

Public Financial Management in Decentralised and Decentralising Environments

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What is public financial management and how is it used in decentralised and decentralising systems?

Public financial management (PFM)—the science and art of budgeting, spending, and accounting for public funds—is among the most fundamental elements of public sector reform¹. PFM not only helps to ensure that there are clearly defined and well applied rules and processes for managing public resources and to limit opportunities for corruption, but it also provides citizens with information they can use to evaluate the revenue generation and service delivery performance of the governments that serve them.

PFM has long been a rather technical field, but there is growing recognition that political and institutional conditions can heavily influence whether (and at which pace and sequence) even a seemingly robust PFM reform can work on the ground. The challenges faced in practice have led to an evolution in thinking, generating an increasingly interdisciplinary and pragmatic approach to designing and implementing PFM reforms. Cangiano, Currstine and Lazare (2013) review recent developments in PFM (not specific to developing countries) and outline how it is likely to be approached in the future.

Some form of decentralisation has also become nearly universal practice in public sector reform in developing countries. Decentralisation is usually understood as the assignment of public functions to subnational



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¹ See this reading pack on Public Financial Management: http://www.gsdrc.org/docs/open/reading-packs/PFM_RP.pdf

governments along with supporting structures, systems, and resources². Subnational governments, as much as central governments, require a well-structured PFM system to help ensure appropriate and accountable use of public resources in pursuit of developmental goals. Shah (2007) provides a detailed treatment of the elements of subnational public financial management, including basic accounting and reporting, cash management, procurement, debt management, internal control and audit, and external audit and performance evaluation.

Reading 1: Cangiano, M., Curristine, T., and Lazare, M. eds. (2013). *Public Financial Management and Its Emerging Architecture*. Washington, DC: International Monetary Fund, pp. 1-17.

<http://www.imf.org/external/np/exr/bforums/2013/pfm/pdf/excerpt.pdf> (introductory chapter to this volume can be downloaded with the link provided)

Reading 2: Shah, A. ed. (2007) . *Local Public Financial Management*. Washington, DC: The World Bank, pp. 1-5.

http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/06/15/000020439_20070615110511/Rendered/PDF/399950PAPER0Lo10082136937701PUBLIC1.pdf (full volume can be downloaded with the link provided to view the introduction and other chapters).

What is the relationship between PFM and decentralisation reforms?

PFM reforms are considered essential for realising the expected benefits of decentralisation because of their central role in enhancing managerial efficiency, transparency, and subnational government accountability to both higher levels of government and to local constituents. Although PFM reforms require standardised rules and central oversight, some subnational autonomy is also important for effective decentralisation. Subnational governments can be critical actors in the successful implementation of national PFM reforms in countries that are decentralised or decentralising. PFM reform that is too lax risks enabling irresponsible local government fiscal behaviour, however if overly restrictive it can constrain local government discretion to the detriment of decentralisation. One of the most critical issues in subnational PFM is getting an appropriate balance between central oversight and local autonomy, as outlined in Ter-Minassian (2012).

Reading 3: Ter-Minassian, T. (2012). Promoting Effective and Macroeconomically Sound Fiscal Decentralisation: The Role of Central Finance Agencies. In: *Decentralisation and the Changing Role of Central Finance Agencies*. Manila: Asia-Pacific Community of Practice on Managing for Development Results, Asian Development Bank, pp. 25-36. [https://wpqr4.adb.org/LotusQuickr/cop-mfdr/PageLibrary482571AE005630C2.nsf/\\$defaultview/8BF45408225FA55048257B6B0013CA29/\\$File/Decentralization and the Changing Role of Central Finance Agencies.pdf?OpenElement](https://wpqr4.adb.org/LotusQuickr/cop-mfdr/PageLibrary482571AE005630C2.nsf/$defaultview/8BF45408225FA55048257B6B0013CA29/$File/Decentralization%20and%20the%20Changing%20Role%20of%20Central%20Finance%20Agencies.pdf?OpenElement)

Reading 4: Fedelino, A. and Smoke, P. (2013) Bridging Public Financial Management and Fiscal Decentralization Reforms in Developing Countries. In M. Cangiano et al. (eds.)

<http://www.elibrary.imf.org/page/226>

² See this reading pack on decentralisation: <http://www.gsdr.org/go/professional-development-reading-packs/decentralisation>

Reading 5: Klingebiel, S. and Mahn, T. (2013). *Strengthening the Accountability of Local Governance: How to Bridge the Gap between Decentralisation and Public Financial Management*. A summary of work conducted by the German Development Institute was published by *The Broker Online*. <http://thebrokeronline.eu/Articles/Strenghtening-the-accountability-of-local-governance>

What are some of the prominent emerging trends in the intersection between PFM and decentralisation reform?

1. How can the full extent of local public sector expenditures and revenues be properly measured and accounted for?

Much policy work and research on fiscal decentralisation in developing countries has focused on devolution – the form of decentralisation that involves assigning powers and functions to elected subnational governments with significant autonomy. In many countries, however public services may be delivered through other forms of decentralisation, specifically deconcentration (provision of local services through agencies of higher levels of government) and delegation (provision of local services by a governmental or nongovernmental entity contracted by the government with formal responsibility).

These other approaches involve different budgeting, financing and managerial arrangements than devolution. For example, deconcentrated spending is normally included in central government rather than local government budgets--and can be quite important. All of these forms of decentralised service financing and delivery must be subject to sound PFM systems and must ultimately work together to bring about good developmental results in particular local jurisdictions. Boex (2012) discusses the nature and significance of the broader local public sector and the implications of failing to properly understand the mix of arrangements used to execute local public functions.

Reading 6: Boex, J. (2012). *Exploring the Measurement and Effectiveness of the Local Public Sector: Toward a Classification of Local Public Finances and a Comparison of Devolved and Deconcentrated Finances*. Washington, DC: The Urban Institute. <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412474-Exploring-the-Measurement-and-Effectiveness-of-the-Local-Public-Sector.PDF>

2. How can local government fiscal responsibility be encouraged?

A basic PFM system is important for managing local government finances, but there has also been growing attention to the need to develop robust fiscal responsibility frameworks. The role of such frameworks has been embraced at least since the significant Latin American subnational debt crises of the 1990s. As local (particularly urban) governments in many developing countries have assumed more prominent fiscal roles and are looking to borrow funds for needed capital investments, such as infrastructure, the interest in fiscal responsibility rules has been growing.

Such frameworks must be tailored to the context of specific countries, and they are not enough on their own to create a robust environment for responsible local government fiscal behaviour, but they can be an important element of a strong intergovernmental fiscal system. Liu and Webb (2011)

review international experience with fiscal responsibility frameworks and consider the advantages and disadvantages of various approaches.

Reading 7 : Liu, L. and Webb, S. (2011). *Laws for Fiscal Responsibility for Subnational Discipline*. Policy Research Working Paper 5587. Washington, DC: The World Bank.
<https://openknowledge.worldbank.org/bitstream/handle/10986/3354/WPS5587.pdf?sequence=1>

How can local government budget transparency and accountability be assessed and promoted?

As interest in citizen participation and civic activism in subnational government affairs has grown with the advancement of decentralisation and democratisation trends, there has been increasing momentum to promote open access to local government information through budget transparency. Much of the focus on this topic has been at the national level (e.g. with Freedom of Information and Right to Information legislation), but decentralisation policies that increase the responsibilities of subnational governments have recently generated more attention to transparency at the local level. This includes not only information on how subnational governments generate and spend their own resources, but also on how they have used funds transferred from higher levels of government.

Such information also allows citizens to determine the extent to which local government development plans and annual budgets are implemented as published and has the potential to improve accountability. Schaeffer and Yilmaz (2008) examine legal and budgetary instruments and processes that increase public accessibility to information on local government activities. Kroth (2012) reviews basic concepts and practices involved in subnational budget transparency, and synthesises the results of recent case studies of ten developing countries commissioned by the International Budget Partnership.

Reading 8: Schaeffer, M. and Yilmaz, S. (2008) *Strengthening Local Government Budgeting and Accountability*. Washington, DC: The World Bank.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297806

Reading 9: Kroth, V. (2012). *Subnational Budget Transparency: An Analysis of Ten Pilot Studies*. Washington, DC: International Budget Partnership.
http://internationalbudget.org/wp-content/uploads/Subnational-Synthesis-Paper_final.pdf

Discussion Questions

1. What is the status of PFM and decentralisation reform in the country you are working on? Is one reform more advanced than the other?
2. Is there any formal focus of PFM reforms on the subnational level or of decentralisation reforms on local public financial management? Are the efforts in any way coordinated? Are they largely consistent or are there consequential conflicts in the underlying policies and practices?
3. How has the political economy environment shaped the nature of, progress with and relationships between PFM and decentralisation reforms? Which national and local political and bureaucratic dynamics (actors/factors) have influenced the design of these reforms and how they have been implemented at the national level and on the ground?
4. Do PFM and decentralisation policies take account of the structure of the larger local public sector--devolution, deconcentration and devolution? What are the implications of the answer to this question?
5. Have there been efforts to promote a fiscal responsibility framework? If so, is there a sense of how well it is designed (with an appropriate balance between central oversight and local autonomy)? Is it being applied in practice?
6. What efforts have been made to promote subnational budget transparency and accountability? Have these been taken primarily by the central or local governments? Are they being used effectively?