Public Financial Management capacity development within the context of the Global Development Challenge

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Introduction

Mr Nelson Mandela, speaking in London in February 2005, strongly exhorted: *"In this new century, millions of people in the world's poorest countries remain imprisoned, enslaved and in chains. They are trapped in the prison of poverty. It is time to set them free."* The Millennium Development Goals (MDGs)[1], endorsed by 189 countries at the UN Millennium General Assembly in September 2000, constitute a compact for eradicating poverty. Their overriding goal is to halve the proportion of people living in extreme poverty by 2015.

Effective, efficient, transparent, accountable and predictable Public Financial Management (PFM) in developing countries is a prerequisite for long term and sustainable reduction of poverty and effective use of scarce financial resources. The HIPC[2] Debt Initiative underscored the connection between the quality of PFM systems and poverty reduction several years ago. PFM is directly linked to opportunities for democratic governance, and the ability to fight corruption, and furthermore provides the opportunity for effective development cooperation. Over the last decade the development community has come to understand the importance of strong PFM (accountability) systems through which national policies are transformed into practice and which support the achievement of the MDGs.

Hegarty (2005) argues that improved PFM capacity is at the core of good governance and lies at the heart of achieving the MDGs. Developing countries are beginning to recognise that problems in sectors such as health, education, and agriculture may have a common origin: weak PFM. While capacity development is central for all modes of delivery of development aid, the growing interest among donors to move to budget support as an alternative to project-based lending, has fuelled increased concerns over capacity development in PFM.

In the following sections the nature, scope and purpose of PFM capacity development within the context of the global development challenge is explored. This is followed by a discussion of conditions and principles underlying good PFM capacity development.

Nature and scope of PFM capacity development

The United Nations Development Programme[3] defines *capacities* as comprising "the ability of people, institutions and societies to perform functions, solve problems, and set and achieve objectives". *Capacity development* denotes the *process* by which partner countries are enabled to make better use of existing capacities and to further develop capacities at three levels: *(i)* the individual level, *(ii)* the level of organisations; and *(iii)* the institutional and political level. *Capacity* includes the individual and collective ability to perform functions, solve problems, set and achieve objectives, etcetera. When this definition is applied to PFM it relates to the ability of both financial and non-financial public officers (including parliamentarians) and their organizations to perform the financial management function in the public sector. This PFM function is primarily a support function that provides services to those in the front line who actually deliver public services.

A wide spectrum of stakeholders in developing countries requires some level of PFM capacity development. These include government institutions at central, sub-national and local levels, committees of parliament, as well as public entities. Even regulatory organisations as well as the accounting and auditing profession, to the extent that they are involved in public sector financial management activities, may qualify. According to Bennet (2004) PFM capacity development covers a number of groups:

- the budget and accounts officers who provide these information and treasury services;
- the personnel of oversight agencies such as internal and external audit, certain parliamentary committees, anti-corruption agencies, donor groups, etc.;
- non-financial managers, such as program managers and agency heads who commonly have a PFM responsibility to the legislature as well as to their immediate superiors in the government: they need the capacity to understand their PFM responsibilities under the law, and how they can use the information and treasury services provided; and
- the NGOs representing civil society organisations and other direct beneficiaries of public services (lateral accountability). These NGOs also need to understand PFM law, systems and organisation, so that they know who to hold accountable and for what[4].

Aim and purpose of PFM capacity development

The Norwegian Agency for Development Cooperation (NORAD) and the Swedish International Development Cooperation Agency (SIDA) state that c*apacity development in PFM* aims at developing the rules and procedures in PFM, organising the work and providing resources (physical, human, financial) in a way that facilitates their efficient implementation; and equips people in the organisations with competencies to operate efficiently in accordance with them. The overall aim is to make PFM an efficient tool for implementing policies and producing services for the benefit of the people as well as providing an accountability mechanism for controlling government and the public service.

In the past *project-based lending*, including segregated project management units, has given some assurance within the development community that funds were being used properly — but the parallel systems have only undermined capacity development. Resources that could have gone directly into PFM enhancements instead went into setting up external (ring-fenced) structures. For *budget support* to gain wider usage, donors must still find ways to respond to the fiduciary concerns of their national stakeholders. There is a need for reliable information on how budget support is used and that it is "properly managed and used", so that they can be accountable to their own taxpayers, and also be able to continue this support. But developing countries have the same interest concerning their own funds, as part of the budget. The challenge therefore is to develop this commonality of interest into a country led concern with sound PFM, which is supported by donors, and includes dialogue based on mutual objectives and trust. Improvement of the capacity of PFM systems is one of the ways that partner countries are looking to address these fiduciary concerns.

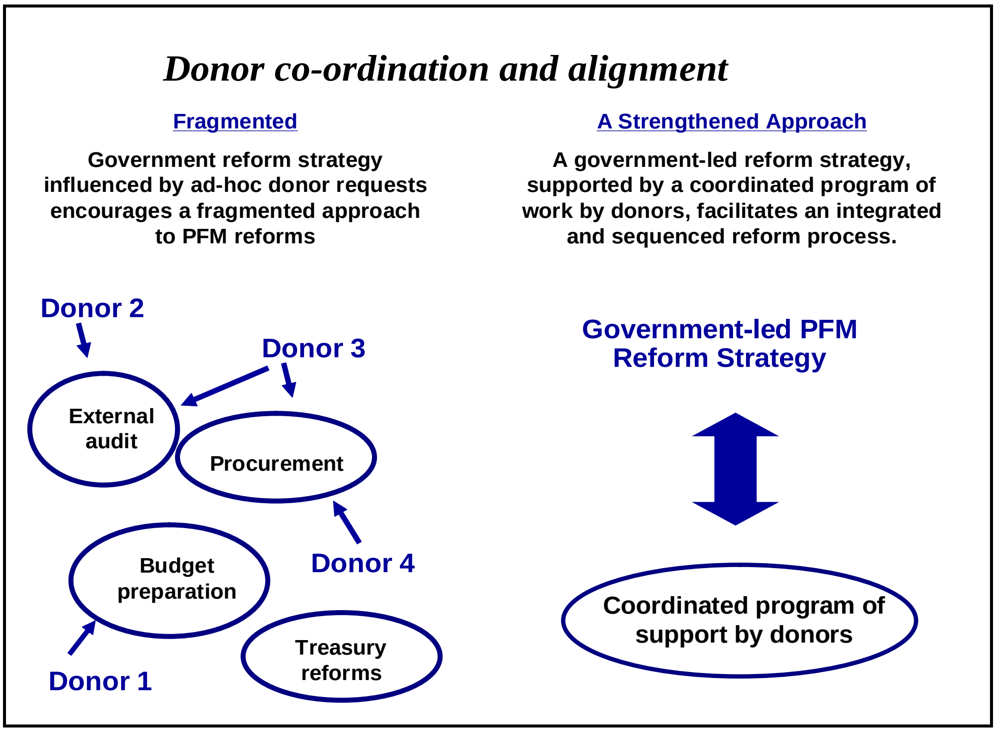
Common principles for effective capacity development in PFM

An overarching principle to guide future work is that capacity development is not a donor activity, but a task for developing country governments. In other words, capacity development is primarily endogenous to a country, based on voluntary action and motivation. Donor aid initiatives can support capacity development — these efforts should be rooted in the partner country's goals and strategies. Though many efforts by donors to support capacity development have fallen short of expectations, the following table[5] summarises important principles that have emerged to guide future work:

1. Supporting country leadership and ownership should be central to donor approaches
▪ Capacity development is most likely to succeed when countries view it as serving their self interests and are committed to taking the actions necessary to implement it. ▪ Donors have little ability to create incentive for capacity development where it does not already exist and their role is to *facilitate* rather than direct the process of turning broad goals and strategies into an actionable plan. ▪ Country ownership implies an engagement throughout the entire chain of activity problem definition, diagnostic analysis, design of the action plan and proposed interventions, and implementation. ▪ Ownership and commitment require strong *political support* from the highest levels, evidenced in timely decisions and agreement to introduce new legislation. Working-level commitment from the government's staff is also essential.
2. Capacity development design and sequencing should fit specific country circumstances,

rather than reflect standard or imported solutions
▪ Effective capacity development starts with a premise of *building* upon what already exists, rather than transplanting entirely new systems. ▪ It should make use of local knowledge and build upon existing values where possible. ▪ Many developing countries may not have adequate facilities for PFM training. There may be a need to build such institutes or make alternative training arrangements before taking up any big PFM capacity development projects or program. ▪ The timing and scope of interventions are designed to be consistent with the country's capacity – be it political, social, or managerial – to implement change. All too often, well-meaning capacity development programmes have led to over-stretching key government officials and dispersing effort, thus minimising results. Reform overload should therefore be avoided. ▪ Well-sequenced capacity development with the government's own reform agenda takes into account the building blocks of a PFM system that must be in place for subsequent reforms to succeed. It balances the need to generate short-term "wins" with a longer-term view of how deep and lasting change occurs. ▪ Legal and regulatory requirements that are based on traditional business processes, systems and documentation should be changed to match new PFM systems in order to avoid conflict with reformed processes and systems.
3. The institutional, organisational and individual levels of capacity development, including managerial and technical aspects, should all be taken into account in programme design and implementation
▪ Capacity development must be viewed from a holistic or systemic perspective, and not merely as a transfer (*e.g.* of skills). Though new equipment, training programmes, and updated procedures all play a role, design of effective capacity development takes into account the political, institutional and organisational context in which change must occur. ▪ Technical solutions should be also supplemented by *reviewing* the broader social/political context, incentives for various stakeholders, the impact of human resource policies and practices, as well as the culture of the public service as a whole. In some cases, individuals may already have the necessary skills and experience, but the environment or organisation in which they work inhibits performance. ▪ Capacity development is linked with institutional and human development. Care should be taken to build on the existing base and not to "re-invent the wheel" or unnecessarily create new institutions. ▪ In promoting change, and in order to achieve sustainable results instead of temporary islands of excellence, it is important to understand how these various system levels interact. Change management issues must increasingly be considered. ▪ Use technology appropriately for modernization of PFM functions. The level of sophistication of systems should take account of the real information needs and the capacity to operate the system. It is important to have the users in the driver's seat, not the donors, nor IT professionals.
4. Donor support should be provided in a coherent, coordinated, and programmatic manner
▪ One of donors' primary responsibilities should be to minimise the transaction costs (of working with multiple donors) to government. Therefore, wherever possible, donors should strive to harmonise procedures and monitoring mechanisms. ▪ As to the content of capacity development, the government's own action plan should be the focal point for determining support. ▪ Support should be phased over a multi-year horizon in order to take into account the long-term nature of capacity development. Likewise, interventions should be programmed in a way that reflects how they fit with the country's development objectives. ▪ Mainstream project financial management. The government ministries and departments should as far as possible assume the role of project financial manager using the government's own PFM systems and develop their own capacity in financial management.

The elements of principle number 4 above are illustrated in the diagram below.



Conclusion

The MDGs offer concrete targets for everyone to rally around in the global fight against poverty. However, with just a decade to go to 2015, reaching the MDGs, as noted by the G8 Finance Ministers at their meeting in the UK in June 2005, will require accelerated and concerted action from both developing and developed countries. The Global Monitoring Report (GMR), prepared by staffs of the World Bank and the IMF in April 2005 in consultation with other development partners, proposed a 5-point agenda for accelerating progress toward the MDGs. One of these points is to "Improve the environment for growth by strengthening fiscal management; improving governance by upgrading public sector management and combating corruption; easing constraints on business; and strengthening economic infrastructure." Also, it can be noted that the Declaration from the Paris High Level Forum on Ownership, Harmonization, Alignment, Results and Mutual Accountability (February 28 – March 2, 2005) includes a commitment by partner countries to take leadership of the PFM reform process.

To conclude: Developing of PFM capacity is a means and not an end in itself — it is an integral part of the overall development agenda. Consequently, a capacity development strategy must be based on a broader vision of improved PFM and increasing organizational effectiveness leading to good governance. While country ownership is critical, the capacity development efforts have to be tailored to match the existing human resources, institutions, legal system, as well as the administrative and political culture. Furthermore, the motivation for capacity development should transcend the mode by which it is to be delivered.

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Endnotes

[1] Refer to the web page: http://ddp-ext.worldbank.org/ext/MDG/home.do
[2] HIPC = Heavily Indebted Poor Countries.
[3] UNDP (2002), Developing Capacity through Technical Cooperation. p.2.
[4] The same argument can be made in favor of training journalists, broadcasters, etc.
[5] It draws significantly from the publication: ***Harmonising Donor Practices for Effective Aid Delivery - Volume 2:*** *Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management.*