Ephrem Gondha, President, Reform Committee, Ministry of Finance, DRC

Sanjeev Gupta, Deputy Director – Fiscal Affair Department, IMF

Paz Guzman, Expert Governance & Budget Support, BTC

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Norman Hiropuhi, Ministry of Finance and Treasury, Solomon Islands

Anna Holmryd, Department for Management and Methods in Development Cooperation, Ministry for Foreign Affairs, Sweden

Lulzim Ismajli, Director of the Treasury Ministry of Finance, Kosovo

Stephen Jones, Principal Consultant, OPM

Samura Kamara, Vice President and Minister of Finance, Sierra Leone

Camille Karamaga, Regional PFM Adviser for West Africa, IMF; Former Director of Budget, Ministry of Finance, Rwanda

Stephanie Kettler, Public Policy, GIZ

Ismoil Khujamkulov, Consultant in the PFM council secretariat, Ministry of Finance, Tajikistan

Andrew King, Deputy Head of Macroeconomic Coordination & Strategy Team, HM Treasury, UK

Philipp Krause, DPhil Candidate at LSE

Andrew Lawson, Director, Fiscus Consulting

Ian Lienert, Independent Consultant

Stephen Lister, Principal Consultant, Mokoro

Jon Lomoy, Director, Development Cooperation Directorate, OECD

Mark Lowcock, Director-General for Country Programmes, DFID

Judith Madzorera, Ministry of Finance, Zimbabwe

Richard Manning, Independent Consultant

Marcus Manuel, Director of BSI and Head of CAPE, ODI

Matthew Martin, Director, Development Finance International

Mustafa Mastoor, Deputy Minister of Finance, Afghanistan

Simon Maxwell, Senior Research Associate, ODI

Lynne McKenzie, Southern Cross Advisors

Andres Mejia Acosta, Research Fellow, IDS

Katherine Monahan, Representative, Brussels Office, USAID

Samuel Moon, Research Officer – CAPE, ODI

John Morlu, Auditor General, Government of Liberia

Håkon Mundal, Aid Strategy and Development Economics Department, NORAD

Anthony Myers, Focal Point, Ministry of Finance, Liberia

Karim Nashashibi, Advisor to Prime Minister, Palestinian National Authority

Iain Nettleton, PKF (UK)

Augustine K.Ngafuan, Minister of Finance, Liberia

Andy Norton, Director of Research, ODI

Kojo Oduro, Adviser, Crown Agents

Rachel Perrin, PFM team, DFID

Manuel Pietra, Executive Director, Free Balance

Emilia Pires, Minister of Finance, Timor-Leste

Mark Plant, Deputy Director, Africa Department, IMF

Anand Rajaram, Sector Manager, World Bank

Matthieu Robin, Policy Officer, Financial Governance Unit, Ministry of Foreign & European Affairs, French Government

Graham Scott, Executive Director, Southern Cross Advisers

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Joachim Wehner, Lecturer, LSE

Leni Wild, Research Officer – PoGo, ODI

Richard Williams, Managing Consultant, PFK

Tim Williams, Team Leader and Senior Governance Adviser, Governance and Institutions Team, Africa Regional Department, DFID

Gavin Woods, Former Chair of the Parliament Account Committee, South Africa

Annex iii - Issue papers

Session 1 - Delivering effective financial support – joining the dots from Afghanistan to Zimbabwe

Chair: ***Richard Manning***, Past Chair of OECD Development Assistance Committee.

Panel: ***Mark Lowcock***, Director-General for Country Programmes, UK Department for International Development.
Anand Rajaram, Sector Manager, Public Sector Reform and Capacity Building Unit, Africa Region, World Bank.
Jon Lomoy, Director, Development Cooperation Directorate OECD.
Patricia Alonso-Gamo, Senior Advisor in the Middle East and Central Asia Department of the International Monetary Fund.

Ministers of Finance will also act as resource persons for this session.

Discussion points

1. Are donors acting fast enough?
2. How can we increase the scale of resources in risky environments?
3. Are the right types of assistance being deployed?
4. Should a proportion of aid fully use a recipient's systems?
5. Does the cutting of administration budgets reduce aid effectiveness?

Context

Many of the factors that make contexts 'fragile' also make it harder to deliver effective financial assistance. There have been successes and failures, and we need a better understanding of what works and why.

Fragile and post-conflict situations vary considerably, and 'effective' financial assistance will depend on the context. In one country, 'effective' financial assistance might mean helping the armed forces meet their salary bill. In another, it could mean targeting public works and in a third, it would focus on service delivery. Guidance to DAC donors is provided via 'Principles for Good International Engagement in Fragile States and Situations' (Box 1).

Box 1: Principles for Good International Engagement in Fragile States and Situations

- Take context as the starting point
- Ensure all activities do no harm
- Focus on state-building as the central objective
- Prioritise prevention
- Recognise the links between, political, security and development objectives
- Promote non discrimination as a basis for inclusive and stable societies
- Align with local priorities in different ways in different contexts
- Agree on practical co-ordination mechanisms between international actors
- Act fast…but stay engaged long enough to give success a chance
- Avoid pockets of exclusion ('aid orphans')

1. Are donors acting fast enough?

Late is as bad as never, as financial assistance is vital to support fragile situations. There are often lengthy delays in disbursement (Box 2). Why does it often take too long to provide support? Should we be trying to build infrastructure faster? Can multi-donor trust funds release sufficient funds quickly enough if World Bank procedures are followed? Is bilateral funding better? How can we address the lack of clear donor accountability? Should one international financial institution take charge?

Box 2: Multi-donor Trust Funds (MDTFs): the Sudan example

The Multi-donor Trust Fund (MDTF) in Southern Sudan, administered by the World Bank, and was supposed to ensure coordinated external donor support through to 2011. However, the rate of disbursement has been excruciatingly slow, with most projects failing to deliver 'tangible goods' to the public (Fenton 2008). Pantuliano (2009) points to bureaucratic World Bank procedures, staffing problems and protracted negotiations on who does what as key reasons for poor disbursements. Overall it appears that the design of the MDTF is not suited to post-conflict situations and and this is common knowledge. Pantuliano (2009) asks why, therefore, lessons have not been learnt.

2. How can we increase the scale of resources in risky environments?

Are we investing enough in fragile environments? The volume of assistance can tail off rapidly once immediate emergency and peacekeeping operations scale down. Normal donor appraisal procedures can lead to delays and an overly cautious approach. There is a trade-off between the risk of a higher proportion of failed interventions and a potentially greater impact of rapid aid in post-conflict situations. Are these risks understood? Are donors taking on too much or too little risk?

3. Are the right types of assistance being deployed?

Financial support can be provided as traditional aid, technical assistance (TA) and through new modalities such as cash on delivery. TA is positive when it supports reforms that are context-appropriate (Box 3). It is also important to support domestic revenue generation through simple, feasible, and practical approaches (Symansky, 2010). What are the trade offs in providing budget support? Should arrears clearance have higher priority... effectively a form of budget support?

Box 3: Planning and budgeting reforms in Southern Sudan

The Government of Southern Sudan has developed integrated systems for planning and budget preparation. These systems have been built from scratch. Two factors, in particular, have influenced their success:

1. Strong technical leadership from an integrated Ministry of Finance and Economic Planning, responsible for planning, budgeting and aid coordination.
2. System development that was tailored to this specific context, with incremental improvements aligned to development in local capacity.

International technical assistance (TA) played a mixed role – positive when focused on the development of context-appropriate systems, negative when trying to introduce systems that exceeded local capacity to manage them.

4. Should a proportion of aid fully use a recipient's systems?

Budget support has provided support in a range of post-conflict settings including: Rwanda, Mozambique, Sierra Leone, Pakistan, Cambodia and Afghanistan. Even if it is not possible to provide high levels of budget support early on, a proportion at least should be channelled through recipient governments' systems, perhaps through sector budget support or sector basket funds. Funds can be provided bilaterally or as pooled funds (Symansky, 2010 suggests the latter). Donors should, at the very least, report their activities to the government in a manner that is timely and consistent with the post-conflict government's accounting system (Symansky, 2010).

5. Does cutting administration budgets reduce aid effectiveness?

Financial assistance needs to be supported by solid analytics in fragile situations. Failure to understand the context can lead to serious mistakes. It could be argued that all foreign aid becomes less effective as 'more is delivered with less' and development agencies reduce their staff and administration budgets relative to funds they manage. This is more pressing in fragile states, where donor offices need to think fast and relate support to the local, and often changing, context. Are the OECD-DAC Principles (Box 1) feasible with a low head count?

Session 2 - Developing local financial management capacity – moving from quick fixes to sustained reforms

Chair: ***Simon Maxwell***, Senior Research Fellow ODI.

Panel: ***Graham Scott***, Executive Chairman, Southern Cross Advisers; former Secretary to the Treasury, New Zealand.
Mark Plant, Deputy Director, Africa Department, International Monetary Fund.
Ephrem Gondha, President, Reform Committee, Ministry of Finance, Democratic Republic of Congo.
Matthew Martin, Director, Development Finance International.

Discussion points

1. Build on existing capacity and systems
2. Take care when using international experts
3. Avoid introducing short term distortions without a clear exit strategy
4. Concentrated versus deconcentrated reform efforts
5. Consider overall civil service reform
6. Support coordination of Technical Assistance (TA)

The reform of public financial management (PFM) systems in fragile states faces acute human capacity constraints. There is a tension between the pace at which PFM systems can be developed and the building of long term capacity. Donors often use external expertise but this can become an obstacle to the creation of sustainable long term capacity.

There is a tendency to look at capacity building as a technical fix rather than taking a longer term perspective and focusing on the values, culture behaviour and relationships that vary from one context to the next. Standardised 'solutions' to PFM are also used. Which aspects of PFM systems benefit from this approach, and which do not?

1. Build on existing capacity and systems

The key challenge is to rebuild capacity while avoiding long-term distortions. Prevention is better than cure. PFM institutions may exist, albeit in a poor condition, and the priority is to preserve and build on them.

When the PFM systems are non-existent, is there are role for capacity building approaches used in more stable situations? How can reform be sequenced to make best use of existing capacity and minimise the distortions?

Donors are often under pressure to produce demonstrable results in the short term and to design interventions that are easily monitorable. How can reform programmes support longer term processes while satisfying evaluability criteria?

2. Take care when using international experts

It may be necessary to rely on international experts on occasion, but care is needed. They are often brought in with little understanding of the local situation and try to apply systems that they have developed elsewhere. Their appointment can cause resentment and disillusion among local staff. They need to be selected carefully and posted for a long enough time period. Good interpersonal skills and sensitivity to local circumstances may be preferable to technical excellence.

Would it be better to use those from the national Diaspora or returnees? Where are the examples of good practice in this area?

3. Avoid introducing short term distortions without a clear exit strategy

Donors often use exceptional measures to affect a rapid increase in local capacity, such as financial inducements to attract or retain local staff, or to attract those from the national Diaspora. These distort local salary scales and are seldom sustainable once donor funding is withdrawn. Care is needed over such short term measures and there needs to be a clear exit strategy.

Are there good examples of innovative approaches that draw on, for example the outsourcing of some functions?

4. Concentrated versus deconcentrated reform efforts

Often Ministries of Finance can be over whelmed by the multiple demands on them. A Ministry of Finance should concentrate on its core areas of responsibility.

A concentrated effort on just one area or function may create an island of excellence. Its effectiveness, however, may be impeded by poor capacity elsewhere. A relatively well performing Ministry of Finance, for example, may lack good quality budget inputs from line ministries. Or good financial discipline in the centre may be undermined by poor capacity at lower levels. How to ensure a balance between working with a few key actors and a wider, more diffused effort?

PFM has to be operational, at even a basic level, before decentralised control can be effective. Leaving PFM reform in line ministries and lower administrative levels too long, however, appears to impede improvement of service delivery. Again, how do we strike the balance?

Capacity strengthening should not be limited to the PFM functions within government: accountability and oversight also need to be strengthened, including parliamentary oversight and citizen groups. These functions are rudimentary in most fragile states. What good practice exists to train these wider groups of stakeholders and how high a priority is it?

5. Consider Overall Civil Service Reform

Staff working on PFM are part of the overall civil service structure. Sustainable progress on PFM is linked to improvements in the civil service as a whole. Civil service reform programmes are difficult, complex and time-consuming. How can capacity for PRM functions be advanced in a timely manner while remaining part of the wider civil service reform? Are there good examples and models?

Pay levels are often insufficient to attract and retain good staff. Should donors do more to support pay reform? How can adequate fiduciary safeguards be provided?

6. Support Coordination of Technical Assistance

Technical assistance for capacity building needs to be well coordinated to be effective. In practice, however, there is often duplication and poor coordination. Few governments in fragile states have coordination capacity, and the donors' own coordination mechanisms are poorly developed. How can more effective coordination mechanisms be put in place and are there good examples to draw on?

There needs to be a clear strategy for training. Should training be separated from implementation? Is there need to revisit the training skills of incoming experts?

Is too much emphasis placed on the training of individuals rather than the building of institutions? Could greater emphasis be given to the reinforcement of cadres, such as accountants and budget monitors, over a prolonged period by building up local institutions? The tension between quick fixes and sustainable solutions needs to be managed.

Session 3 - The role of transparency and accountability

Chair: ***Andy Norton***, Director of Research ODI.

Panel: ***John Morlu***, Auditor-General, Liberia.
Karim Nashashibi, Advisor to the Prime Minister, Palestinian National Authority.
Paolo De Renzio, International Budget Partnership.
Joachim Wehner, Lecturer, London School of Economics.
Gavin Woods, former Chair of the Parliament Accounts Committee, South Africa.

Discussion points

1. Does Parliament have an immediate role to play in the accountability system, or does this emerge as the institutions are established?
2. There is emerging consensus on transparency tools and measurement, but how is the information used?
3. Does aid make transparency and accountability a more complex process?
4. How is transparency best achieved?

1. Does Parliament have an immediate role to play in the accountability system?

The legislature plays an important role in oversight of the actual implementation of the budget and, particularly in more developed countries, a role in the examination and amendment of budget plans. These two functions are important for domestic accountability structures, but to what extent are they valuable or even constructive in situations where the legal and political role of the parliament is being established?

2. There is emerging consensus on transparency tools and measurement, but how is the information used?

An array of different initiatives on budget procedures and transparency, such as the Public Expenditure and Financial Accountability assessments and the Open Budget Index, show strong consensus on the core documents and procedures needed in an accountable public finance system. Is there a convergence on global norms for the supply side of public finance accountability systems?

On the other hand, it is less clear how this information is used by parliament, civil society and other external actors, even in more developed countries. From a technical point of view, the ability to analyse and advocate on PFM issues requires a component of capacity building amongst stakeholders. This can be extremely challenging and nigh on impossible in the poorest and most fragile states. The role of analysis and advocacy mechanisms could be described as a public good in the accountability structures of public finance, but how is the transaction cost for this role covered in the poorest and most fragile countries?

Building a strong demand for government financial information by users requires more than capacity to analyse and present government information for advocacy purposes. It needs sizeable traction from citizens based on credible platforms for reform. In poor and fragile states is it enough to focus on the supply side of accountability systems? Or is this a wasted effort when the demand side of accountability is weak, with limited options for development?

3. Does aid make transparency and accountability a more complex process?

The Open Budget Index typically finds that aid dependent countries have a lower ranking. But does this understate the complexity of accountability structures for these countries, where aid provides much of the service delivery for the population, and up to half of overall national revenues?

Budgets are the link between policies and their implementation, between political visions or programmes and their delivery. They allocate resources both in terms of money and time to plans. Policies are implemented through government departments, agencies and local governments. These institutions, and their managers, are accountable to the political leadership. Politicians, in turn, are accountable to citizens for the implementation of national policies for health care and education, for example. If this cycle of accountability is not carefully observed and supported in the delivery of aid, it is likely to be undermined (Brautigam and Knack 2004, and Barder, 2009). One way this can happen is that aid is often delivered with accountability structures that are parallel or divorced from those of the government.

Furthermore, in countries that are aid dependent, a high proportion of total government revenue is derived from aid rather than taxes and this may reduce the interest or attention that a government pays to its citizens in favour of donors. In both these scenarios, the citizenry's ability to hold their government to account for the services they deliver may be weaker as a result of the provision of aid.

It is unlikely, and also may not be optimal, for all aid to be delivered using government systems in full. However, high levels of aid do make the accountability structures in a country more complex and it is important that aid is planned for and delivered in ways that do not undermine government accountability. How can aid be delivered to support the development of domestic accountability?

4. How is transparency best achieved?

There is no solid consensus on key drivers for greater transparency. Transparency in public finance emerges from supply side effects, such as champions in the cabinet, parliament or public service, or public finance reforms that improve accountability systems. It can, however, be driven by demand side effects such as donor conditionalities, pressure to match the developments of neighbouring countries, or a vocal electorate. Rarely, however, do noticeable improvements in public finance transparency happen just by accident.

Mechanisms to support government planning and execution processes, such as virtual funds, provide an opportunity to make public finance more transparent in poorer countries. Individual personalities such as a strong auditor general or finance minister may also catalyse the effect by pushing for greater accountability, or by supporting reforms under their guidance that lead to more accountable systems. The Open Budget Index also demonstrates that higher transparency is something of a regional phenomenon, with East and Central Africa and the Indian sub continent having noticeably better scores than neighbouring regions. In Europe, northern countries are amongst the most transparent, while southern European countries are fairly average on the global scale. What is the evidence on how to develop effective transparency?

Session 4 - Public financial management reform in fragile states – what works and why

Chair: ***Marco Cangiano***, Assistant Director, Fiscal Affairs Department, International Monetary Fund.

Panel: ***Matt Andrews***, Assistant Professor, Harvard Kennedy School
Lulzim Ismajli, Director of Treasury, Ministry of Finance, Kosovo.
Camille Karamaga, Regional PFM Adviser for West Africa, IMF; former Director of Budget, Ministry of Finance, Rwanda.

Discussion points

1. How to take stock of the existing situation?
2. What are the key public financial management (PFM) functions that need to be restored first?
3. How should reforms be sequenced?
4. How to ensure sustainability of reforms?
5. Is political buy in for PFM reforms a necessary condition for their successful implementation?

1. How to take stock of the existing situation?

The assessment of the existing situation is vital to restore and develop key PFM functions. Should interventions build on existing structures, including the existing legal framework, or start from first principles? Some argue that existing structures, including the legal framework, should be used whenever possible. This was the case in Afghanistan, where reforms worked well. In Iraq, however, much of the PFM system was destroyed and this approach could not be applied. In other cases, such as Kosovo, PFM reforms had to be established from first principles. Others argue that re-establishing 'normal' PFM practices may require the adoption of a new legal framework that encourages rule of law and routine behaviour based on good practice. Can standard diagnostic tools, or certain aspects, be applied to fragile contexts, particularly in resource-rich countries?

2. What are the key PFM functions that need to be restored first?

There is ample evidence that focusing on budget execution and basic expenditure control mechanisms is vital to address the most basic needs, such as ensuring that civil servants are retained and paid regularly and that key items continue to be purchased, such as medicines and medical equipment. Focusing on this aspect also addresses an early stage misallocation of funds and basic accountability. Governments that focused initially on strengthening budget execution – in Afghanistan, Kosovo, West Bank and Gaza, Sierra Leone, Liberia – have made considerable improvements in their overall PFM performance. But, within budget execution, are there functions that are more essential than others? Should audit functions also be restored rapidly, if not already developed, or could these be left for a later stage? How long can one wait to develop a process for strategic allocation of resources, or strong systems to monitor and scrutinise budget processes? How can we speed up the pace of financial management reform?

3. How should reforms be sequenced?

There has been a proliferation of diagnostic tools over the last ten years. They can all play a useful role, but what makes them helpful rather than an exercise in compliance? Some argue these instruments do not provide much guidance on priorities for reform, and tend to be geared toward 'best practice'. How can they be best used to develop reform strategies and action plans?

The literature on sequencing seems to struggle with this. At one extreme, there seems to be a quest for the 'optimal' sequence, at times producing over-engineered reform plans that are rarely owned by countries and quite difficult to manage. At the other, there is increasing scepticism summarised by a more ad hoc, 'it depends' approach. In the case of fragile contexts and states, there seems to be emerging consensus that basic PFM functions should be addressed first. Systems should be easily configurable so that procedures can easily be adopted over time, and improvements should be made incrementally, taking into account country characteristics. But the so-called 'basics' have also evolved over time. Are there any circumstances under which a big bang approach would be appropriate? What are the pros and cons of such an approach in cases where nation building is at the forefront of the political agenda?

4. How to ensure sustainability of reforms?

Even if an appropriate sequence is devised, managing and sustaining the reform effort is easier said than done. The sustainability of reforms is also determined by factors beyond PFM, including political support (see below), the initial level and development of human capacity, and wider civil service reform agenda. What are the relative roles between country authorities and donors, including international financial institutions? Is it the case that donors often end up driving the process instead of countries? And even where this is not the case, the coordination of donors' efforts is a full time job that can take its toll on countries where capacity is still scarce. How to ensure that countries are, effectively, in the driving seat? Could an early use of country systems play a vital role, if risks are managed carefully, thus providing incentives to sustain the reform effort? Provision of technical assistance (TA) is useful to keep reform processes on track. But TA should focus on capacity building and strengthening self-confidence of local staff to handle their own affairs. Instead, it often ends up substituting rather than complementing and enhancing local skills. How can countries manage these risks best?

5. Is political buy in of PFM reforms a necessary condition for their successful implementation?

Political support and leadership from the very top are essential for reforms. Accountability and service delivery, along with standard macro stabilisation, efficient allocation of resources and income redistribution are often the basis of political platforms. Questions worth examining include: How does such high-level support translate in daily management of reforms? How are reform champions identified and supported? Can a team of motivated and competent technocrats lead the process? Is the high-level political support, often expressed in nation-building statements, sufficient, or is broader buy in also needed for successful implementation? Will reforms eventually sell themselves, i.e., once their benefits have started to materialise?

Annex iv - Issues highlighted by participants in the final session: drawing policy-relevant lessons*

DO MORE OF

1. Support change management
2. Share regional experiences
3. Use country systems with proper accountability
4. Build budget analysis at Parliament
5. Press for transparency
6. Build executive accountability

DO LESS OF

1. Laws – that do not meet relevance/urgency tests
2. Donor micromanagement

DO DIFFERENTLY

1. Procurement – new approach in fragile states
2. PFM reform sequence - focus on actions with most impact/ most critical outcome
3. Ensure Government leadership and context specificity
4. Adjust expectations
5. Link PFM reforms to other reforms
6. De-concentrate responsibility to line ministries

*Cited by 4 or more participants

Annex v - Additional resources

Additional resources from the CAPE Conference 2010, are available from **http://bit.ly/capeconference2010** including:

Interviews

1. Graham Scott - Executive Chairman, Southern Cross Advisers; former Secretary to the Treasury, New Zealand
2. Emilia Pires Minister of Finance, Government of the Demoncratic Republic Timor-Leste
3. Ali Abdi Managing director, The Horn Economic and Social Policy Institute (HESPI)
4. Gavin Woods - former Chair of the Parliament Accounts Committee, South Africa
5. Steve Symansky - former staff member IMF Fiscal Affairs Department
6. Mustafa Mastoor - Deputy Minister of Finance, Afghanistan
7. Marcus Manuel - Head of CAPE, ODI; Director of the ODI Budget Strengthening Initiative
8. Sanjeev Gupta - Deputy Director, Fiscal Affairs Department, IMF
9. Patricia Alonso-Gamo - Senior Advisor in the Middle East and Central Asia Department of the International Monetary Fund

Documents

1. Public Financial Management Reforms in Fragile and Conflict-Affected States, Edward Hedger
2. Discussion Paper, Steve Symansky

The ODI Centre for Aid and Public Expenditure helps to shape and drive the agenda for international development assistance, as well as efficient and effective public spending for development at country level.

Working in close partnership with international and local stakeholders, from donor agencies to local research institutes, our research and policy advisory work addresses how the international financial system needs to be adapted to tackle financial instability in donor and developing countries, and how to better address demands for climate change financing. In addition, we aim to improve understanding of how aid effectiveness and public finance management principles can be applied, in fragile states and emergency situations.

The sixth annual CAPE conference is organised by ODI in partnership with the IMF's Fiscal Affairs Department with support from the UK Department for International Development and GIZ (formerly known as GTZ).