



# STRENGTHENING PUBLIC FINANCIAL MANAGEMENT REFORM IN PACIFIC ISLAND COUNTRIES



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## Executive Summary

### *What is the purpose of this report?*

**The Pacific Financial Technical Assistance Center (PFTAC) produced ‘A Public Financial Management Roadmap for Forum Island Countries’ (“The Roadmap”) in 2009 (PFTAC 2010).** This document was adopted at the Forum Economic Ministers’ Meeting (FEMM) of the Pacific Island Forum as an agreed approach to Public Financial Management (PFM) reform in Forum Island Countries. The document established the need for regular Public Expenditure and Financial Accountability (PEFA) assessments and the development of PFM reform plans for Pacific countries based on PEFA assessments and other inputs. Based on international experience, the document concluded that PFM reforms in Pacific countries should, among other things: i) reflect country priorities; ii) take account of country constraints, including capacity constraints; and iii) have strong country ownership and take political dimensions into account.

**Five years on from the adoption of the Roadmap, this report examines experiences of PFM reform in two Pacific island countries in order to inform future improvements.** Drawing on the messages of the Roadmap we assess PFM reform planning and implementation in case study countries of Kiribati and Tonga over the 2010-2014 period. We assess the extent to which PFM reform planning and implementation in these countries was consistent with the recommendations of the Roadmap. Based on this assessment, we reiterate the relevance of the Roadmap’s messages and present recommendations for improved planning and implementation of Pacific PFM reform in future.

**This report does not assess current PFM systems in case study countries.** Rather, it provides an analysis of previous experiences with PFM reforms, focusing on the research period 2010-2014. PFM problems identified in this report may have since been resolved.

### *Findings from the Case Studies*

**Over the review period, PFM systems were functional in both Tonga and Kiribati, reflecting investment over many years by governments and development partners.** Budgets in both countries provided a reasonably reliable plan for how much would be spent in aggregate and by which ministry (although plans became much less reliable at below-ministry level). Salaries and most payments were generally paid on time, despite limited banking, IT and communications infrastructure. Corruption and fraud were limited in both countries, but there were important concerns regarding inefficiencies.

**Much has been achieved through recent PFM reform efforts in both case study countries.** Over the period under examination, both countries managed to implement reforms that significantly impacted development outcomes. Perhaps because recent macroeconomic challenges faced by Kiribati were so daunting, the success of several PFM reforms is very clear, including reforms to debt management, management of the Revenue Equalization and Reserve Fund (RERF), and some reforms in the SOE sector (such as privatization of the telecommunications utility).<sup>1</sup> In Tonga, improvements in procurement are likely to have led to some improvement in value-for-money in public expenditure, while audit reforms supported increased confidence among development partners, opening the door for increased budget support.

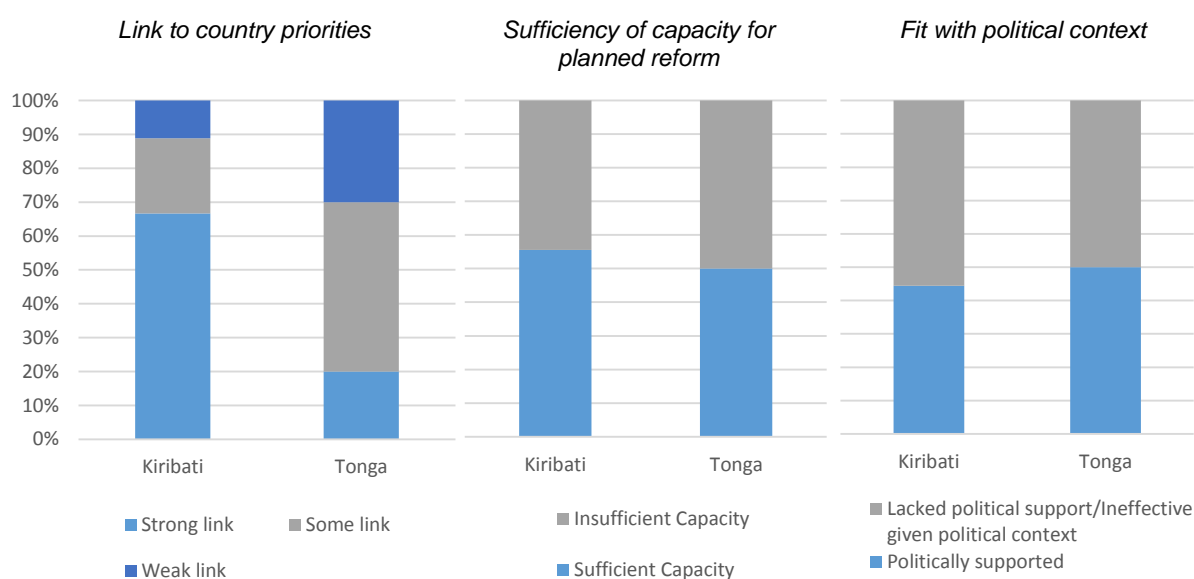
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<sup>1</sup> The Revenue Equalization and Reserve Fund (RERF) is a sovereign wealth fund initially capitalized from the proceeds of phosphate extraction in the 1960s and 1970s.

**Reforms that were well-targeted, consistent with capacity, and enjoyed political support generally achieved their objectives.** There is a very clear association between reforms that were judged to meet the three key recommendations presented in the Roadmap and those that were effective. Around a third of the reforms assessed across both country case studies were considered to have been fully consistent with the Roadmap recommendations and all of these reforms were also judged effective in achieving their intended outcome (although for two reforms gains were not, or have not yet been shown to have been, sustained). This demonstrates the continued relevance of the initial PFTAC recommendations

**While reforms mostly focused on broad PFM areas relevant to priority development problems, there was sometimes a weaker link between specific reforms and required solutions (Figure 1).** Most reforms were responding to real problems at a broad strategic level. Confronted with PFM problems, however, development partners sometimes tended to seek major changes to policies, processes, and systems, rather than working to repair increase compliance with existing systems. Development partners sometimes recommended broad, system-wide and “packaged” reform programs that extended well beyond (or sometimes even omitted) the often relatively simple PFM dysfunction directly causing the observed problem.<sup>2</sup> Examples of such “packaged” reforms include SOE corporatization to address problems of weak SOE financial performance in Kiribati, and implementation of medium-term budgeting to address weak alignment between policy priorities and resource allocation in both countries. The team estimates that around two thirds of reforms in Kiribati had a strong and direct link to the specific PFM dysfunctions contributing to major development challenges. Around one quarter of reforms in Tonga were only weakly linked to main development challenges.

**Figure 1: Summary of analysis of reforms (proportion of reforms)**



**Capacity constraints often undermined implementation across both countries.** Around half of the reforms attempted in Kiribati and Tonga were negatively impacted by capacity constraints. Capacity constraints were encountered for two different reasons. Firstly, in both countries, there were instances in

<sup>2</sup> We define “packaged” reforms as those involving introduction of an internationally-established model for achieving a broad policy objective involving several mutually-dependent changes to processes and rules typically across several agencies. Examples of such “packaged” reforms include SOE corporatization, implementation of an MTEF, or introduction of a VAT.

which the large number of reforms being pursued simultaneously placed an unrealistic capacity burden on government officials. Secondly, some of the reforms recommended or attempted in case study countries were excessively complex given lack of specialized staff and absolute constraints on staff time and numbers. Capacity constraints led to reforms remaining unimplemented or incompletely implemented, or heavily reliant on the continued presence of international technical assistance. Because reforms were typically intended to achieve sustainability over short time horizons, reversals sometimes occurred following the withdrawal of technical assistance. Because of both the number and complexity of reforms, there were cases when reforms in one area diverted capacity from other reforms or core business in central agencies, undermining previous or parallel reform efforts.

**Some reforms were successful because of strong political support, but others did not adequately reflect the political-economy context.** Several important PFM reforms achieved good results because of strong political support, including reforms to the RERF in Kiribati and to procurement in Tonga. But around half the reforms in Kiribati and Tonga were in some way negatively impacted by political economy factors. Negative political impacts arose through two main channels.

- Firstly, some reforms were stalled by direct political opposition or a lack of political support. In some cases this reflected the fact that technocratic PFM reforms were being progressed by development partners as a solution to political decisions that they did not agree with (for example, debt management reforms to address political decisions to contract large external loans, or medium-term budgeting as a solution to ad hoc in-year spending decisions). In other cases, reforms were simply pursued without high-level political buy-in and without key policy-makers understanding the implications or – sometimes – objectives of reform.
- Secondly, reforms were sometimes predicated on unfounded assumptions regarding the incentives facing policy makers and public employees and the ability of technical reforms to change those incentives. Reform plans often relied on assumptions that state-society relations in case-study countries were similar to those in OECD countries, with expectations that – for example – transparency would incentivize and ultimately lead to improvements in efficiency and effectiveness. This was clearly not the case in several instances where international practices were implemented with disappointing results.

**Problems with capacity constraints and misalignment with political priorities reflected some weaknesses in planning.** PFM reforms did not follow a plan in either country, possibly detracting from prioritization and alignment with government priorities. The 2011 Kiribati PFM Reform Plan included too many reforms to be useful in informing planning, and was generally recognized as unhelpful by government and development partners. A PFTAC review of the document identified improving the FMIS and associated business processes as the reform priorities. While the review did not lead to adoption of a revised plan, it influenced donor engagements towards these areas. In Tonga, a careful and consultative process was undertaken to develop a PFM reform plan over several years covered by this report, but the final plan has only recently been endorsed by Cabinet and so did not drive PFM reform planning over the period of analysis.

### ***Recommendations***

**We present five main recommendations to further improve PFM Reform in Pacific island countries.** Recommendations are drawn from our analysis of case study countries and draw on international experience and literature. They overlap and are entirely consistent with previous advice and guidance on PFM reform in Pacific island countries provided in the past by PFTAC and the World Bank (PFTAC 2010; PFTAC 2012; Haque et al. 2013). Crucially, all of the recommendations build on Roadmap advice that PFM reforms should: i) reflect country-specific priorities; ii) take account of country-specific constraints; and iii) enjoy

country ownership and political support (PFTAC 2010). Recommendations presented below will vary in relevance and usefulness depending on country circumstances. They are suggestions that could be tested and improved through future application by Pacific PFM practitioners with specific country knowledge.

### **Recommendation 1: Consolidate progress towards better-prioritized reform plans**

**Substantial progress has already been achieved towards improving Pacific PFM reform plans.** The process of developing a PFM reform plan in Pacific island countries provides an important opportunity to confront the reality that addressing all PFM weaknesses may not be possible with available capacity, and that things may need to be done differently to standard practice in larger countries. Since 2012, PFTAC has moved towards a more country-owned and prioritized approach to PFM reform plan development, involving extensive consultation, increasingly linking PFM reform priorities to development challenges, and encouraging governments to carefully consider why and when a low PEFA score requires corrective action. There is explicit recognition that PFM reform plans should be based on consideration of priority development problems and the priority PFM reforms to address those problems. A number of options exist to consolidate gains and ensure that Pacific PFM reform plans all include a feasible number of reforms which are tightly prioritized towards addressing binding development constraints:

- **Adequate resourcing for roadmap development.** Increasing the time and resources dedicated to developing roadmaps would be useful to ensure that they reflect country context and priorities. Allowing adequate time for in-country consultations is important, as is ensuring that the PFM reform planning team includes (local or international) economists and other country experts to ensure that PFM reforms are not considered in isolation from broader challenges. Adequate consultation at senior levels is also required to ensure buy-in and political support (PFTAC 2012).
- **Improved PEFA Summary Assessments.** PEFA assessments are frequently used as the start-point for PFM reform plans. Existing guidance from the PEFA Secretariat specifies that PEFA Summary Assessments should explain the likely impact of identified PFM weaknesses on fiscal discipline, strategic allocations of resources, and efficient service delivery. However, this does not always occur, with Summary Assessments often summarizing the full range of PFM weaknesses discussed in the document without discussion of which of these weaknesses are more relevant, given the country context. Summary Assessments that followed existing guidance and specified which PFM weaknesses were causing outcome level problems would assist the process of reform plan formation by providing a start-point for prioritization, and avoiding any perceptions that all PFM weaknesses need to be addressed.
- **Beginning planning processes with a fixed resource constraint.** Once planning processes and consultations get underway it can become very difficult for team members to resist calls from officials, politicians, and development partners to include additional reforms in PFM reform plans. This can drive an unfeasibly ambitious reform plan. Gaining broad agreement regarding the envelope of resources available for implementation at the outset can help avoid this outcome (including staff capacity as well as financial resources for technical assistance and infrastructure). Beginning with a resource constraint forces prioritization by making it clear that including additional reforms beyond a certain point can only be achieved at the cost of excluding others (Haque et al. 2013).

## **Recommendation 2: Further strengthen donor coordination and alignment**

**Country working groups could support ongoing coordination.** Development partners and governments need to continuously coordinate to manage PFM reform implementation, establish distribution of labor, and – potentially – update the PFM reform plan as country context and priorities change. A country-level working group, led by a representative of a key government agency (likely Ministry of Finance) and comprising other government and development partner officials, could be given responsibility for coordination of all PFM reforms. The working group could meet regularly to jointly review progress on PFM reforms. To build awareness and ownership among policy-makers, the working group could report regularly to Cabinet on progress and constraints. While the overall path for reform should be ideally set by the PFM roadmap, the working group could play an important role in updating and adjusting the reform agenda – while maintaining a tightly prioritized approach – as country conditions and political priorities change. An important opportunity may arise from the same working group taking responsibility for PFM, budget support coordination, and broader economic reforms. While reducing the time burden associated with additional meetings, this approach could also ensure development partners and government agree on relative priorities and constraints across different areas of engagement, build understanding of the capacity burden arising from different areas of reform, and ensure that donor conditionalities were aligned with prioritized PFM actions.

## **Recommendation 3: Ensure implementation approaches reflect Pacific realities**

**PFM technical assistance models could be altered to provide greater emphasis on outcomes rather than policy, legislative or process changes.** Case studies demonstrated that the large number of reforms that impose additional capacity burdens often leads to recommendations not being implemented or implemented for only a short period of time. There have been growing calls for international organizations to work iteratively and adaptively for institutional reform, focusing on improved outcomes rather than delivering pre-determined outputs such as new rules, procedures, policies, and laws (under labels such as “Doing Development Differently” or “Problem-Driven Iterative Approaches”). In practical terms, such approaches in relation to Pacific PFM reform might involve:

- **Ensuring short-term assistance is coordinated with implementation support.** There were no clear examples from case study countries of short-term assistance leading to substantial reform or improvements in outcomes without subsequent implementation support. Development partners could seek to ensure that resources for such implementation support are available before mobilizing short-term technical assistance, or simply combine analytical and implementation phases of assistance.
- **Innovative approaches to contracting.** Consultants could be provided with greater leeway to change their approach and planned outputs as reforms develop as long, as overall goals remain consistent. In some cases, consultants could be contracted to solve a particular problem or improve the functioning of an existing process (and be held accountable on that basis), rather than necessarily introduce policy or legislative reform or lead significant change to existing systems. Management frameworks could specify outputs and monitor indicators of progress over short time horizon (e.g. quarterly) to allow reforms to adjust using new information about the context or political environment.
- **Investigating the use of financing instruments that increase focus on results.** Development policy operations have proven an effective and useful means of supporting PFM reforms in Pacific island countries. Development policy financing might be usefully complemented by financing mechanisms that allowed a closer focus on results, rather than on significant institutional and policy reforms. Providing financing against results (e.g. reliable supply of pharmaceuticals to clinics) would open space

for development partners and governments to discuss on the most context-appropriate means of achieving the targeted result and reduce the temptation to reach for “packaged” reforms. Focus could be moved towards simple improvements to (or increased enforcement of) existing systems when more ambitious overhauls of policies and procedures was unnecessary and might impose an excessive capacity burden. A focus on results, rather than changes to the formal PFM system, might also encourage development partners and government to consider interactions between PFM systems and broader problems of public sector management. Targeting specific results could magnify the impacts of PFM reforms by incentivizing complementary process and management improvements beyond the PFM system.

**Opportunities for regional capacity sharing and selective outsourcing of capacity-intensive functions could be pursued.** Given that some Pacific island countries may not be able to maintain specialized capacities required for all PFM functions they seek to have fulfilled, capacity supplementation and capacity substitution can play an important role, alongside traditional capacity building. Pacific governments may wish to outsource particular functions to the private sector or regional institutions. Such capacity supplementation and capacity substitution can be delivered sustainably if costs are acknowledged and planned for. Such outsourcing and capacity sharing arrangements need to be considered carefully, however, and previous work has provided a framework for judging when and where such approaches may be appropriate (Haque et al. 2013).

#### **Recommendation 4: Deepen country-specific knowledge**

**Development partners could work to build understanding of Pacific political economy and how it relates to PFM.** Case studies suggest that PFM reforms are sometimes predicated on intervention logics that do not hold in Pacific countries, with the outcomes of PFM reforms depending heavily on the broader institutional and political environment.<sup>3</sup> Development partners could undertake political economy and institutional analysis to ensure that expectations regarding the likely impact of standard PFM reforms in Pacific island countries are accurate. Such work might also usefully inform the design of less-conventional and more-holistic interventions through which desired outcomes could be achieved. For example, political economy analysis may have shown that standard budget transparency measures were – by themselves – unlikely to drive stronger accountability relationships between policy-makers, the bureaucracy, and citizens, and could have informed broader programs for education or civil society engagement to strengthen these relationships.

**Regional bodies could play an important role in developing context-specific approaches to PFM.** Bodies such as the University of the South Pacific (USP), Pacific Island Center for Public Administration (PICPA), PFTAC, the Pacific Island Forum (PIF), and the Pacific Association of Supreme Audit Institutions (PASAI) play an important role in capacity building through training and peer learning. They are also mostly staffed by Pacific islanders with deep country and regional knowledge. Development partners could further support these institutions in developing context-specific solutions to common PFM problems, including through sponsoring knowledge exchange with other countries at similar levels of development or facing similar challenges, and linking such agencies with academic institutions developing (and providing training on) innovative approaches to PFM reform.

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<sup>3</sup> This point has been made in general terms by Schick (1998) and Allen (2010)

## **Recommendation 5: Adopt coordination mechanisms to support good practices**

**Case studies demonstrated that institutional incentives can drive proliferation and excessive complexity of PFM reform interventions.** Development agencies and staff sometimes face incentives to implement more projects that adhere to internationally familiar designs, even when a smaller number of context-specific interventions might have the greatest positive impact. The collective goal of improved Pacific PFM systems might therefore be served by instituting mechanisms to bind development agencies to collective restraint and coordinated action. Such mechanisms might include:

- **Adoption of good practice principles.** Development partners could formally and collectively adopt a set of good practice principles to guide their approaches to Pacific PFM reform. Coordination principles could commit development partners to practices that promote better information sharing between donors and strengthen the dialogue between development partners and the government. Prioritization principles could commit development partners to developing reforms that are realistic, appropriate and solve real problems. Implementation principles could commit development partners to longer-term engagement, flexibility to adapt to changing priorities and problems and a greater variety of reform interventions for governments to choose from. These principles could be discussed, adopted, and monitored at the annual ‘Heptagon’ meeting of major donors. Alternatively, and more formally, the principles could be submitted to the Pacific Islands Forum for formal endorsement, with the Pacific Island Forum Secretariat playing an ongoing role in monitoring compliance. This would help ensure shared commitment to the principles among donors and governments. Annex 1 presents draft principles to inform this discussion.
- **Commitment to sharing and mutual review of project design documents, consultant terms of reference, and training plans.** Through mutual review, development partners can seek to ensure coordination and broad agreement on the appropriateness of reforms being pursued. Development partners could collectively consider whether or not the proposals adequately reflected the priorities agreed in the country working groups and the capacity of the government to support or implement the proposed deliverables.

**Table 1: Summary of Findings and Recommendations**

		Good Practices		
		Focus on Country Priorities	Take Account of Constraints	Take Account of Politics
Areas of possible improvement		<ul style="list-style-type: none"> <li>• Reliance on pre-determined reform models</li> <li>• Important problems sometimes unaddressed</li> </ul>	<ul style="list-style-type: none"> <li>• Too many reform processes</li> <li>• Solutions sometimes excessively complex</li> </ul>	<ul style="list-style-type: none"> <li>• Some reforms lacked political support</li> <li>• Some reforms predicated on inaccurate assumptions regarding political and institutional incentives</li> </ul>
Recommendation	Planning	<ul style="list-style-type: none"> <li>• Adequate time allowed for reform plan development</li> <li>• Reform plan teams include economists, social sector specialists, and governance advisors</li> <li>• PEFA Summary Assessments provide guidance on most pressing PFM constraints</li> </ul>	<ul style="list-style-type: none"> <li>• Reform planning begins by identifying resource and capacity constraints</li> </ul>	<ul style="list-style-type: none"> <li>• Reform plan teams include economists, social sector specialists, and governance advisors</li> </ul>
	Coordination	<ul style="list-style-type: none"> <li>• Country-level coordination groups manage reforms and seek consistency with identified priorities</li> </ul>	<ul style="list-style-type: none"> <li>• Country-level coordination groups seek to maintain number of simultaneous reforms at manageable level</li> </ul>	<ul style="list-style-type: none"> <li>• Country-level coordination groups seek to maintain consistency with political priorities and constraints</li> </ul>
	Implementation	<ul style="list-style-type: none"> <li>• Project designs rebalanced towards results and away from new policies, procedures, and laws</li> </ul>	<ul style="list-style-type: none"> <li>• Regional approaches utilized with outsourcing of specialized functions as appropriate</li> </ul>	<ul style="list-style-type: none"> <li>• Country-level coordination groups review implementation objectives regularly against policy priorities</li> </ul>
	Knowledge	<ul style="list-style-type: none"> <li>• Regional institutional training bodies strengthened, including knowledge exchange and training on problem-driven approaches to reform</li> </ul>		<ul style="list-style-type: none"> <li>• Knowledge of political economy context relevant to PFM reforms in Pacific countries deepened and documented</li> </ul>
	Mutual Accountability	<ul style="list-style-type: none"> <li>• Good practice principles for Pacific PFM based on Pacific PFM Roadmap recommendations adopted by major Pacific development partners, with progress potentially monitored by the Pacific Island Forum</li> <li>• Development partners agree to mutual peer review of all project designs, consultant terms of reference, and training plans, to support coordination, ensure consistency with country realities, and encourage compliance with agreed good practice principles</li> </ul>		

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# 1. What is the purpose of this report?

## *1.1. This report is intended to inform improvements to planning and implementation of PFM reform in Pacific countries*

**A well-functioning public financial management (PFM) system is a vital tool for development.** Institutions governing public finances have a determining impact on the economic and social costs and benefits of revenue collection and expenditure. Sound PFM systems are vital to the delivery of social services for the achievement of social development goals and the provision of infrastructure and public institutions that enable economic growth. Reflecting their importance for the achievement of development outcomes, substantial attention and resources are being devoted to strengthening the PFM systems of developing countries worldwide.

**Improving PFM systems is a joint priority of Pacific island countries and development partners.** Interest in, and funding for, PFM and public sector management reform has increased significantly since the early 2000s (de Renzio et al. 2010). Global trends towards increased investment in PFM reform are apparent in the Pacific. Pacific governments have publically committed to improving PFM systems. Most of the independent Anglophone Pacific countries currently have PFM reform programs of some sort underway, supported by international technical assistance (Haque, Knight, and Jayasuriya 2015). Many of these PFM reform programs have achieved substantial gains.

**The IMF's Pacific Financial Technical Assistance Center (PFTAC) produced 'A Public Financial Management Roadmap for Forum Island Countries' ("The Roadmap") in 2009 (PFTAC 2010).** This document was adopted at the Forum Economic Ministers' Meeting (FEMM) of the Pacific Island Forum as an agreed approach to PFM reform in Forum Island Countries. The document established the need for regular PEFA assessments and the development of PFM reform plans for Pacific countries based on PEFA assessments and other inputs. Based on international experience, the document concluded that PFM reforms in Pacific countries should, among other things: i) reflect country priorities; ii) take account of country constraints, including capacity constraints; and iii) have strong country ownership and take political dimensions into account.

**Five years on from the adoption of the Roadmap, this report examines experiences of PFM reform in two Pacific island countries in order to inform future improvements.** Drawing on the messages of the Roadmap we assess PFM reform planning and implementation in case study countries of Kiribati and Tonga. We assess the extent to which PFM reform planning and implementation in these countries has been consistent with the recommendations of the Roadmap. Based on this assessment, we reiterate the relevance of the Roadmap's messages and present recommendations for improved planning and implementation of Pacific PFM reform in future.

## *1.2. There is particular need for prioritization in Pacific island countries*

**The recommendations of the Roadmap reflect that capacity constraints are a defining feature of government in Pacific island countries.** Along with all of the challenges faced by larger countries in implementing PFM reforms, small island states face additional important and well-known challenges due to small populations. With limited pools of human resources, a small number of public servants, and important weaknesses in institutions providing secondary and tertiary education, small island governments are often unable to access the skills required for some specialized PFM functions from local labor markets (Baker 1992; Brown 2010; Horscroft 2014). Often, there are simply too few people to complete all of the functions required in a full PFM system, with available staff stretched across a wide range of functions.

The public sector in PICs also faces strong competition for human resources from the local private sector, donors, and NGOs, both locally and overseas. Capacity building efforts are often undermined, as staff with newly acquired skills and qualifications emigrate or move to new roles in or outside of the public service. The strength of capacity within any agency often varies significantly over time and can change quite suddenly with the departure of one or two key staff. While many countries face capacity constraints in PFM, evidence suggests that these constraints are particularly severe in small countries, and exert a significant negative influence on PFM performance as measured by PEFA scores (Haque, Knight and Jayasuriya 2015). While larger countries may be able to build capacity to fill capacity gaps over time, capacity constraints arising from small population sizes are likely to be longer-term, with capacity-building efforts not always a sufficient solution (Haque et al. 2013).

**There is a growing consensus regarding the importance of prioritization in Pacific PFM reform.** A significant literature discusses the importance of prioritization and sequencing in PFM reform (see Box 1). Most international guidance stresses the need for gradualism, and a ‘basics first’ approach (Allen, Schiavo-Campo and Garrity 2004; Diamond 2013; Diamond 2013a; Tomassi 2013). In the Pacific context of severe and sustained capacity shortages, prioritization becomes even more essential (PFTAC 2010; Haque et al. 2013). Some Pacific island countries are likely to remain unable to implement a full ‘best practice’ PFM system or address all of the weaknesses identified through the application of common benchmarking tools (such as PEFA assessments) for many years to come. While PFM reforms need to be prioritized and sequenced in all countries, some Pacific countries may not be able to implement all aspects of a ‘good practice’ PFM system (such as assessed under the PEFA framework) for the foreseeable future. Decisions must therefore be made not just about what reforms should come first, but also about what reforms and systems are most important, given that doing everything is not possible, potentially even over the longer term. Policy makers must consider not only sequencing, but broader questions about what type of PFM system is desirable and achievable within long-term capacity and resource constraints. Governments and their advisors need to consider the impacts of reforms not only on the area in which reform is taking place, but also in terms of the opportunity costs: should scarce capacity be used to undertake reform in one particular area when this makes reforms (or perhaps even sustaining existing levels of functionality) in another area impossible?

**Building on the recommendations of the Roadmap, this report draws on recent literature regarding ‘problem-driven approaches’ to further inform analysis of and recommendations for prioritization of PFM reforms.** Institutional reform in developing countries has often involved ‘transplanting preconceived and packaged “best practice” solutions to institutional reform’ (Andrews, Pritchett, Woolcock 2012). “Problem-driven” approaches instead emphasize the need to develop context-specific reform solutions to carefully-identified context-specific problems (Fritz and Levy 2009; Andrews 2012; Andrews, Pritchett and Woolcock 2015; Andrews and Woolcock 2015). Based on concepts from this emerging literature, recent guidance has encouraged Pacific PFM practitioners to target scarce resources towards specific PFM dysfunctions that are having the greatest negative impact on development progress, taking account of what is likely to be possible within a specific country and institutional context (Haque et al. 2013). Such approaches are fully consistent with the application of the PEFA framework and PEFA scores can provide an important input when identifying PFM dysfunctions to be targeted in prioritized reform plans (Diamond 2013; PEFA Secretariat 2016). Through the application of this approach, Governments and their advisors can identify where scarce PFM reform capacity can be most usefully deployed to maximize development impacts.

### *1.3. Methodology*

**We review PFM reforms in each case study country in terms of key recommendations of the Roadmap.** We begin by trying to identify the main PFM constraints contributing to major development problems in each country during the research period, as identified through interviews with policy makers and officials. Using a framework previously developed by the World Bank and PFTAC, we assess the extent to which reforms pursued by government and development partners were targeted towards these pressing development constraints over the period (Haque et al. 2013). From this point, we assess the extent to which those PFM reforms took account of capacity constraints through detailed analysis of reform implementation and outcomes. Finally, we assess the extent to which those reforms enjoyed country ownership and took account of country-specific political factors (Table 4). Our broad operating assumption is that sound prioritization processes should have led to PFM reform efforts that: i) were targeted towards addressing pressing development challenges; ii) were achievable with available capacity and therefore not derailed by capacity constraints; and iii) were aligned with government priorities and the political environment, and therefore not undermined by a lack of political support or other political economy factors. By analyzing patterns in when and whether these criteria were met, we develop recommendations as to how prioritization efforts could potentially be improved in future.

**Kiribati and Tonga were selected as case study countries because of important divergences in the quality of their PFM systems and their overall levels of development.** Generalizability of findings to the wider Pacific is strengthened by including case studies with variance across important dimensions. Incomes in Tonga are among the highest in the Pacific, and considerably higher than those in Kiribati. Human development outcomes in Tonga are much higher than those in Kiribati – which are among the worst in the Pacific. Dysfunction of ‘basic’ PFM systems in Kiribati has contributed significantly to both poor coverage and quality of services and challenges to long-term fiscal sustainability. In contrast, a reasonably well-functioning PFM system in Tonga has supported strong social outcomes and relatively sound fiscal management, with the authorities now focused on addressing a deficit of public accountability and some perceived technical inefficiencies at the level of line ministries (Table 2 and Table 3). While capacity constraints remain a major challenge in both countries given their small populations (both around 100,000) and small public services, access to technical training differs considerably. Tonga has leveraged higher incomes and migration links with New Zealand and the United States to build a cadre of highly-educated public servants occupying key senior roles, while Kiribati continues to struggle to recruit, train, and retain staff with relevant tertiary-level qualifications.

**This report represents the conclusions of joint work between the World Bank, the New Zealand Ministry of Foreign Affairs and Trade, and the Australian Department of Foreign Affairs and Trade, and the Overseas Development Institute.** The analysis is based on a desk review of existing literature and in-depth case study evidence. The team, comprising both global and regional PFM experts and practitioners, travelled to both case study countries and conducted more than fifty interviews with government officials, development partner representatives, and civil society organizations (see Annex 2 for a list of meetings). Findings were tested through extensive follow-up discussions with additional technical and regional specialists.

**Table 2: PEFA Scores – Kiribati**

Cluster	NR	NA	D	D+	C	C+	B	B+	A	Total
Credibility of Budget	1		1				1		1	4
Comprehensiveness & Transparency			2	1	2		1			6
Policy-Based Budgeting				1		1				2
Predictability & Control in Budget Execution				6	1	1	1			9
Accounting Reporting & Recording			2	2						4
External Scrutiny & Audit				1		1	1			3
Donor Practices		1	2							3
<i>All clusters</i>	1	1	7	11	3	3	4	0	1	31

**Table 3: PEFA Scores - Tonga**

Cluster	NR	NA	D	D+	C	C+	B	B+	A	Total
Credibility of Budget								2	2	4
Comprehensiveness & Transparency		1			1				4	6
Policy-Based Budgeting					1				1	2
Predictability & Control in budget execution			1	1		3	1	1	2	9
Accounting Reporting & Recording			1					3		4
External Scrutiny & Audit				2		1				3
Donor Practices				1	2					3
<i>All clusters</i>		1	2	4	4	4	1	6	9	31

**Table 4: Summary of Methodology**

	Objective
<b>Context setting</b>	Identify main PFM-related constraints to development in case study countries.  Survey major PFM reforms pursued in case study countries between 2010 and 2014.
<b>Assessment of Reforms</b>	Assess alignment between PFM reforms and pressing development priorities.  Assess the extent to which PFM reform efforts have encountered capacity constraints.  Assess extent to which PFM reform efforts were aligned with political priorities and political context.
<b>Analysis</b>	Identify reasons for strengths and weaknesses in prioritization and alignment with political priorities.
<b>Recommendations</b>	Propose recommendations for improving alignment between development constraints, political priorities, and PFM reform efforts.

### **Box 1: Recent literature on Planning and Sequencing PFM Reforms**

A substantial literature discusses appropriate sequencing and prioritization of PFM reforms (Allen, Schiavo-Campo and Garrity 2004; Diamond 2013; Diamond 2013a; Tomassi 2013). While there remain areas of debate, a general consensus has emerged around the need to focus on ‘basics first’ and take an incremental approach to improving PFM systems (Diamond 2013).

The PEFA Secretariat has recently published good practice guidance on sequencing PFM reforms, which provides a range of practical suggestions and recommendations to governments and development partners (Diamond 2013; Diamond 2013a; Tomassi 2013). The World Bank and PFTAC also recently produced guidance for planning PFM reforms, with a specific focus on prioritization under the capacity and resource constraints facing Pacific island countries (Haque et al. 2013).

There is broad consensus that: i) reforms should be tailored to unique country circumstances and take into account non-technical factors (including cultural and political economy factors); ii) there is no universal, off-the-shelf PFM reform program, and an incremental approach should be followed; iii) sequencing must not be seen as a purely technical exercise and should reflect country constraints and realities; and iv) success should be judged by improved PFM deliverables.

This report is loosely based around the application of the framework presented in the World Bank/PFTAC Guidance Note, given its specific relevance to Pacific contexts. The Guidance Note suggests potential benefits from applying a ‘problem driven’ approaches to PFM reform in Pacific contexts where capacity is sometimes lacking to even achieve all of the ‘basics’ identified in the broader literature. In the context of pressing capacity constraints, the note argues that PFM priorities should reflect the broader macroeconomic and development challenges preoccupying policymakers, and presents a framework for tracing observed macroeconomic and service delivery constraints to underlying contributory PFM dysfunctions. Through the application of this approach, and drawing on recent work from the broader governance literature, the Guidance note also emphasizes the need to focus on ‘function’ rather than ‘form’, allowing for systems and processes that do not take the same form as those applied in advanced country contexts (and may therefore be unlikely to meet criteria for high PEFA scores) as long as the underlying PFM function is being successfully fulfilled (Andrews 2010; Andrews 2015).

## 2. Are we pursuing the right PFM reforms?

**In this section we review PFM reform efforts in case study countries over the review period (2010-2014).** We begin by identifying important PFM problems that were contributing to the major development constraints in each country over the research period, as identified by policy makers and senior officials. We then describe actual PFM reforms pursued over the period and assess them against three criteria: i) the extent to which they targeted the main PFM problems constraining development; ii) the extent to which they were weakened or undermined by capacity constraints; and iii) the extent to which they reflected the political context and the political priorities of government. It is important to note that this report does not evaluate current PFM performance, and many of the constraints and problems noted over the period of the review may have been addressed through subsequent reforms.

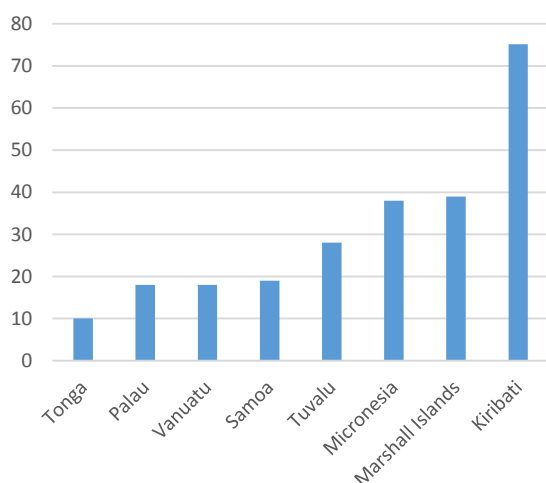
### 2.1. Country Case Study: Kiribati

**Figure 2: Development Constraints in Kiribati**



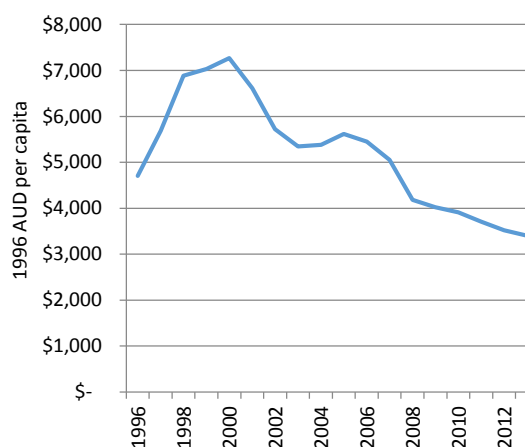
**Two main development challenges were identified as the most-pressing over the research period by those interviewed in Kiribati.** These challenges were: i) weaknesses in service delivery; and ii) unsustainable fiscal deficits. In this section we describe the PFM-related problems contributing to these challenges, and assess the extent to which PFM reform efforts have been targeted towards addressing these problems.

**Figure 3: Under-five mortality - per 1,000 live births**



Source: World Development Indicators

**Figure 4: Real per capital RERF balances 1996-2013**

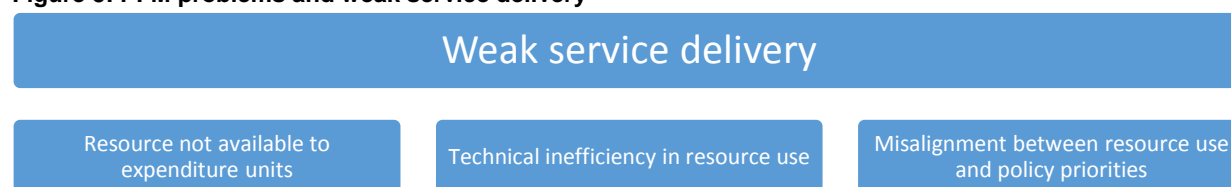


Source: Team calculations, IMF Article IV

### 2.1.1. What PFM problems are constraining development in Kiribati?

**Kiribati faced important challenges in basic service delivery.** In interviews with the authorities, the poor quality of basic social services was cited as a primary PFM-related development constraint. This assessment was supported by most data and indicators, especially when Kiribati was compared against other Pacific island countries (Figure 3: Under-five mortality - per 1,000 live births). Kiribati is ranked 121 out of 187 countries on the Human Development Index, among the lowest in the Pacific. Primary net enrolment, at 82 percent, is the lowest among small Pacific island countries, and substantially below the average for the East-Asia and Pacific region. Enrolment drops significantly from primary to junior secondary school levels. Health outcomes are of particular concern. Infant and child mortality rates are the highest in the region, as are infectious diseases including diarrhoeal diseases and respiratory infections associated with overcrowding and lack of access to safe water. Kiribati's rate of HIV was the highest in the Pacific in the early 2000s (though the number of new cases has been low since 2006) and in 2014 there were 119 new cases of leprosy diagnosed in South Tarawa (MHMS 2016). Urbanization and reorientation of consumption patterns towards imported foods has contributed to rising rates of diabetes and other non-communicable diseases since the early 1990s. Despite improvements in some areas, Kiribati was off track with the MDGs for primary education, child mortality and maternal health care (GoK 2015).

**Figure 5: PFM problems and weak service delivery**



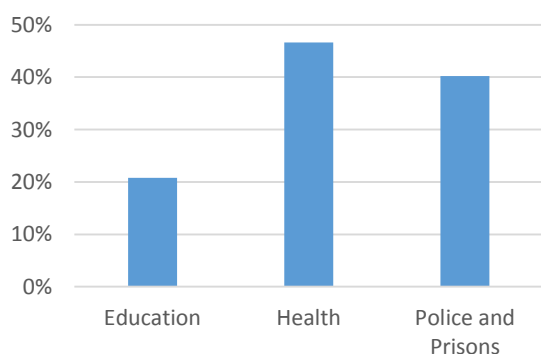
**Problems with service delivery were partially driven by problems with PFM systems.** Many factors contributed to problems with service delivery, including overall resource constraints, geographical dispersion, and weak capacity within line ministries and service delivery units. There is no reason to believe that PFM problems were the only, or even the most significant, contributor to problems of service delivery in Kiribati. However, based on a thorough assessment of the PFM system (including a review of the most recent PEFA assessment) several weaknesses in the PFM system were identified by the team that could reasonably be considered to have exacerbated – or at least limited the capacity to resolve – service delivery challenges. These included:

- **Expected resources not reliably available to expenditure units.** While the Ministry of Finance had capacity to access both its sovereign wealth fund balances and commercial bank overdrafts to avoid cash shortages, there were instances in which basic payment systems caused delays and disruption. Delays in payment of purchase orders led to some suppliers requiring payment in advance, with subsequent disruption of spending plans. Medical supplies, including pharmaceuticals, sometimes ran out. Utility payments were often delayed, with flow-on impacts for the financial management of government-owned utilities. In outer islands, local government units reported frequent disruption of payments. Several underlying PFM dysfunctions were reported to have contributed to this problem:
  - **Geography-related system vulnerabilities.** In the absence of reliable internet access, and with a very limited network of commercial bank branches, government relied heavily on paper-based systems. With frequent transportation delays and disruptions between islands, documents, cash, and procured goods were sometimes held up or lost. These challenges were compounded by the telegraphic money order 'TELMO' system. Without a banking system, the private sector can make transfers between islands using the post office, through the TELMO

- system. TELMO transfers transit through the main government account, which means that the government is handling both private and public money, and makes it hard to monitor the true government balance, without reconciling the many different transactions.
- **Weak expenditure management by line ministries.** In the absence of an integrated FMIS, line ministries encountered problems with tracking expenditure and commitments against budget allocations. Line ministries sometimes tried to manage expenditure by delaying the transmission of payment orders received from expenditure units to the Ministry of Finance, disrupting service delivery.
  - **Delays in processing of payment requests by MoF.** While specific causes are not known, several line ministries reported delays in Ministry of Finance processing of payment requests. This may simply be related to slow internal processes in the Treasury Department, which was responsible for making all payments, and to the difficulties faced in reconciling returns from line ministries and transactions made through the telegraphic money order ‘TELMO’ system.
  - **Delays in updating payroll records to reflect staff movements.** Staff in outer islands and line ministries reported that, while salaries were generally paid on time, staff experienced payment delays following changes in staff duty stations. Delays in payment were also experienced by new contract teachers. Late payments arose from delays in updating payroll information to reflect staff records, given infrequent reconciliation.
- **Technical inefficiency in expenditure.** Respondents cited concerns regarding the efficiency and accountability of resource use by line ministries and expenditure units over the period. The team was informed of instances of corruption, and perceptions that low-quality expenditures, including overtime payments, were squeezing resources available for service delivery. Several underlying PFM dysfunctions were reported to have contributed to this problem:
    - **Problems with procurement.** The team heard different views regarding the extent to which procurement processes were followed within ministries over the period. The lack of a central procurement system was cited as limiting the quality and cost effectiveness of overall procurement. Lack of capacity at some Ministries also contributed to poor procurement outcomes.
    - **Absence of incentives for efficiency and effectiveness across line ministries.** External accountability mechanisms were generally considered to be weak. While there was substantial progress in the frequency and coverage of audit over recent years, follow-up action on audit recommendations was limited, while information and data to track efficiency in delivering outputs and achieving outcomes was typically absent. The team heard different views regarding the extent to which hiring and promotion decisions were based on merit, but this was cited as a concern by some officials.
  - **Poor alignment between resource allocation and policy priorities.** Analysis of expenditure patterns showed a declining proportion of resources devoted to specified government priority areas over time. While budget execution at the ministry level was usually within 10 percent, there was substantial variance between budgeted and actual spending at the level of line items, while ministries reallocated substantial resources during the year from front-line service delivery towards administrative expenses (Government of Kiribati and World Bank 2012) (Figure 6). Over-expenditure was driven by unforeseen costs associated with State-Owned Enterprises and debt service, while salary allocations were typically underspent, with salary allocations frequently reallocated to temporary staff and other operating costs (Figure 7). Poor alignment between resource allocation and policy priorities was driven by three factors:

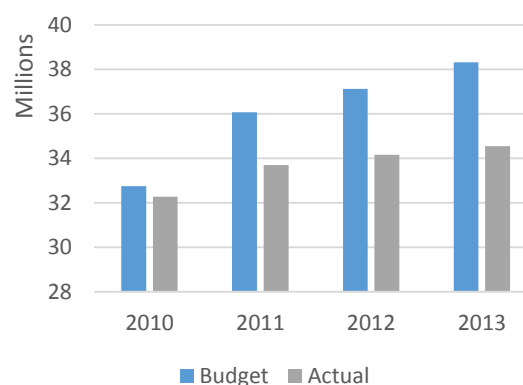
- **Weak budget formation based on incremental budgeting.** In earlier years of the review period, budget preparation was highly incremental with limited capacity and incentives at the line ministry to improve the quality of budget. Line ministry budgets were generally set at the level of the previous year, adjusted for new initiatives or cost and wage increases. Under- and over-expenditure was not corrected for in budget allocations, and therefore reproduced in subsequent fiscal years.
- **Insufficient control over transfers.** While some controls were in place (for example to prevent operating allocations being used to finance new hiring), ministries retained some flexibility to reallocate resources between programs and line-items but with limited information captured or produced to facilitate oversight of resource use. During the period, control over transfers was centralized within the Ministry of Finance to help address these issues. Output data was not systematically tracked, provided to the Ministry of Finance or reported in budget documents.
- **Weak alignment between planning and budgeting.** For most of the period, plans at the National and Ministry level were not adequately costed, and therefore could not be realized within available budgetary resources. The medium-term cost implications of plans were not reflected in medium-term budgets, despite the inclusion of medium-term projections at the line level in budget documentation.

**Figure 6: Average absolute variance of expenditure lines by large ministry (2013)**



Source: Team calculations, BOOST data

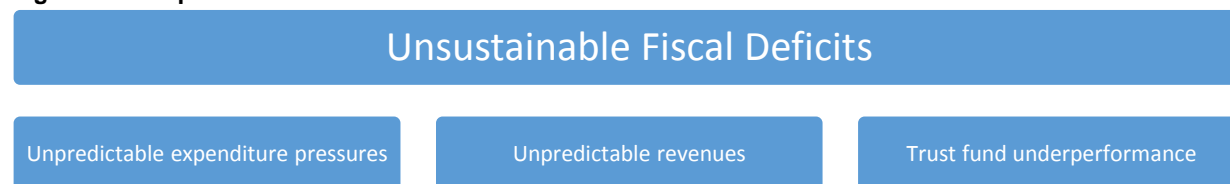
**Figure 7: Budget and actual salary expenditure by year**



Source: Team calculations, BOOST data

**Kiribati also experienced problems with macroeconomic management.** Authorities also cited long-term fiscal sustainability as an important PFM-related challenge. Such concerns were particularly pressing during the early years of the research period, with the value of the RERF sovereign wealth fund – on which government relied for budget support – negatively impacted by declining asset values during the Global Economic Crisis, and government running successive large fiscal deficits. Due to declines in asset values and successive large drawdowns, the real per capita value of the trust fund declined by more than 50 percent between 2008 and 2011, generating concerns that RERF balances would fall into an irreversible downward spiral without uncomfortably large fiscal adjustment. Such concerns have since eased, with massive increases in fishing license revenues supporting large budget surpluses and some recapitalization of the RERF over recent years.

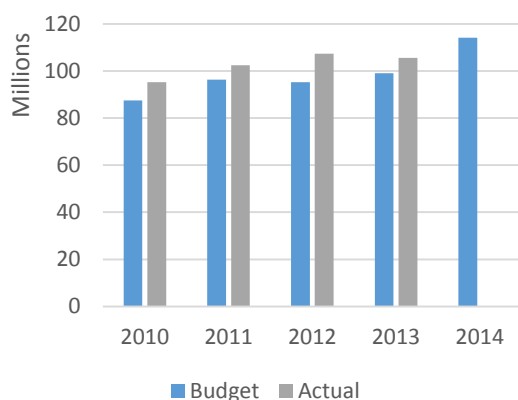
Figure 8: PFM problems and unsustainable fiscal deficits



**Problems with macroeconomic management were partially driven by weaknesses in PFM systems.** The decline in RERF values between 2008 and 2011 can only be indirectly and partially ascribed to PFM weaknesses. Unsustainable drawdowns were the result of well-informed political decision-making, with reliance on such drawdowns frequently discussed in Parliament (with debates broadcast on radio) and reflected in public budget documentation. Again, however, our analysis of the PFM systems suggests that PFM weaknesses exacerbated and limited government options to respond to these challenges. Relevant PFM weaknesses included:

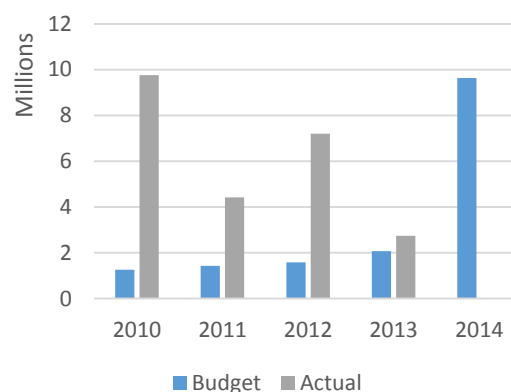
- **Unpredictable expenditure pressures.** Unforeseen expenditure pressures arising within budget years led to increases in allocations through supplemental budgets and growth of fiscal deficits (Figure 9). These unforeseen expenditure pressures were, themselves, driven by PFM dysfunctions.
  - **Weak financial management of SOEs.** Periodic bailouts to SOEs generated an unpredictable source of additional expenditures over the period, contributing to deficits. The Government of Kiribati spent AUD19.4 million (or 11 percent of current GDP) on bailing out SOEs through the budget between 2003 and 2013. The Public Utility Board was largest recipient of subsidies, followed by Air Kiribati. Further unpredictable budget shortfalls were imposed through the failure of several SOEs to pay corporate taxes and the frequent practice of withholding the PAYE taxes of their employees.
  - **Unplanned and expensive borrowing.** High and unbudgeted interest costs on domestic debt further increased budget pressures. Partly to finance SOE bailouts, while avoiding unsustainably large draw-downs from the RERF, GoK drew heavily on overdraft facilities provided by the only commercial bank during 2011 and 2012. By mid-2012, the commercial debts through overdraft facilities had reached AU\$20 million (around 11 percent of GDP), with a \$14 million balance held over from between FY2011 and FY2012. The nominal interest charged on these facilities was 11 percent per annum (Figure 10). This borrowing occurred on an ad hoc basis, was incurred without Cabinet approval, and was collateralized against RERF assets. This practice was eventually eliminated through debt policy reforms discussed below.

**Figure 9: Budget and actual total expenditure**



Source: Team calculations, BOOST data

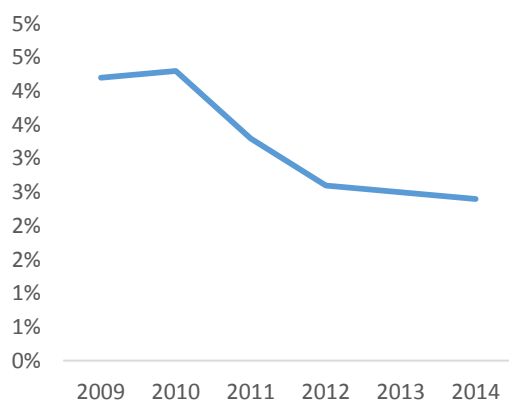
**Figure 10: Budget and actual debt service**



Source: Team calculations, BOOST data

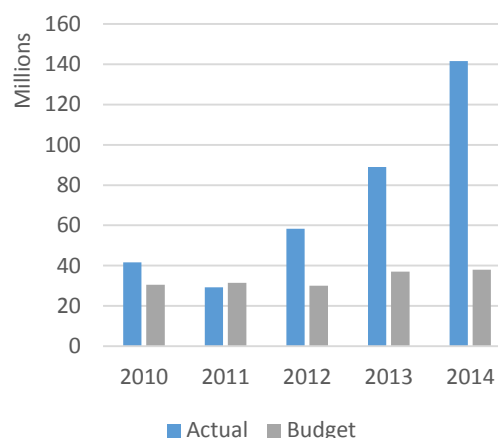
- **Unpredictable revenues.** Unsustainable deficits were also driven by persistent revenue shortfalls, with weak and unpredictable revenues from most sources.
  - **Weak tax compliance.** Fiscal deficits which were exacerbated by declining revenue performance. During the period of declining RERF balances, tax revenues declined from 14 percent to 12 percent of GNI with significant declines in import duties and company tax receipts (declines in company tax were reversed, however in 2015) (Figure 11). While the tax-free threshold on income tax was increased in 2008, declines in revenue were too great to be explained by any policy changes. Import duties declined as a proportion of imports, without any adjustment to rates, indicating growing compliance problems with trade taxes. Broader weaknesses in the justice system exacerbated revenue collection challenges, with no successful prosecutions for tax non-compliance.
  - **Poor systems for managing fisheries revenues.** Over the period, fisheries revenues grew rapidly, driven by regional mechanisms to ration supply. With weak communication between Ministry of Fisheries and MFED, fisheries revenue forecasts were developed amid substantial uncertainty. Over the period of analysis, the Ministry of Fisheries consistently declined to share any information with MFED regarding the source of revenues, the agreements that revenues are generated from, or the commercial performance of joint ventures. Consequently, it was impossible for the budget team to make any meaningful projections of future revenue performance. Lack of predictability in fishing revenues undermined realism of overall revenue forecasts, with fisheries license fees sometimes accounting for as much as 80 percent of total revenues. (Figure 12).

**Figure 11: Company tax as % GDP**



Source: Team calculations, BOOST and IMF data

**Figure 12: Budget and actual fisheries revenues**



Source: Team calculations, BOOST data

- RERF underperformance.** The RERF was severely impacted by the Global Economic Crisis including through exposure to Icelandic banks. The portfolio suffered a large, irrecoverable loss when the three largest Icelandic banks defaulted on their debt in the fall of 2008, and the Icelandic króna became non-convertible. The real value of RERF assets declined by AUD 75 million, or around 12 percent of the fund's total value (Figure 4). Subsequent analysis by technical assistance providers has suggested that this exposure was inappropriate, and reflected both an unsuitable investment strategy on behalf of asset managers, and a lack of adequate government oversight. Subsequent fiscal sustainability challenges can, therefore, be partly attributed to RERF management and governance arrangements, which are arguably a component of the PFM system.

### ***2.1.2. Have the right PFM reform efforts targeted the right problems in Kiribati?***

**In this section we discuss PFM reforms implemented in Kiribati.** We discuss these reforms in terms of: i) the extent to which reforms targeted and adequately addressed the main PFM problems constraining development, including identification of important PFM problems left unaddressed; ii) the extent to which reforms were weakened or undermined by capacity constraints; and iii) the extent to which reforms were suited to the political context and reflected the political priorities of government.

#### *PFM reforms to address weaknesses in service delivery*

- Reform effort was targeted at problems of resource disruption facing line ministries.** One technical assistance project was intended to strengthen the Attaché Financial Management Information System (FMIS) and expand access to line agencies. This would have allowed daily tracking of expenditures, avoiding over-commitment of expenditure warrants and the need for Ministries to withhold payment orders submitted by expenditure units. While progress was made in a number of areas – notably in bank reconciliations through the establishment of a separate Access-based system – the project was not successful in expanding the use of Attaché outside MFED due to persistent problems with meeting IT requirements, inadequate capacity to effectively utilize the system, and limited buy-in from line ministry staff. A new project focusing on treasury systems was implemented in 2014. This project was critical of the use of Attaché software, a system that was primarily designed for small to medium sized commercial businesses. The project commented that Attaché fell short of each functionality criterion for a government accounting system. The use of Attaché has significantly impeded PFM reforms in Kiribati.

Various informal efforts were made to accelerate the processing of payment orders by the Ministry of Finance, but without evidence of systematic reduction in payment delays. Sporadic efforts were made to address basic system failures, including the weaknesses of the TELMO system and reliance on the unreliable mail system, but these were ultimately unsuccessful given limited internet connectivity, and resource constraints to meeting hardware requirements. No payroll system reforms were undertaken to reduce delays in salary payments following staff movements.

**Table 5: Reforms to address resource disruption facing line ministries**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Attempted FMIS system improvements</b>	<b>Ineffective</b>	<b>Strong:</b> Intended to address a key constraint to service delivery	<b>Insufficient capacity:</b> Capacity constraints significantly impacted implementation	<b>Lacked political support:</b> Use of Attaché system was a significant problem.
<b>Ad hoc attempts to improve payment efficiency</b>	<b>Some impact</b> but not sustained	<b>Strong:</b> Intended to address a key constraint to service delivery	<b>Insufficient capacity:</b> Improvements reliant on technical advisors and not sustained.	<b>Politically supported:</b> Not politically contentious

- **Several major reforms were attempted to address problems of technical inefficiency within line ministry operations.** A procurement review was undertaken by a major donor, providing recommendations for strengthening procurement rules and processes. The major recommendation of the review, however, was the outsourcing of all major procurement services, which attracted strong political opposition. As a result, little progress was made against any of the major recommendations. Some respondents argued that the establishment of a separate, donor financed and TA-supported procurement unit within MFED to deal with procurements for major infrastructure projects reduced the incentive for government to strengthen its own systems. However, the successful operations of this unit does demonstrate the need for a centralized procurement system for all procurement within the Ministry of Finance.

Substantial effort was also dedicated to improving audit functions, to increase accountability for resource use and reduce incidence of wastage and corruption. The capacity of the Kiribati National Audit Office (KNAO) was substantially strengthened, and a backlog of audits reduced. With a weak public accounts committee and no evidence of the legislature or the executive taking action on audit recommendations, outcome-level impacts of this reform remain to be realized.

**Table 6: Reforms to improve technical efficiency in line ministries**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Procurement review</b>	<b>Ineffective</b> with main recommendations politically unacceptable	<b>Strong:</b> Intended to address a key constraint to service delivery	<b>Insufficient capacity:</b> Insufficient capacity to implement recommendations once outsourcing rejected	<b>Lacked political support:</b> Little political appetite for outsourcing
<b>Audit strengthening</b>	<b>Effective</b> in improving audit, but limited impact	<b>Medium:</b> Priority unclear given likely limited impact	<b>Sufficient capacity:</b> Sufficient capacity within Audit office	<b>Ineffective given political context:</b> No follow through on audit recommendations.

- **Additional reforms were pursued to deal with weak alignment between public expenditure and policy priorities.** Initial attempts to introduce an output-based budgeting approach in the 1990s were too complex and were not maintained. Substantial effort has been expended over several years to implement a medium-term expenditure framework, with the budget including three-year projections at the line-item level. A medium-term fiscal model has been developed, incorporating macroeconomic and revenue projections, and was intended to be populated with out-year expenditure information from budget initiatives. Improvements could be made to the system with better out-year estimates provided by line Ministries. Execution of the annual budget remains weak below ministry level and annual expenditures and revenues vary substantially from ceilings established in Medium-Term Expenditure Frameworks (MTEFs) (see Box 2).

Institutional reforms within the budget office were more successful in improving the alignment between plans and budgets. Under an international advisor with line management responsibilities and financed by a donor agency, the National Economic Planning Office was restructured so that budget officers were responsible for both planning and budgeting functions for a cluster of ministries, rather than dividing the planning and budgeting functions. This reform was widely considered to have ensured ministry annual plans were more commensurate with resource availability and allocations.

Recently, efforts have been made to improve the realism of annual budget allocations, with the Ministry of Finance liaising closely with line ministry staff to identify upcoming expenditure pressures and have them reflected in annual allocations. Adjustments are now made for previous over- or under-spending, and for new policy proposals. Prior to this, annual allocations were based on allocations in previous years, rather than on actual resource use, leading to wide divergence between budget and actual expenditure at below-ministry level. This simple measure has improved budget formation, leading to some improvements in execution as major cost pressures are known in advance.

**Table 7: Reforms to improve alignment between public expenditure and policy priorities**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>MTEF</b>	Ineffective, with MTEF not credible (see Box 2)	<b>Weak:</b> Not linked to main constraints to budgeting and resource allocation	<b>Insufficient capacity:</b> Insufficient institutional capacity to produce inputs, with large variance in revenue estimates	<b>Lacked political support:</b> Expenditure ceilings consistently breached
<b>NEPO restructuring</b>	Effective	<b>Strong:</b> Effective means of improving alignment between policy priorities and expenditure	<b>Sufficient capacity:</b> Did not impose additional capacity burden	<b>Politically supported:</b> Not politically contentious
<b>Budget consultations to inform expenditure ceilings</b>	Effective	<b>Strong:</b> High priority given weak execution at below-ministry level	<b>Sufficient capacity:</b> Pragmatic, low capacity approach	<b>Politically supported:</b> Not politically contentious

#### *PFM reforms to address challenges to fiscal sustainability*

- **Several reforms were implemented to improve revenue predictability and performance.** One donor financed a long-term tax administration advisor to help address the decline in tax compliance and collection, and initial improvements in systems yielded some good results. In 2012, however, at

the urging of development partners and consistent with the recommendations of several technical assistance reports, government moved to introduce a value-added tax (VAT) within short timeframes. Policy preparation and administrative preparation for the introduction of the VAT absorbed a large proportion of tax office capacity, and most of the tax advisor's time (who had been hired to provide tax administration rather than policy advice). Uneven understanding of the new tax within the executive, and in the context of upcoming elections, led to the introduction of several exemptions which effectively eliminated expected revenue gains. Introduction of the VAT, however, has incentivized improved compliance with company tax requirements, leading to some recovery of company tax revenues in 2015.

As a first step towards improved information flows between the Ministry of Finance and the Ministry of Fisheries, the two ministries jointly produced and published a public report regarding fishing license fee revenue developments in 2014. A similar report was produced for 2015 with technical assistance support. At the time of the research visit, there was some evidence of improved information flows, including monthly reconciliation of revenue received. However, there is little improvement in the accuracy of MFEP's fisheries revenue projections.

No substantial reform efforts have so far been dedicated to improving customs performance, although a new in-line technical assistant was mooted at the time of the field visit to assist Customs management including legislative reform.

**Table 8: Reforms to address revenue predictability and performance**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Tax administration TA</b>	Effective, but efforts somewhat distracted by VAT implementation	<b>Strong:</b> Addressed basic system weakness	<b>Sufficient capacity:</b> Reflected appropriate approach with limited capacity	<b>Politically supported:</b> Reflected high-level commitment to increase revenues
<b>VAT implementation</b>	Implemented, but with substantial capacity burden and policy weaknesses	<b>Weak:</b> Simpler and more-direct alternatives to improving revenue were not pursued	<b>Insufficient capacity:</b> Implementation substantially disrupted by capacity constraints	<b>Lacked political support:</b> Lack of buy-in led to new exemptions undermining objectives
<b>Production of joint fisheries license revenue report</b>	Ineffective to date	<b>Medium:</b> Broadly targeted to problem but ineffective given political economy context	<b>Sufficient capacity:</b> Production reliant on technical assistance within MFED	<b>Lacked political support:</b> Did not build strong political support for information sharing

- **Several PFM reform initiatives were implemented to address unplanned and expensive borrowing.** On the advice of development partners, the Ministry of Finance drew down on the RERF to clear expensive overdraft balances and some outstanding SOE debt. A debt policy was agreed by Cabinet and has been effectively implemented, preventing new accumulation of commercial debt and instituting requirements for approval of all borrowing at the level of Cabinet and the President's office. The adoption of the new debt policy was not an easy process, however, with an initial debt policy drafted by development partners being rejected on the basis that it was overly complex and unfeasible within current capacity constraints.

A short-term technical assistance mission was also mobilized to provide advice on managing RERF drawdowns. This TA recommended the establishment of a cash buffer through a once-off transfer of RERF resources to manage cash-flows. Fiscal rules could then be implemented to preserve the RERF

without the need for drawdowns to meet short-term cash management needs. No action was taken on these recommendations, reflecting limited policy dialogue on recommendations, and the presence of different political views regarding the appropriate frequency and extent of RERF drawdowns.

One development partner provided technical assistance on institutional and system reforms to improve debt management, and recommendations have been implemented. Limited priority was initially ascribed to improving debt management given perceptions that risks were limited by the simple debt portfolio comprising a small number of highly concessional loans. Since early 2014, MFED has taken important steps towards implementation of the debt management reform recommendations under the leadership of an international advisor holding an in-line management position. Among other things, a full debt database has been established and debt information included in budget documents and the MFED Annual Report. Cabinet is also provided with a regular assessment of the debt situation in Kiribati.

**Table 9: Reforms to address unplanned and expensive borrowing**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Debt policy TA</b>	Effective once simplified	<b>Strong:</b> Targeted immediate challenge to sustainability	<b>Sufficient capacity:</b> Did not impose additional capacity burden	<b>Politically supported:</b> Supported by political leadership
<b>TA on cash management and fiscal rules</b>	Ineffective, unimplemented	<b>Strong:</b> Targeted important cause of RERF drawdowns	<b>Insufficient capacity:</b> Insufficient capacity to implement	<b>Lacked political support:</b> Fiscal rules not politically supported
<b>Debt management TA</b>	Effective	<b>Weak:</b> Management of simple debt portfolio did not pose major risks	<b>Sufficient capacity:</b> Sufficient capacity to implement reforms under in-line advisor	<b>Politically supported:</b> Not politically contentious

- **Ambitious governance reforms were implemented to address the weak financial management of SOEs.** Broad SOE reforms were implemented over the period. These were intended to improve the financial management of SOEs and reduce their drain on the budget, improve the quality of services they provided, and allow for selected divestment of those SOEs not serving a public good function. An early step was passage of a new SOE law which borrowed heavily from New Zealand's SOE framework. The new law: i) commercialized designated SOEs by establishing legal requirements that they operate on commercial terms; ii) established a formal process for budgeting and gaining approval for Community Service Obligations (CSOs); iii) introduced requirements that SOEs produce a Corporate Plan and Statement of Corporate Objectives to be agreed-upon with the government; iv) established an independent committee to advise on the selection of SOE directors; v) established rules for director eligibility to prevent conflicts of interest in SOE management; and vi) established a Public Enterprise Review and Monitoring Unit within the MFED with responsibility for monitoring SOE performance, coordinating technical assistance to reforms, and overseeing future divestments and restructuring.

Largely as the result of technical assistance, financial management and reporting of SOEs has improved. Many aspects of the governance model, however, remain unevenly implemented. The Ministry of Finance has exerted substantial energy in ensuring compliance with board membership

requirements, but faces important challenges in finding board members with adequate skills. SOEs lack the capacity to meet full documentation requirements under the new legislation without ongoing technical assistance. While Community Service Obligations were formally established and funded with a line in the annual budget, Cabinet continues to consider requests for financial assistance from SOEs on an ad hoc and as-needed basis (although capped within the total allocation for CSOs within the budget). Recent data shows that the overall fiscal burden from SOEs has declined.

Several SOEs were privatized, including a trade store and the telecommunications utility. Privatization of the telecommunications utility was an important success and was supported by long-term technical assistance.

Work was initiated to improve the efficiency of SOEs involved in the copra sector through a restructuring of involved entities. Production subsidies for copra were imposing large costs on government generating strong political support for reform of the sector. While technical assistance support led to the realization of some efficiency gains in the sector, the fiscal savings were quickly offset by increases in the regulated price of copra paid by government to growers, in the lead up to elections.

**Table 10: Reforms to address financial management of SOEs**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>SOE Corporatization</b>	Mixed effectiveness	<b>Medium:</b> Some elements necessary, others only weakly linked to problems	<b>Insufficient capacity:</b> Implementation uneven and imposed ongoing capacity burden	<b>Mixed political support:</b> Strong political support for some reforms under the model, less support for others
<b>Copra sector reform</b>	Early improvement but sustainability unclear	<b>Strong:</b> Targeted important driver of unsustainable expenditures	<b>Sufficient capacity:</b> Model intended to reduce overall capacity burden by simplifying systems	<b>Mixed political support:</b> Political support for organizational reforms but savings undermined by copra price increases
<b>Telecommunications liberalization</b>	Effective	<b>Strong:</b> Targeted important and unnecessary source of expenditure pressures	<b>Sufficient capacity:</b> Process reflected capacity constraints with extensive TA provided	<b>Politically supported:</b> High-level commitment to reform despite unforeseen higher prices through monopolistic control of the industry

- **Additional reforms were implemented to address the weak performance of RERF asset managers.** Recent RERF reforms began with a substantial analytical report delivered to the Ministry of Finance in 2011 by a multilateral development agency. The analysis included in the report, however, was highly technical, and recommendations proved beyond the implementation capacity of MFED. From 2012, another donor provided a sustained program of technical assistance to implement a range of changes largely in accordance with the recommendations of the initial report. This culminated with the governments' decision in early 2015 to replace both asset managers, with new asset managers operating under revised and more-appropriate investment strategies. It remains unclear whether improvements in monitoring will be sustained after the current program of technical assistance expires, but reforms to date have had an important impact in reducing government's inappropriate exposure to investment risks.

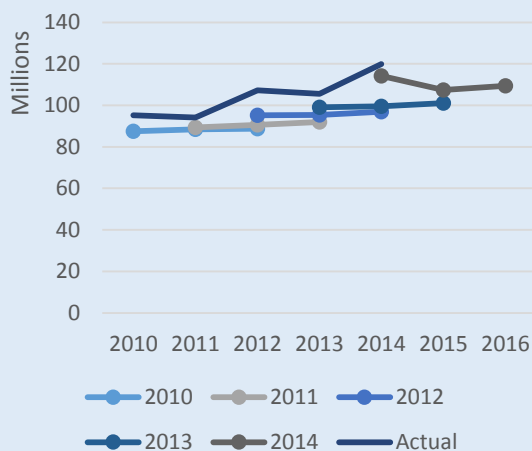
**Table 11: Reforms to improve performance of RERF asset managers**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>RERF management TA report</b>	Effective once TA support for implementation provided	<b>Strong:</b> Addressed important problems with asset management	<b>Insufficient capacity:</b> Report recommendations could not be absorbed by MFED staff	<b>Lacked political support:</b> No political buy-in given limited engagement
<b>RERF extended technical assistance</b>	Effective	<b>Strong:</b> Addressed important problems with asset management	<b>Sufficient capacity:</b> Designed to provide long-term capacity support	<b>Politically supported:</b> Strong commitment through long-term engagement

## Box 2: Assessing medium-term budget credibility

Kiribati has implemented a medium-term budget framework since the 2010 budget. Aggregate revenue projections have been rendered highly inaccurate by unexpectedly strong fishing revenue performance. In the context of rapidly increasing revenues, the aggregate and ministry-level expenditure projections have been consistently surpassed. Accuracy of projections has been further undermined by unexpected debt servicing obligations driven by SOE debt and use of the cash overdraft facility (see above).

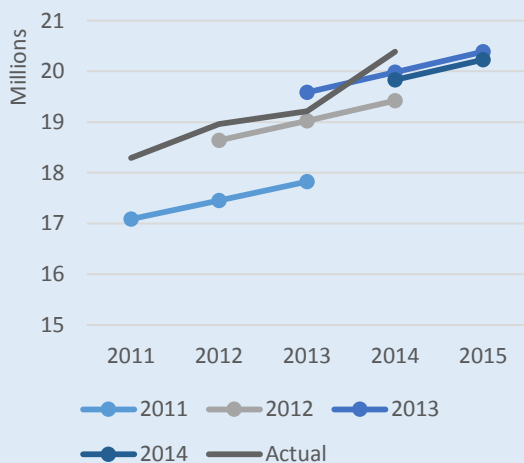
**Figure 13: Total recurrent expenditure - projections vs. actual**



**Figure 14: Revenues - projections vs. actual**



**Figure 15: Education recurrent expenditure - projections vs. actuals**



**Figure 16: Debt service - projections vs. actual**



Source: Budget documentation, BOOST data

**Table 12: Summary of constraints and reforms in Kiribati**

<i>Development constraint</i>	<i>PFM weakness</i>	<i>Underlying problem</i>	<i>PFM Reform</i>	<i>Effectiveness Assessment</i>	<i>Prioritization Assessment</i>	<i>Explanation</i>	<i>Capacity assessment</i>	<i>Ownership assessment</i>
Weak service coverage and quality	Resources not reliably available to expenditure units	Inherent vulnerabilities in telmo system	Not addressed, but superior alternatives to existing system not apparent					
		Ministries delay forwarding payment requests to MOF	Attempted FMIS system improvements	Ineffective, with Attache under review.	Strong	Addressed key PFM weakness	Insufficient capacity	Lacked political support
		Ministry of Finance delays processing payments	Ad hoc attempts to improve payment efficiency	Some improvements but not sustained	Strong	Addressed key PFM weakness	Insufficient capacity	Politically supported
		Delays in updating records to ensure payment of staff moving between posts	Not addressed, with no substantial reforms to public service practices					
		Systems inadequate to provide up-to-date information on resource use	Attempted FMIS system improvements	Ineffective, with Attache under review.	Strong	Addressed key PFM weakness	Insufficient capacity	Lacked political support

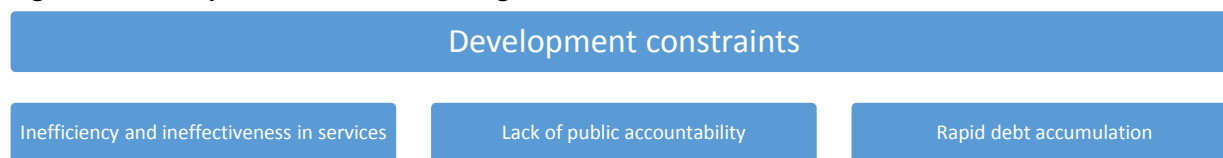
<i>Development constraint</i>	<i>PFM weakness</i>	<i>Underlying problem</i>	<i>PFM Reform</i>	<i>Effectiveness Assessment</i>	<i>Prioritization Assessment</i>	<i>Explanation</i>	<i>Capacity assessment</i>	<i>Ownership assessment</i>
	Technical inefficiency in expenditure	Weak procurement	Procurement review	Recommendation of outsourcing politically unacceptable. No implementation of other recommendations.	Strong	Addressed key weakness in resource use	Insufficient capacity	Lacked political support
		Weak accountability and oversight systems and incentives	Audit strengthening, including progress towards performance auditing.	Effective in strengthening audit, but limited outcome impact to date.	Medium	Broadly targeted at problem but intervention logic weak given political context. Performance audit excessively complex.	Sufficient capacity	Ineffective political context
		Weak internal control	Improvements in account reconciliations	Effective.	Strong	Addressed key PFM weakness	Sufficient capacity	Politically supported
	Poor alignment between resource allocation and policy priorities	Weak budget formation, incremental budgeting	MFED reorganization to improve alignment of planning and budgeting	Effective	Strong	Supported more effective spending	Sufficient capacity	Politically supported
			MTEF introduced	Supported greater liaison on medium-term expenditure pressures, but not credible.	Weak	Did not address key constraint of unpredictable revenues and ad hoc spending	Insufficient capacity	Lacked political support
			Increased MFED consultation with line ministries in budget preparation	Effective	Strong	Supported improved budget formation and execution	Sufficient capacity	Politically supported
		Insufficient control over transfers	Now centralized in MOF, reversing previous reform.					

<i>Development constraint</i>	<i>PFM weakness</i>	<i>Underlying problem</i>	<i>PFM Reform</i>	<i>Effectiveness Assessment</i>	<i>Prioritization Assessment</i>	<i>Explanation</i>	<i>Capacity assessment</i>	<i>Ownership assessment</i>
Unsustainable fiscal deficits	Unpredictable expenditure pressures	Unplanned and expensive borrowing	Debt Policy TA	Initially ineffective. Effective once simplified.	Strong	Addressed expensive debt	Sufficient capacity	Politically supported
			TA on cash management and fiscal rules	Ineffective. Insufficient ongoing support.	Strong	Intended to address excessive RERF drawdowns	Insufficient capacity	Lacked political support
			Debt Management TA	Effective	Weak	Management of simple debt portfolio did not pose major risks, and debt management was not contributing to fiscal issues	Sufficient capacity	Politically supported
		Weak financial management of SOEs	SOE corporatization	Mixed effectiveness - improved financial management. Unclear if governance reforms sustainable. CSOs ineffective.	Medium	Some elements necessary, others weakly linked to problems	Insufficient capacity	Mixed political support
			Copra reform	Early improvement, but ultimate outcome unclear.	Strong	Addressed key SOE inefficiencies	Sufficient capacity	Mixed political support
			Telecommunications privatization	Effective.	Strong	Important fiscal benefits but monopoly has led to price increases	Sufficient capacity	Politically supported

<i>Development constraint</i>	<i>PFM weakness</i>	<i>Underlying problem</i>	<i>PFM Reform</i>	<i>Effectiveness Assessment</i>	<i>Prioritization Assessment</i>	<i>Explanation</i>	<i>Capacity assessment</i>	<i>Ownership assessment</i>
	Unpredictable revenues	Weak tax compliance	Tax administration TA	Effective, but derailed by VAT.	Strong	Addressed declining revenues	Sufficient capacity	Politically supported
			VAT implementation	VAT implemented, but at cost of substantial disruption and capacity burden.	Weak	Poorly timed and did not effectively address major constraint of weak compliance and enforcement	Insufficient capacity	Lacked political support
		Poor systems for managing fisheries revenues	Production and publication of fisheries revenue report	Ineffective to date.	Medium	Broadly targeted at problem but intervention logic weak given political context	Sufficient capacity	Lacked political support
	RERF losses	Weak performance of asset managers due to weak MOF oversight	RERF TA Report	Effective once TA mobilized for implementation.	Strong	Addressed major risk to macro stability	Insufficient capacity	Lacked political support
			RERF extended TA	Effective.	Strong	Addressed major risk to macro stability	Sufficient capacity	Politically supported

## 2.2. Country Case Study: Tonga

Figure 17: Development constraints in Tonga

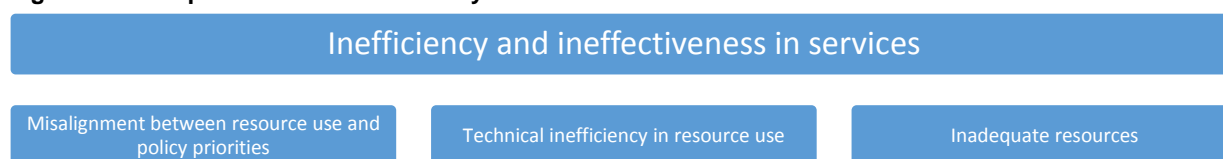


**Two main development challenges were identified as most-pressing over the research period by those interviewed in Tonga.** These challenges were: i) inefficiency and ineffectiveness in service delivery; and ii) weak public accountability over public resource use. Some of those interviewed were also concerned about recent unsustainable accumulation of public debt. In this section we describe the PFM-related problems contributing to these challenges, and assess the extent to which PFM reform efforts have been targeted towards addressing these problems.

### 2.2.1. What PFM problems are constraining development in Tonga?

**Tonga enjoys strong social outcomes, but may have scope to improve efficiency in service delivery.** Tonga does not face major problems in service delivery, especially if considered relative to Kiribati. Health and education have long been government priorities, and social indicators were already strong at independence. Primary school enrolment rates, for example, were nearly 90% in 1970, and subsequently increased to over 95%. Literacy is effectively universal, life expectancy at birth is around 72 years and absolute poverty rates are close to zero. As a result, the 2015 Human Development Index ranks Tonga third only to Palau and Fiji among small island countries in the Pacific. Despite these strong indicators, the authorities believed that further progress was both possible and necessary, and cited inefficiency and ineffectiveness in public service delivery as important PFM-related constraints to further development over the research period.

Figure 18: PFM problems and inefficiency and ineffectiveness in services



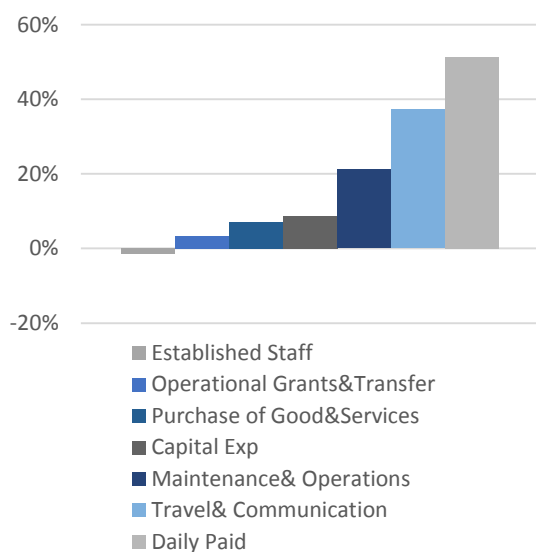
**Strong social outcomes were supported by generally well-functioning PFM systems, but some weaknesses were undermining efficiency.** Tonga did not suffer from the same weaknesses as Kiribati in terms of basic accounting and reporting systems. Payments were made in a timely fashion – The Ministry of Finance and National Planning (MFNP)’s 2015/16 Corporate Plan claims that 70% of eligible vouchers were paid within a day in 2014/15. Cash management is supported by large cash buffers in government accounts (although cash reserves were at precariously low levels during the early years of the research period). MFNP is able to maintain aggregate fiscal control. Resources can be tracked through the financial management system to the service delivery level. However, our analysis of PFM systems – drawing on the PEFA assessment, interviews, and review of budget and other formal documentation – suggested that there are some weaknesses that may be constraining service delivery:

- **Poor alignment between resource allocation and policy priorities.** Expenditure analysis showed some important weaknesses in budget execution in Tonga are undermining the capacity of government to utilize resource in line with plans and priorities. The PEFA self-assessment for 2014 showed that expenditure deviations were generally within 5% of the original budget, in aggregate. However, as the

budget is disaggregated it becomes less credible. At the line level, actual expenditures commonly exceeded the allocated budget by more than 50 percent. In aggregate, ministries consistently spent above or below the budget for some items, as shown in Figure 19, including daily paid staff, travel allowances, and maintenance. Similar patterns of consistent over-expenditure were also present at the ministry level, with the Ministry of Foreign Affairs, Palace Office and Ministry of Education consistently overspending (Figure 20). The following underlying PFM dysfunctions were considered to have contributed to these problems:

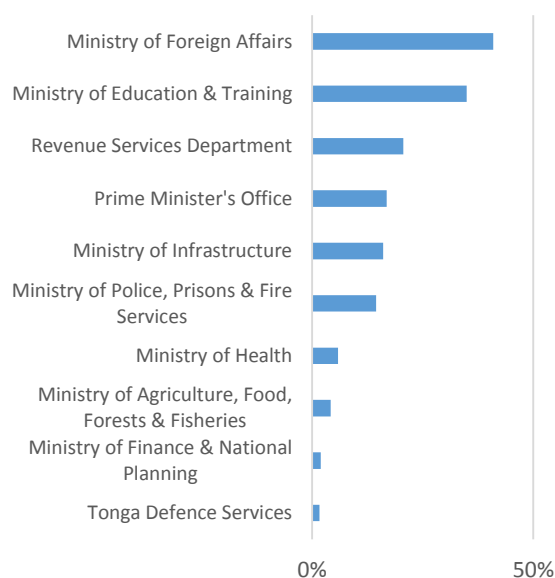
- **Weak budget formation.** Line ministries cited weaknesses in budget preparation as a cause for weak budget execution. From the perspective of line ministries, increases and reductions in allocations often seemed arbitrary. With inadequate consultation, allocations for new programs or specific needs were often scaled down without apparent awareness of indivisibilities or economies of scale. As in Kiribati, annual budgets were prepared on the basis of the previous years' budget, and have not systematically taken account of in-year execution.
- **Weak controls over transfers.** Following the implementation of 'program budgeting', MFNP relinquished control over resource use below program level, and MFNP staff are no longer required to approve transfers at that level. While MFNP staff appreciated the reduction in time commitment to approving transfers, this change – in the absence of strong accountability at the ministry or division level – may have contributed to problems of weak alignment between policies and budgets. Partly due to these concerns, controls over transfers at the sub-program level were reintroduced in 2014.

**Figure 19: Average annual overspend/underspend by category**



Source: Budget database

**Figure 20: Average annual overspend by ministry**

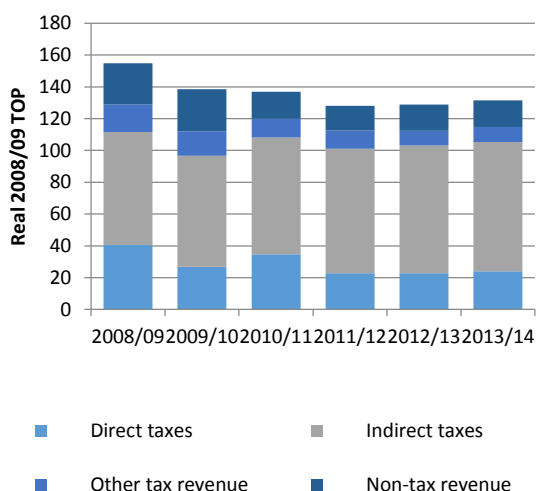


Source: Budget database

- **Inadequate revenues.** Total tax revenues in Tonga were cited as a concern for several stakeholders. Tax revenue in Tonga, while around the average for small states, remain well below that of neighboring comparator countries, Fiji and Samoa. Large tax expenditures were cited as an important contributor to this problem, with tax exemptions imposing large revenue costs while bringing little economic benefit.

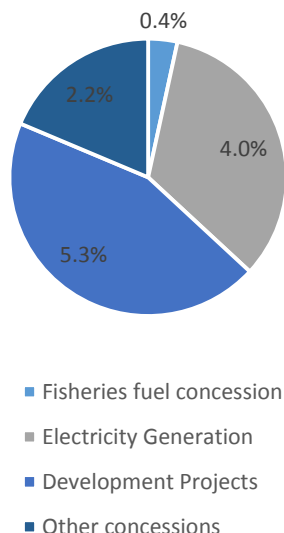
Tonga provided a fairly broad range of tax exemptions, mostly applied at the border. These included exemptions for aid projects, electricity generation, and goods consumed by the Royal family (Figure 22). PFTAC estimated the value of these exemptions at nearly TOP45 million over the two years to August, 2011. The process for granting exemptions was also problematic, requiring only an Order in Council, rather than full parliamentary approval.

**Figure 21: Revenues by source**



Source: IMF Article IV reports

**Figure 22: Tax expenditures as % total revenues**



Source: PFTAC Revenue Review

- **Technical inefficiency in expenditure.** Respondents cited concerns regarding the efficiency and accountability of resource use by line ministries and expenditure units. There were widespread perceptions that low-quality expenditures, including overtime payments and travel, were squeezing resources available for service delivery. Several underlying PFM dysfunctions were reported to have contributed to this problem, including:
  - **Weak procurement.** Some respondents noted a lack of competition and potential for nepotism in procurement processes. Weaknesses in procurement practices were confirmed by a DFAT-financed review, which found nearly none of the procurements in the review sample had been carried out in accordance with formal rules. Few respondents, however, considered corruption to have in fact been a major issue or constraint to service delivery even if improved procurement could have achieved better value for money.
  - **Limited accountability for efficiency.** As discussed below, external accountability mechanisms were generally considered to be weak. While audits were carried out, follow-up action on audit recommendations was limited, while information and data to track efficiency in delivering outputs and achieving outcomes was typically absent. More fundamentally, also discussed below, some respondents considered that Tonga was yet to develop a culture of civil society and public oversight, given the long history of monarchy and limited experience with democratic institutions.

**A lack of public accountability over public expenditure decisions may also be constraining development.** Tonga has recently undergone major political transition. After a long period monarchy, Tonga's first fully democratic elections were held in 2010 and 2014 (IDEA 2015). While political institutions have been reformed, some argued that fiscal institutions remain non-transparent, with decision-

making powers too narrowly concentrated with the executive, and with little opportunity for public oversight. Understanding of the roles and functions of different government institutions remains unevenly understood at all levels. These problems are thought to both contribute to resource allocation decisions that do not fully align with public needs and interests, and prevent the deepening of political inclusion and participation under a newly democratic system.

**Figure 23: PFM problems and lack of public accountability**



**There are some weaknesses in existing PFM systems that may have contributed to weaknesses in public accountability and legislative oversight.** Tonga’s PFM system is well-functioning. Most of the processes required under standard Westminster models of governance are followed, and associated documentation produced and published. There are, however, some areas where existing PFM processes are less facilitative of public oversight than would be ideal:

- **Despite sound formal processes, accountability through audit mechanisms is limited.** Financial reports are prepared that allow the comparison of budgets and actual expenditures, and these are audited by the Tonga Audit Office which has been made independent of the executive. Disagreements between the Audit Office and MFNP mean that audit reports can take a long time to be finalized, but the financial reports are mostly compliant with international standards and the audit is debated in the Public Accounts Committee of the legislature before being published. However, in practice, the external oversight functions are still weak within the new democratic context, and play a relatively small role in enforcing accountability for public finances. At the time of writing, the Public Accounts Committee was dominated by Government, and understanding of its role among members was uneven. One senior MFNP official suggested that there are few “difficult questions” on the budget and the 2014 PEFA assessment concludes that “follow up on audit recommendations is weak and could be strengthened through more awareness at the CEO and Minister’s level of the financial risks involved”.
- **Public access to fiscal information has been limited.** Several respondents stated that the Tongan public lack information with which to hold government adequately accountable for resource use. There is some evidence to support this view. Tonga scored a ‘C’ against the PEFA indicator measuring public access to key fiscal information, with only one of the recommended six ‘good practice’ criteria met. While year-end financial statements were made available to the public, the budget was not published until approved by parliament, audited financial statements of government were published later than required, no in-year budget execution reports were initially produced, no details of contract awards were published, and no information was available regarding resources available to service delivery units.

**Some stakeholders reported concern regarding rapid debt accumulation in Tonga.** Following the political turmoil of the mid-2000s, Tonga contracted two loans from EXIM Bank China in 2007 and 2010 for roads and the reconstruction of Nuku’alofa. As a result of these loans, external debt increased from negligible levels to nearly 50% of GDP in 2013 (IMF 2015). The contracting of these loans appears to have reflected a clear political decision, and does not appear to reflect weaknesses in PFM processes. Following the contracting of these loans and subsequent concerns regarding debt sustainability, Tonga implemented a de facto “no new borrowing” policy which has only been softened over recent years to allow for highly

concessional borrowing from multilaterals for Cabinet-approved, high-priority projects. In general, the Government has been able to implement measures which maintain fiscal stability even during periods of political and economic uncertainty, and the country remains at only “moderate” risk of debt distress under the World Bank/IMF Debt Sustainability Framework.

### *2.2.2. Have the right PFM reform efforts targeted the right problems in Tonga?*

**In this section we discuss PFM reforms implemented in Tonga.** We discuss these reforms in terms of: i) the extent to which reforms targeted and adequately addressed the main PFM problems constraining development, including identification of important PFM problems left unaddressed; ii) the extent to which reforms were weakened or undermined by capacity constraints; and iii) the extent to which reforms were suited to the political context and reflected the political priorities of government.

#### *PFM reform measures to address weaknesses in service delivery*

- **Several initiatives were taken to strengthen the alignment of expenditure with government policy priorities.** A range of “strategic budgeting” reforms were pursued in Tonga, including the introduction of requirements for medium-term budgeting and ministry corporate planning.
  - **Medium-term budgeting.** While utilizing a top-down Medium-Term Fiscal Framework (MTFF) since 2005/06, development partners allocated substantial resources to supporting development of a bottom-up full medium-term budget framework from 2011, with all ministries required to provide fully-costed 3-year projections at line-item level for all existing and new policy commitments. These expenditure projections were to be situated within a rolling medium-term fiscal framework, involving various fiscal targets informed by a macroeconomic model. Initial moves towards output budgeting were implemented, with increased inclusion of output information in corporate plans, and ministries gaining discretion over use of resources at the program level. At the time of research these reforms had made little tangible impact on budget management. In interviews medium-term budgets were hardly mentioned by MFNP or line ministry officials, but those who did also noted that budgeting remains focused on the next financial year only. As in Kiribati, there is large variation between budget and actual expenditure at the below-ministry level on an annual basis, expenditure projections included in previous-year medium-term budgets were generally ignored, and the budget process remained focus on current year pressures (See Box 3). The combination of limited output information with increased discretion over resource use were thought by some respondents to have had some perverse outcomes in terms of increased expenditure on persistently overspent ‘low quality’ items such as overtime, allowances, and travel.
  - **Corporate planning.** Corporate plans were clearly a more visible document, and were intended to provide performance information on outputs and outcomes to inform allocation decisions and build accountability to the executive, parliament, and the public. Several respondents claimed that preparation of corporate plans had proven disruptive and absorbed substantial time and capacity. Corporate plans are now submitted to Parliament each year, but officials in MFNP and line ministries claimed that these were not aligned with either the national development plan or the budget. Development partners have recently sought to support government in simplifying the content and format of corporate plans to reduce the capacity burden.

**Table 13: Reforms to improve alignment between public expenditure and policy priorities**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Medium-term budgeting</b>	Limited impact	<b>Weak:</b> Did not address basic problems of unpredictable revenues and ad hoc in-year expenditures	<b>Insufficient capacity:</b> Imposed unrealistic capacity burden, and therefore not meaningfully sustained	<b>Lacked political support:</b> Projections not credible given in-year expenditure and reallocation decisions
<b>Corporate planning</b>	Induced increased consultation between MFNP and line agencies but high compliance costs	<b>Medium:</b> Somewhat addressed constraint of weak alignment between policy priorities and expenditure but through excessively complex means	<b>Insufficient capacity:</b> Implementation substantially disrupted by capacity constraints	<b>Politically supported:</b> Not politically contentious given limited impact on actual expenditure patterns

- **Additional reforms were introduced to address revenue inadequacy.**
  - **Revenue administration technical assistance.** Substantial long-term in-line technical assistance was provided to both the Inland Revenue and customs divisions to strengthen core administration procedures and processes, including strengthening compliance and taxpayer services functions. This technical assistance was highly valued by government and delivered improvements in compliance. Some development partners were concerned about the sustainability of gains, with in-line advisors fulfilling core functions rather than building local capacity.
  - **Exemptions transparency.** As a condition for joint-donor budget support, the Ministry of Finance began publishing details of tax expenditures in the annual budget in 2011. This increased transparency, however, did not have any major impact or lead to increased political scrutiny, attracting little attention from the public accounts committee, the legislature or the public. Perhaps reflecting limited demand for the inclusions of this information, it was dropped from budget documents from 2013.

**Table 14: Reforms to address revenue inadequacy**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Tax and customs administration TA</b>	Effective in improving compliance	<b>Strong:</b> Addressed basic system weakness	<b>Sufficient capacity:</b> Reflected appropriate approach of sustained TA in context of limited capacity	<b>Politically supported:</b> Reflected high-level commitment to increase revenues
<b>Tax expenditure reporting</b>	Little evidence of impact, discontinued	<b>Medium:</b> Targeted pressing problem, but intervention logic weak given political context	<b>Sufficient capacity:</b> Reporting did not impose substantial capacity burden	<b>Ineffective given political context:</b> Little impact arising from transparency measures

### Box 3: Assessing MTEF credibility in Tonga

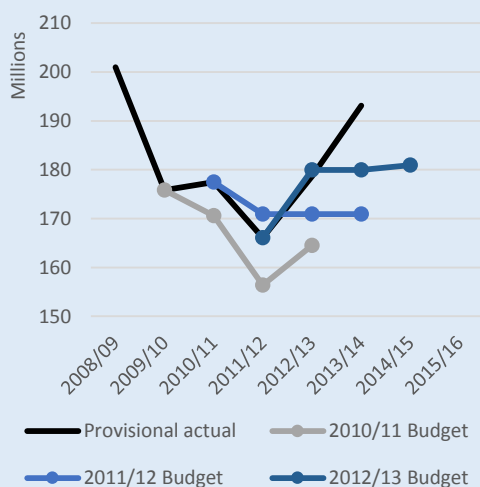
Comparison of medium-term budget projections and actual expenditures in Tonga shows large variance at the aggregate and line ministry level. As in Kiribati, conservative expenditure projections have been outstripped by rapid expenditure growth, with expenditure increasing by 18 percent and 12 percent in 2014/15 and 2015/16 respectively, relative to no increases under the 2013/14 expenditure framework.

At the level of line ministries, the Ministry of Health experienced substantial budgeted expenditure growth relative to projected declines, while budgeted recurrent expenditure under the Ministry of Education increased significantly less than projected in 2014/15 and significantly more than projected in 2015/16.

**Table 15: Projections vs. budgets**

	2013/14	2014/15	2015/16	2013/14 to 2014/15	2014/15 to 2015/16
	TOP	TOP	TOP	% change	% change
<b>Total recurrent expenditures</b>					
Projection in 2013/14	198.8	197.4	199.9	-1%	1%
Approved budget	198.8	235.3	263.7	18%	12%
<b>Ministry of Health</b>					
Projection in 2013/14	31.1	29.4	25.3	-5%	-14%
Approved budget	31.1	35.0	37.5	13%	7%
<b>Ministry of Education</b>					
Projection in 2013/14	47.2	56.5	58.0	20%	3%
Approved budget	47.2	53.3	60.9	13%	14%

**Figure 24: Total recurrent expenditure projections vs. actuals**



**Figure 25: Ministry of Education recurrent expenditure - projections vs. actuals**



Source: Budget documents

- **Several reforms were introduced to improve technical efficiency in the operation of ministries.**
  - **Procurement review and reform, including establishment of centralized procurement unit.** A procurement reform plan was developed with donor support and procurement subsequently centralized in the Procurement Division of MFNP for amounts in excess of TOP 7,500. In contrast to the model proposed for procurement reform in Kiribati, recommendations for Tonga did not involve full outsourcing, but rather the establishment of a separate internal unit supported by development partner technical assistance. The reforms drew substantial criticism from line ministries during interviews. While some suggested that procurement had been an area of abuse in the past, especially on larger contracts, many officials did not see why reform was needed and thought reforms were being implemented because “donors think we are corrupt”. Officials also claimed that the new unit did not initially have the capacity to manage their requests, leading to delays, and some ministries were not fully informed of new procedures and responsibilities. The MFNP responded to requests from line ministries for the thresholds to be raised and provided clarification over what constituted emergency procurement, and greater flexibility to meet urgent demands.

It is not possible to state conclusively if these reforms have had an impact on the value for money of procurement itself. The PEFA indicator (PI-19) was marked down in the 2014 self-assessment, but this is not a good indicator of procurement functionality, and the lower score was partly due to inconsistencies in the legal framework and because the independent complaints body had not yet been set up. More certain is that the new processes are becoming more accepted and compliance is improving, even if some ministries continue to flout procedure. The MFNP reports compliance with formal processes has increased by 10 percent between FY2014 and FY2015. As reforms become more embedded it is possible that the new systems will deliver better value for money in procurement which could free up resources for improving service delivery. However, it is too early in the reform process to make such conclusions, especially without better indicators of procurement functionality.

- **Strengthened audit capacity and independence.** The Audit Act was revised in 2007 to move the Auditor General from the executive to the legislature, then in 2012 to place audit staff under the responsibility of the Auditor General, independent from the government. The budget for the Tonga Audit Office was also increased to allow it to fulfil its responsibilities, though there have been challenges finding suitably qualified auditors. Support provided through PASAI built capacity to undertake performance audits.

The Tonga Audit Office has welcomed these reforms, and the Minister and Public Accounts Committee were quick to identify this as an important reform area. However, auditors did not think that its independence has led to any greater follow-up on audit queries and recommendations. The Public Accounts Committee were not fully familiar with the specific benefits of performance audits (relative to financial audits), and claimed such approaches needed to be “translated into the Tongan language” to be useful within the Tongan context.

**Table 16: Reforms to improve technical efficiency**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Procurement review and reform</b>	Impact debated. Capacity burden increased but supported donor confidence	<b>Strong:</b> Addressed basic system weakness	<b>Sufficient capacity:</b> Reflected appropriate approach of sustained TA in context of limited capacity	<b>Politically supported:</b> Reflected high-level commitment improving procurement
<b>Audit strengthening</b>	Little evidence of outcome impact given limited follow up	<b>Medium:</b> Targeted pressing problem, but intervention logic weak given political context	<b>Sufficient capacity:</b> Sufficient capacity existed within the audit office	<b>Ineffective given political context:</b> Little impact given weak follow up

*Reforms to improve public accountability*

- **Several reform were introduced to improve fiscal and budget transparency.** For the FY2012/13 budget process, and as a condition of donor budget support, a complete set of budget documents were able to be obtained by the public through the Ministry of Finance website at the time it was submitted to the legislature. In the FY2013/14 budget, however, while the approved budget was made publicly available, the budget proposal was not made publicly available. In-year budget execution reports were prepared and routinely made available to the public on the Ministry of Finance website (within one month of their completion) until the second half of FY2012/13, again as a condition for budget support. This practice ceased when staff changes led to delays in the preparation of reports and staff capacity was diverted during the budget process, amid significant staff turnover and several vacancies. It is not clear that this information was ever used by the legislature or general public, and we could find no evidence of public awareness that the information had become available, or that publication had ceased.
- **Substantial effort was dedicated to strengthening audit functions.** As discussed above, audit strengthening efforts did not lead to increased legislative accountability or substantial changes in practices or performance. Recent developments point to the possibility of future progress, however, with a Cabinet Audit Oversight Committee established in 2015 (as a condition for donor budget support), and the Ministry of Internal Affairs being provided with additional resources to promote civil society development. Reforms in this area have arguably served as an important signal – to Tongans and to development partners – of commitment to change and “good governance”. This signifier of “good governance” was widely recognized by donors and achieved with relative ease, arguably because it did not fundamentally change the behavior of other parts of the bureaucracy.

**Table 17: Reforms to improve public accountability**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Changes to budget process to include publication of draft budget</b>	Limited outcome impact	<b>Medium:</b> Theoretically improved transparency, but no audience and limited impact	<b>Sufficient capacity:</b> No significant additional capacity burden	<b>Ineffective given political context:</b> Little impact given limited public engagement
<b>In-year expenditure reporting</b>	Limited impact, discontinued	<b>Medium:</b> Theoretically improved transparency, but no audience and limited impact	<b>Insufficient capacity:</b> Imposed additional capacity burden on budget office, and was partly discontinued because of competing priorities	<b>Ineffective given political context:</b> Little impact given limited public engagement

*Reforms to address rapid debt accumulation*

- **Debt management reforms were pursued, but lacked a clear linkage to debt sustainability challenges.** Tonga accessed two standard debt management technical assistance products over the period: a debt management reform plan mission and a medium-term debt strategy mission. The debt reform plan provided a long list of recommendations for strengthening debt management practices and procedures, including policy and institutional reforms within the debt management office. The medium-term debt strategy was intended to support the Ministry of Finance assessing its financing options and identifying a suitable mix of debt instruments to meet financing needs. Follow-through on debt management reform plan recommendations was limited. While the medium-term debt strategy was recently agreed by Cabinet, its core recommendations of restraining borrowing to concessional lenders while pursuing domestic debt market development were arguably unsurprising, and had little immediate operational impact. The debt management unit lacks the capacity to update the strategy to reflect current fiscal policy.

**Table 18: Reforms to improve debt management**

Reform	Effectiveness	Prioritization assessment	Capacity assessment	Ownership assessment
<b>Debt management reform plan TA</b>	Limited impact	<b>Weak:</b> Debt management was less of a constraint than debt sustainability	<b>Insufficient capacity:</b> Debt management office unable to implement or sustain recommendations	<b>Politically supported:</b> Politically uncontentious
<b>Medium-term budget strategy TA</b>	Limited impact	<b>Weak:</b> Debt management was less of a constraint than debt sustainability	<b>Insufficient capacity:</b> Debt management office unable to update analysis to inform policy	<b>Politically supported:</b> Politically uncontentious

**Table 19: Summary of constraints and reforms in Tonga**

<i>Development constraint</i>	<i>PFM weakness</i>	<i>Underlying problem</i>	<i>PFM Reform</i>	<i>Effectiveness Assessment</i>	<i>Prioritization assessment</i>	<i>Explanation</i>	<i>Capacity assessment</i>	<i>Ownership assessment</i>
<i>Inadequate public service quality and resourcing</i>	Poor alignment between resource allocation and policy priorities	Weak budget formation, poor communication between MFNP and LMs	Corporate planning	Induced increased consultation between MFNP and LMs, but high compliance costs	Medium	Addressed a constraint but through excessively complex model	Insufficient capacity	Politically supported
			Medium-term budgeting	Limited obvious impact	Weak	Not clear how linked to problem of unpredictable revenues and ad hoc in-year expenditure decisions	Insufficient capacity	Lacked political support
		Insufficient control over transfers	Not addressed, potentially worsened					
	Inadequate revenues	Excessive tax expenditures	Tax expenditure reporting	Little evidence of impact, discontinued.	Medium	Targeted problem but intervention logic weak given political context	Sufficient capacity	Ineffective given political context
		Weaknesses in tax and customs compliance	In-line support to tax and customs administration	Effective in improving compliance and strengthening systems	Strong	Appropriate focus on addressing basic system weaknesses	Sufficient capacity	Politically supported
	Technical inefficiency in expenditure	Weak procurement	Procurement review and reform, including establishment of centralized procurement unit	Impact debated. Capacity burden increased, but supported donor confidence.	Strong	Met donor risk management requirements - unclear if procurement was major source of inefficiency	Sufficient capacity	Politically supported
		Weak accountability and oversight systems and incentives	Audit strengthening	Limited outcome impact to date.	Medium	Broadly targeted at problem but intervention logic weak given political context	Sufficient capacity	Ineffective given political context

Development constraint	PFM weakness	Underlying problem	PFM Reform	Effectiveness Assessment	Prioritization assessment	Explanation	Capacity assessment	Ownership assessment
Weak public accountability	Weaknesses in public information	Gaps in transparency fiscal	Changes to budget process to include publication of draft budget	Limited outcome impact.	Medium	Broadly targeted at problem but intervention logic weak given political context	Sufficient capacity	Ineffective given political context
			In-year expenditure reporting	Limited outcome impact, discontinued.	Medium	Broadly targeted at problem but intervention logic weak given political context	Insufficient capacity	Ineffective given political context
			Tax expenditure reporting	Little evidence of impact, discontinued	Medium	Targeted at key problem but intervention logic weak given political context	Sufficient capacity	Ineffective given political context
	Weaknesses in legislative oversight	Weaknesses in audit and PAC operations	Audit strengthening	Limited outcome impact.	Medium	Broadly targeted at problem but complex approach and limited impact given political context	Sufficient capacity	Ineffective given political context
	Unsustainable debt accumulation	Weak borrowing processes	Political rather than PFM-related constraints	Debt management reform plan	Limited impact.	Weak	Addressed debt management rather than sustainability	Insufficient capacity
			Medium-term debt strategy	Limited impact.	Weak	Addressed debt management rather than sustainability	Insufficient capacity	Politically supported

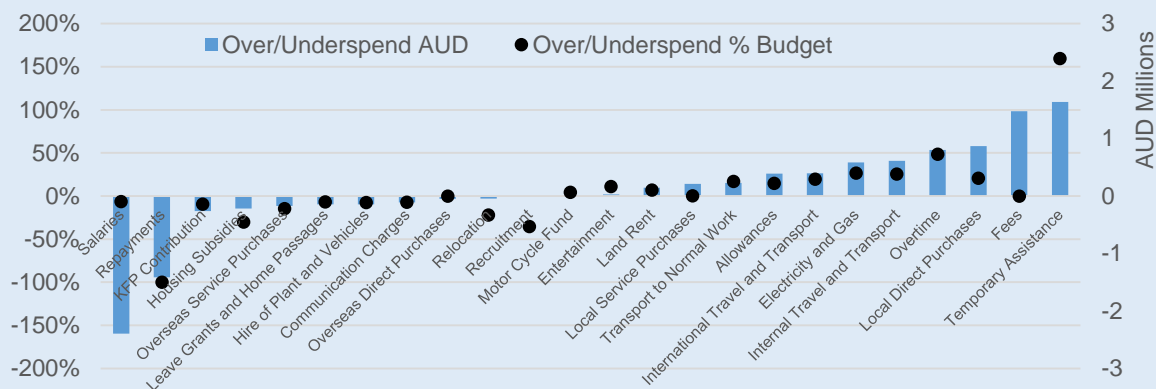
### Box 7: Was medium-term budgeting an appropriate priority in case study countries?

World Bank analysis has shown that medium-term budgeting can have a positive impact on fiscal outcomes and resource allocation to vital social sectors (World Bank 2013). The use of medium-term budget frameworks, with medium-term projections prepared down to the line-item level, could also theoretically be very helpful in case study countries in supporting improved budget formation and thereby budget execution. By preparing such forecasts based on detailed understanding of exogenous cost pressures (such as demographic change), the implications of new policy measures, and the “tail costs” of capital investments, policy makers can gain a greater understanding of available fiscal space and the medium-term implications of current budgeting decisions.

In the case of case study countries, however, it is not clear that medium-term budgets as they were implemented were likely to achieve the potential benefits. Aggregate fiscal discipline was not being undermined so much by unforeseen expenditure pressures arising from past government policy decisions as from poor revenue forecasting and in-year ad hoc expenditure decisions (including through the allocation of ‘contingency funds’ in Tonga and allocation of persistent windfall fisheries license fee revenue in Kiribati).

Both countries faced major weaknesses in annual budget execution at the ministry, program, and line-item level. Underspending occurred against lines where expenditure forecasting should have been possible without detailed medium-term projections (e.g. salaries). Overspending occurred against items for which ministries would be expected to have considerable discretion such as temporary staff, overtime, and allowances (Government of Kiribati and World Bank 2012). As the Pacific PFM Roadmap has stated “a system that cannot accurately forecast resources on an annual basis is unlikely to be able to have success at planning a number of years into the future” (PFTAC 2010).

Figure 26: Average annual overspend/underspend by line item (Kiribati, average 2010-2013)



Source: Team calculations, BOOST data

Overall, it is not clear that medium-term budgeting was the best solution to the most pressing problems faced by case-study countries during the period of analysis. Improving budget execution could have been achieved in a number of ways, including strengthening revenue forecasting, ensuring that costs of debt servicing and SOE bailouts were being accurately projected and budgeted for, and implementing controls to prevent ad hoc reallocations at below-ministry level. Building some basic understanding of medium-term cost pressures within line ministries and introducing a credible medium-term fiscal framework could have been useful initial steps before medium-term budgeting at the line-item level.

### 3. Conclusions from the Case Studies

**In this section we draw conclusions from the case studies presented above.** We summarize lessons from examples of successful reform. We assess recent efforts to further strengthen PFM systems in terms of their consistency with PFTAC recommendations that such reforms should: i) reflect country priorities; ii) take account of country constraints, including capacity constraints; and iii) have strong country ownership and take political dimensions into account.

#### *3.1. What worked well?*

**PFM systems are functional in both Tonga and Kiribati, reflecting investment over many years by governments and development partners.** Budgets in both countries provide a reasonably reliable plan for how much will be spent in aggregate and by which ministry (although plans become much less reliable at below-ministry level). Salaries and most payments are generally paid on time, despite limited banking, IT and communications infrastructure. Corruption and fraud are limited in both countries, but there are important concerns regarding inefficiencies.

**Much has been achieved through recent PFM reform efforts in both case study countries.** Over the period under examination, both countries managed to implement reforms that significantly impacted development outcomes. Perhaps because the macroeconomic challenges faced by Kiribati were so daunting, the success of several PFM reforms is very clear, including reforms to debt management, management of the RERF, and some reforms in the SOE sector (such as privatization of the telecommunications utility). In Tonga, improvements in procurement are likely to have led to some improvement in value-for-money in public expenditure, while audit reforms supported increased confidence among development partners.

**Reforms that were well-targeted, consistent with capacity, and enjoyed political support generally achieved their objectives.** There is a very clear correlation between reforms that were judged to meet the three key recommendations presented in the Roadmap and those that were effective. Around a third of the reforms assessed across both country case studies were considered to have been fully consistent with the Roadmap recommendations and all of these reforms were also judged effective in achieving their intended outcome (although for two reforms gains were not, or have not yet been shown to have been, sustained). This demonstrates the continued relevance of the initial PFTAC recommendations. These reforms varied in terms of their areas of engagement, objectives, and approaches but seem to provide some useful lessons:

- **Progress did not necessarily require high-level policy changes.** The sustained presence of international advisors led to important improvements within existing policy settings. Examples from Kiribati include improvements in tax administration, the reorganization of the National Economic Planning Office to integrate budgeting and planning, and improved systems for account reconciliation. In Tonga, in-line assistance to tax and customs administration delivered important gains.
- **Technical assistance reports had impact only when followed by implementation support.** In the case of RERF reform in Kiribati and procurement reform in Tonga, initial short-term technical assistance delivered sound analysis but achieved limited immediate results. This reflected limited government capacity to implement technical reforms. It was only when analysis and recommendations were picked up by subsequent technical assistance providers with the resources to support government through required reform processes that important gains were achieved.

- **Crises can spur action.** The context of declining RERF balances and rapidly accumulating expensive overdraft debt in Kiribati was an important factor in mobilizing political support for reforms. Success with debt policy and RERF management reforms may have reflected deep concerns among policy-makers regarding RERF losses during the Global Economic Crisis and the pressing need to return to a sustainable fiscal situation.

### *3.2. Were PFM reform efforts targeted towards the right areas?*

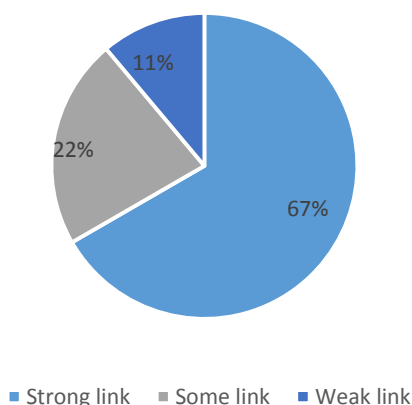
**PFM reforms in Kiribati and Tonga were generally targeted to broad areas relevant to development constraints.** It is clear that governments and development partners were to some extent strategic in devoting resources to particular reform areas, and conscious of how weaknesses in broad areas of PFM contribute to broader development problems. In Kiribati, government and development partners clearly recognized that improvements in expenditure quality and aligning expenditures with policy priorities was vital for addressing key weaknesses in service delivery, while improving revenues and debt management was important for fiscal sustainability. In Tonga, reform efforts generally focused on weaknesses in alignment between expenditure and policy priorities and the overall desire to improve public accountability.

**Within each of these broad problem areas, however, there was sometimes a weaker link between specific PFM problems and the reforms pursued.** While reforms were responding to real problems at a broad strategic level, development partners sometimes recommended broad, system-wide and “packaged” reform models that extended well beyond (or sometimes even omitted) the often relatively simple PFM dysfunction directly causing the observed problem. Development partners sometimes focused on implementing new policies, processes, and systems, rather than devoting efforts to repairing existing systems. The team estimates that around two thirds of reforms in Kiribati had a strong and direct link to the specific PFM dysfunctions contributing to major development challenges, while a similar proportion had some link in Tonga (Figure 27 and Figure 28). For example:

- A perception that public debt was a cause of concern in Tonga led to fairly technically advanced reform efforts to build debt management institutions and optimize borrowing strategy, despite very simple debt portfolios and very limited debt management capacity (two junior officers). Staff of the debt management office viewed their role as primarily administrative (processing repayments) and were typically not consulted on policy decisions regarding new borrowing or borrowing options. The primary (and fundamentally political) problem of politicians contracting loans without proper process and analysis was largely managed through high-level engagement by development partners at the political level.
- In Kiribati, SOE reforms involved implementation of an entire new governance model based on OECD experience, including boards of directors and relatively elaborate reporting and accountability systems. Implementation of this model imposed substantial capacity burden on the Ministry of Finance, which was forced to constantly enforce rules regarding board membership and reporting requirements. Problems of poor financial management could arguably have been addressed more directly through simpler financial management technical support to distressed SOEs.
- Attempts to implement medium-term budgeting in both countries had only limited linkage to immediate resource allocation problems in contexts where annual budget execution was very weak and revenue projections highly inaccurate (as was especially the case in Kiribati). Neither country systematically quantified the out-year expenditure implications of policy and capital investment decisions, nor adequately funded maintenance of capital projects and infrastructure. But the implementation of

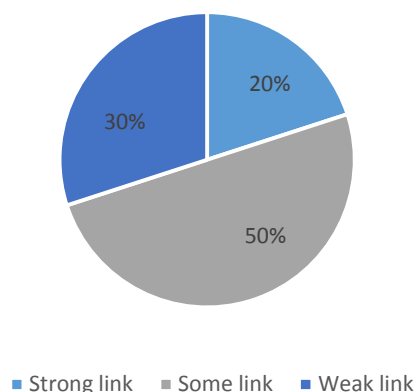
medium-term budgets was neither a necessary nor sufficient response to this challenge. Simpler systems for recording recurrent cost implications of major expenditure decisions could have been implemented with reduced capacity demand and potentially greater potential for sustainability (an excel spreadsheet of the small number of major projects and programs with inflexible and substantial ongoing expenditure implications could have been established within the Ministry of Finance).

**Figure 27: Reform link to priority PFM problem by proportion of reforms (Kiribati)**



Source: Team assessment, refer Table 12

**Figure 28: Reform link to priority PFM problem by proportion of reforms (Tonga)**



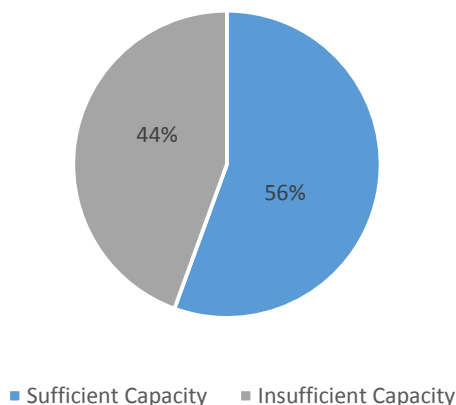
Source: Team assessment, refer Table 19

**While the reforms that were pursued often targeted important problems, several important problems were also left unaddressed.** In Kiribati, analysis undertaken by the Ministry of Finance showed major problems with tax and customs compliance. Initial technical assistance to improving tax administration was largely distracted by the process of VAT implementation. No technical assistance was provided to customs administration. In both countries, substantial effort was allocated to establishing medium-term budgeting and planning frameworks (including through medium-term budgeting in both countries and the corporate planning process in Tonga), when a range of problems continued to undermine annual budget execution, including persistent over-appropriation to salaries, inaccurate revenue projections in Kiribati, and use of the ‘contingency fund’ to provide appropriation for ad hoc in-year policy decisions in Tonga.

### **3.3. Did PFM reform efforts take account of capacity constraints?**

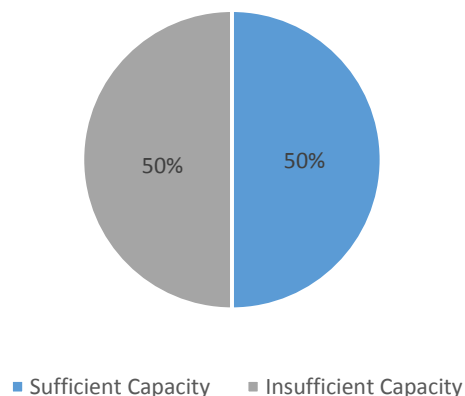
**Capacity constraints often undermined implementation across both countries.** Development partners and government sometimes did not take adequate account of capacity constraints and the need for systems and processes that were robust to uneven and variable capacity. Nearly half of the reforms attempted in Kiribati and Tonga were significantly impacted by capacity constraints (Figure 29 and Figure 30). Capacity constraints were encountered for two different reasons. Firstly, in both countries, there were instances in which a large number of reforms being pursued simultaneously placed an unrealistic capacity burden on government officials. This led to reforms remaining unimplemented or incompletely implemented, or heavily reliant on the continued presence of international technical assistance. Because reforms were typically intended to achieve sustainability over short time horizons, reversals sometimes occurred following the withdrawal of technical assistance. In both countries, reforms in one area sometimes diverted capacity from other reforms or core business in central agencies, undermining previous or parallel efforts.

**Figure 29: Adequacy of capacity by proportion of reforms (Kiribati)**



Source: Team assessment, refer Table 12

**Figure 30: Adequacy of capacity by proportion of reforms (Tonga)**



Source: Team assessment, refer Table 19

**As well as too many reforms being pursued, some reforms were too complex.** Some of the reforms recommended or attempted in case study countries were excessively complex given lack of specialized staff and absolute constraints on staff time and numbers. For example:

- Attempts to roll out medium-term budgeting at the line level relied on macroeconomic forecasting capacity within the Ministry of Finance and systems to record out-year expenditure pressures within line ministries. At the time the reforms were implemented these underpinning capacities were not established.
- In Tonga, compliance requirements for corporate planning, including specification of intervention logics and output and outcome indicators often proved too complex for line ministry staff, necessitating extensions of and continued reliance on international technical assistance.
- Initial recommendations for improved management of the RERF trust fund in Kiribati were too complex to be absorbed by officials with responsibility in those areas. Recommendations initially included in a comprehensive report provided by a multilateral development agency remained unimplemented for nearly three years until they could be translated into specific policy steps through subsequent assistance.

### ***3.4. Did reforms have country ownership and take account of political context?***

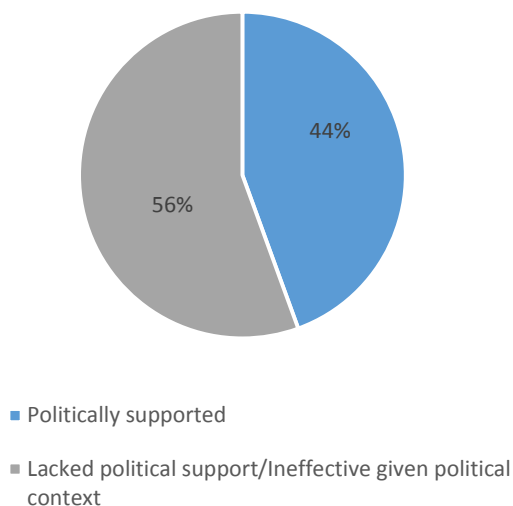
**Some reforms were successful because of strong political support, but others did not adequately reflect the political-economy context.** Several important PFM reforms achieved good results because of strong political support, including reforms to the RERF in Kiribati and to procurement in Tonga. But around half of reforms in Tonga and Kiribati were in some way negatively impacted by political economy factors (Figure 31 and Figure 32). Negative political economy impacts arose through two main channels. Firstly, some reforms were stalled by direct political opposition or a lack of political support. In some cases this reflected the fact that technocratic PFM reforms were being progressed by development partners as a solution to political decisions that they did not agree with (for example, debt management reforms to address political decisions to contract large external loans, or medium-term budgeting as a solution to

political decisions to underinvest in asset maintenance). In other cases, reforms were simply pursued without high-level political buy-in and without policy-makers understanding the implications or – sometimes – objectives of reform (for example, the introduction of value-added tax in Kiribati was seriously impeded by incomplete understanding among Cabinet members of how the tax would work).

**Political economy factors were also significant in terms of the implicit intervention logic underpinning recommended reforms.** Reforms were often predicated on unfounded assumptions regarding the incentives facing policy makers and public employees. Reform plans often relied on assumptions that state-society relations in case-study countries were similar to those in OECD countries. This was clearly not the case in several instances:

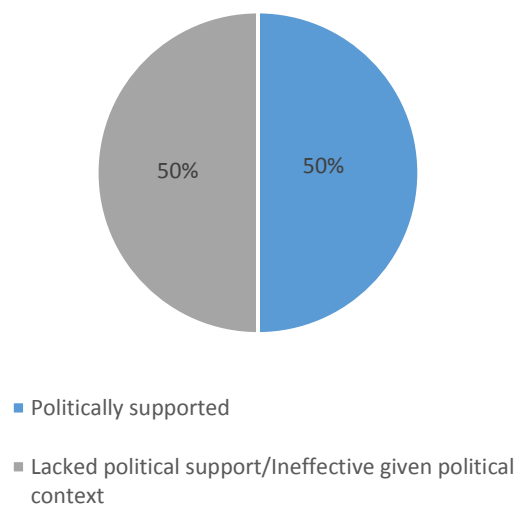
- Expectations regarding outcomes from strengthening audit capacity in both countries did not reflect the reality that such audit findings seldom led to action (which was clearly noted in both PEFA reports). Most of those interviewed did not believe that there was strong public pressure for legislators to take action on audit recommendations, and did not believe that audit purpose and procedures were widely understood by the general public. Similarly, efforts to improve performance through enhanced fiscal transparency did not reflect the absence of legislative and public oversight and weakness of civil society. Especially in Tonga, extensive efforts were allocated to improving the comprehensiveness of budget documents and publish additional fiscal information. The expected audience for this increased supply of information was not clear, nor how supplying this information could be expected to lead to changes in decisions and outcomes. This is not to say that fiscal transparency measures, including basic audit strengthening measures, should not have been pursued. But, firstly, the likely limited short-term impact of such measures could have been more explicitly taken into account when considering the likely impact and relative priority of such measures. Secondly, such measures could usefully have been complemented by broader efforts to engage parliament, the public, and civil society to generate the desired accountability relationships. Pursuing standard recommendations to strengthen audit and publish more budget information was unlikely to have been enough, on its own, to achieve the outcome being sought given the context within which reforms were introduced.
- ‘Strategic budgeting’ agendas were heavily predicated on assumptions that senior officials would be motivated to deliver on stated goals and targets, presumably due to oversight from politicians who were, in turn, held accountable by their electorate for quality in service delivery. Under New Public Management logics, the executive was expected to be both capable and inclined to discipline and reward well- and poorly-performing ministries through increases or reductions in fiscal allocations. In reality, performance had little influence on resource-allocation decisions, with policy-makers generally considered to be more concerned with constituency and patrimonial obligations. The capacity of Ministers to incentivize high performance among staff of their ministries was similarly weakened by cultural and organizational norms, and networks of patronage influencing senior public sector appointment and promotion decisions.

**Figure 31: Consistency with political context by proportion of reforms (Kiribati)**



Source: Team assessment, refer Table 12

**Figure 32: Consistency with political context by proportion of reforms (Tonga)**



Source: Team assessment, refer Table 19

**The political economy of development support also influenced approaches to PFM reform.** The team interviewed several staff of development agencies and government officials to explore the institutional incentives influencing provision of PFM technical assistance. While all respondents noted capacity to resist such incentives to some extent, development partner representatives reported pressures to spend, generating incentives to establish technical assistance engagements. Spending pressures could be general (the need to exhaust a country or regional allocations) or specific (the need to access a specific facility or mobilize assistance in an areas of internal priority). Government representatives, on the other hand, reported being generally reluctant to turn down assistance of any kind, citing the need to maintain good relationships with development partners and avoid the risk of ‘losing’ an opportunity to access specialist assistance in any area. Development agency staff also outlined several factors influencing the type of PFM assistance that development partners would offer. Representatives of development agencies cited greater ease in obtaining clearance and resourcing for assistance that: i) took forms that were intelligible to reviewing or senior staff without familiarity with country context, such as implementation of “packaged” reforms such as medium-term budgeting or development of a medium-term debt strategy; and ii) relied on a generalized skillset that could be accessed from easily-available consultants. Further, development partners also sometimes faced incentives to be able to quantify progress from their interventions, driving a focus on improving PEFA scores, sometimes with limited consideration of the strength of links between PEFA score improvements and outcomes.

### ***3.5. Were PFM reforms adequately planned and coordinated?***

**Problems with capacity constraints and misalignment with political priorities reflected some weaknesses in planning.** PFM reforms did not follow a plan in either country, possibly contributing to weaknesses in prioritization and alignment with government priorities. The 2011 Kiribati PFM Reform Plan included too many reforms to be useful in informing planning, and was generally recognized as unhelpful by government and development partners (see Box 4). A PFTAC review of the document identified improving the FMIS and associated business processes as the reform priorities. While the review

did not lead to adoption of a revised plan, it did influence reform efforts towards these areas, although limited progress was ultimately achieved, as described above. In Tonga, a careful and consultative process was undertaken to develop a PFM reform plan over several years covered by this report, but the final plan has only recently been endorsed by Cabinet and so did not drive PFM reform planning over the period of analysis (see Box 5).

**As a result of the weaknesses in formal planning processes, both countries relied on de facto planning mechanisms with varying degrees of success.** Economic reform coordination groups, established to manage budget support and comprising government and representatives from a small group of major donors providing budget support assistance, played an important de facto role in coordination PFM reforms in both countries. In Kiribati, for example, reforms to RERF management were largely managed through the Economic Reform Task Force, with participating donors able to respond to a pressing macroeconomic challenge identified as a priority by both government and all development partners. In Tonga, specific revenue policy reforms identified as priorities by both development partners and government were implemented with technical assistance mobilised through the Budget Support Management Committee process.

**Much technical assistance, however, was provided outside of these processes.** Sometimes, such support was supply-driven and initiated without any opportunity for collective consultation or assessment. Uncoordinated provision of technical assistance inevitably made it difficult to ensure that reform efforts were always aligned with the highest relative priorities. The weaknesses of formal prioritisation processes opened the door for ad hoc requests and “requests for requests” based on different development partners’ specialisations or resource availability. In some extreme instances development partner regional offices were unaware of the activities being carried out by headquarter-based teams, while in one instance, a senior official was unaware of the tasks being undertaken by a technical advisor operating within his division.

**Development partners had limited opportunity to inform or influence each other’s activities.** While regional PFM coordination meetings were held in various formats and locations, some development partners were concerned that coordination efforts often involved simple information sharing about respective plans, rather than genuine coordination of activities around shared objectives. Few development partner representatives reported any capacity to engage sufficiently early in planning processes to substantively influence other development agencies’ program or project designs. This lack of mutual oversight may have contributed to instances in which reform efforts were inadequately attuned to country priorities and contexts, and weakly aligned with ongoing reform efforts.

#### Box 4: The Kiribati PFM Reform Plan

The Kiribati PFM Reform Plan was completed in draft form in 2011. The reform plan is a simple inversion of the PEFA. All weaknesses (reasons for not achieving a perfect score) identified in the PEFA assessment are listed against ‘policy actions’ required to address those weaknesses. These policy actions are both extremely ambitious, and sometimes extremely vague. A weakness, such as “failure to record expenditure arrears” is listed against a corrective measure such as “record expenditure arrears [and] ensure arrears stock is modest”. Targets for 2014 are established based on these corrective measures which, if achieved, would have placed Kiribati among the highest scoring countries globally. Overall, the PFM reform plan does not function usefully as a plan for three reasons:

- Firstly, it includes a huge range of tasks or activities without prioritization or sequencing. Given inevitable capacity and resourcing constraints, a primary function of planning is left unfulfilled.
- Secondly, the plan does not provide any realistic, specific, or practical details regarding how outcome goals (such as reducing expenditure arrears) would be achieved. New IT systems, revised legislation, and upgraded “systems” are recommended without providing guidance to inform a government-led process towards achieving these goals;
- Finally, the plan omits all issues not explicitly raised in the PEFA assessment. For example, crucial macroeconomic issues of RERF management and the difficult political questions around fiscal sustainability and management of fisheries revenues are simply not addressed.

Figure 33: PEFA scores and targets - Kiribati

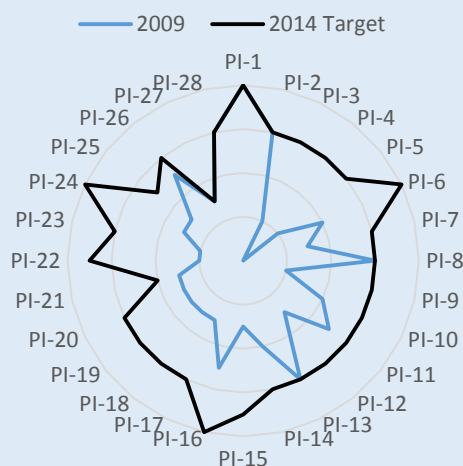
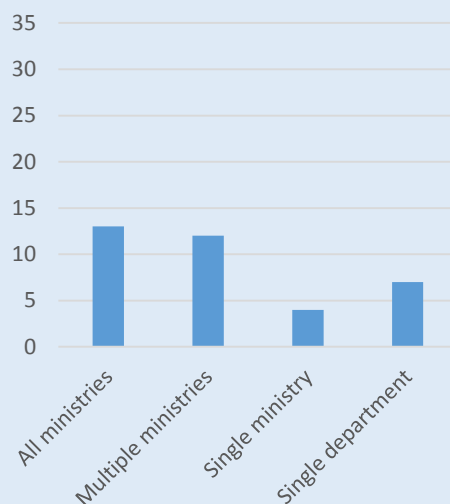


Figure 34: Number of reform actions - Kiribati



Source: Kiribati PFM Reform Plan

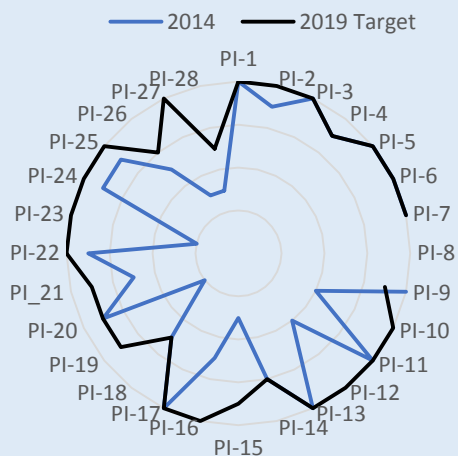
### Box 5: Tonga's PFM Reform Plan

The more-recent Tonga PFM reform plan represents a significantly more useful document. The higher quality of the Tonga plan reflects substantial efforts by PFTAC over recent years to ensure government ownership of reform plans (rather than delivery by external consultants), extensive consultation, and careful consideration of PFM reform needs based on PEFA assessments and other data.

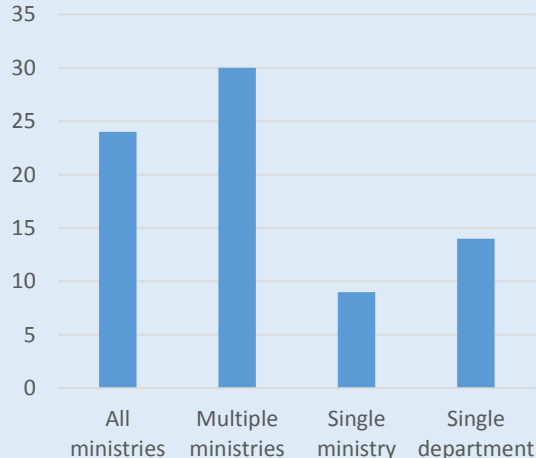
Substantial thought and consultation has gone into developing very specific and methodological plans for implementing reforms. Reforms are specified in terms of detailed and carefully sequenced process steps, rather than just as improvements against outcome indicators. Identification of reform actions is situated within a clear discussion of the outcome being sought, and a general discussion of progress in that area over recent years. While the general structure of the document follows the PEFA assessment, reforms are discussed in more practical terms.

The document, however, could more clearly explain linkages between specific reforms and broader development or macroeconomic challenges. While the executive summary helpfully identifies IFMIS upgrading and improved budget execution as key priorities, it is difficult for the reader to identify relative priorities between remaining listed policy reforms, with reforms with major resource implications (such as reducing tax expenditures) and those relating to changes in accounting standards (adoption of IPSAS) given apparently equal weight. The number of reforms included in the plan – over 70 actions to be completed in the next five years, most of which will require coordination across multiple government departments – also raises questions regarding both the credibility of the plan and its usefulness in guiding prioritization beyond the high-level priorities identified in the executive summary.

**Figure 35: PEFA scores and targets - Tonga**



**Figure 36: Number of reform plan actions - Tonga**



Source: Tonga PFM Reform Plan

## 4. Recommendations

**The analysis above illustrates many achievements but also opportunities for continued improvement.**

This report has shown that PFM reforms undertaken by governments with the support of their development partners helped address important constraints to development in both Kiribati and Tonga. Many reforms adhered to the guidance articulated in the Pacific PFM Roadmap in 2010, including: i) reflecting country-specific priorities; ii) taking account of country-specific constraints (including capacity constraints); and iii) ensuring country ownership and political support. Significant reform effort, however, was also spent on reforms that were poorly targeted towards major constraints, and therefore had little impact, or could not be effectively implemented due to capacity constraints or political factors. In Kiribati, especially, important basic system weaknesses, including in treasury systems, annual budget execution, revenue administration, and revenue forecasting remained unaddressed. For the period under consideration, neither country had a functioning, formal PFM reform plan in place, despite the recommendations of the Pacific PFM Roadmap (although important progress was made towards development of a reform plan in Tonga over the period).

**The assessment of mixed success is largely consistent with global experience.** World Bank global evaluations have shown disappointing results from efforts towards institutional reform (IEG 2008; IEG 2011). Even when reform efforts have been successful in improving systems, there has been limited evidence of “noticeable positive effect on the overall performance of the public sector” (IEG 2011). With this context in mind, clear examples from case studies where development partners have worked successfully with governments to achieve real gains should be celebrated as cause for optimism. Another implication is that there is unlikely to any ‘magic bullet’ or simple set of recommendations that allow all of the problems associated with complex public sector reforms to be avoided.

**In this section we present five key recommendations for consideration by governments and development partners.** These recommendations are drawn from our analysis of experiences in case study countries and draw on international experience and literature. They overlap and are entirely consistent with previous advice and guidance on PFM reform in Pacific island countries provided in the past by PFTAC and the World Bank (PFTAC 2010; PFTAC 2012; Haque et al. 2013). Crucially, all of the recommendations build on Roadmap advice that PFM reforms should: i) reflect country-specific priorities; ii) take account of country-specific constraints; and iii) enjoy country ownership and political support. Adoption of these recommendations is unlikely to ‘solve’ all problems discussed above but may allow incremental progress and allow practitioners to avoid some of the more obvious constraints encountered in the recent past.

**Different approaches will work in different situations.** Recommendations presented below will vary in relevance and usefulness depending on country circumstances. They are suggestions that could be tested and improved through future application by Pacific PFM practitioners with specific country knowledge. Recommendations are summarized and mapped to the original Pacific PFM Roadmap recommendations in the following table and explained more fully in the following text.

**Table 20: Summary of Recommendations**

		Good Practices		
		Focus on Country Priorities	Take Account of Constraints	Take Account of Politics
Areas of possible improvement		<ul style="list-style-type: none"> <li>Reliance on pre-determined reform models</li> <li>Important problems sometimes unaddressed</li> </ul>	<ul style="list-style-type: none"> <li>Too many reform processes</li> <li>Solutions sometimes excessively complex</li> </ul>	<ul style="list-style-type: none"> <li>Some reforms lacked political support</li> <li>Some reforms predicated on inaccurate assumptions regarding political and institutional incentives</li> </ul>
Recommendation	Planning	<ul style="list-style-type: none"> <li>Adequate time allowed for reform plan development</li> <li>Reform plan teams include economists, social sector specialists, and governance advisors</li> <li>PEFA Summary Assessments provide guidance on most pressing PFM constraints</li> </ul>	<ul style="list-style-type: none"> <li>Reform planning begins by identifying resource and capacity constraints</li> </ul>	<ul style="list-style-type: none"> <li>Reform plan teams include economists, social sector specialists, and governance advisors</li> </ul>
	Coordination	<ul style="list-style-type: none"> <li>Country-level coordination groups manage reforms and seek consistency with identified priorities</li> </ul>	<ul style="list-style-type: none"> <li>Country-level coordination groups seek to maintain number of simultaneous reforms at manageable level</li> </ul>	<ul style="list-style-type: none"> <li>Country-level coordination groups seek to maintain consistency with political priorities and constraints</li> </ul>
	Implementation	<ul style="list-style-type: none"> <li>Project designs rebalanced towards results and away from new policies, procedures, and laws</li> </ul>	<ul style="list-style-type: none"> <li>Regional approaches utilized with outsourcing of specialized functions as appropriate</li> </ul>	<ul style="list-style-type: none"> <li>Country-level coordination groups review implementation objectives regularly against policy priorities</li> </ul>
	Knowledge	<ul style="list-style-type: none"> <li>Regional institutional training bodies strengthened, including knowledge exchange and training on problem-driven approaches to reform</li> </ul>		<ul style="list-style-type: none"> <li>Knowledge of political economy context relevant to PFM reforms in Pacific countries deepened and documented</li> </ul>
	Mutual Accountability	<ul style="list-style-type: none"> <li>Good practice principles for Pacific PFM based on Pacific PFM Roadmap recommendations adopted by major Pacific development partners, with progress potentially monitored by the Pacific Island Forum</li> <li>Development partners agree to mutual peer review of all project designs, consultant terms of reference, and training plans, to support coordination, ensure consistency with country realities, and encourage compliance with agreed good practice principles</li> </ul>		

## **Recommendation 1: Consolidate progress towards better-prioritized reform plans**

**Substantial progress has already been achieved towards improving Pacific PFM reform plans.** The process of developing a PFM reform plan in Pacific island countries provides an important opportunity to confront the reality that addressing all PFM weaknesses may not be possible with available capacity, and that things may need to be done differently to standard practice in larger countries. Since 2012, PFTAC has moved towards a more country-owned and prioritized approach to PFM reform plan development, involving extensive consultation, increasingly linking PFM reform priorities to development challenges, and encouraging governments to carefully consider why and when a low PEFA score requires corrective action. These improvements are reflected in Tonga's recent PFM reform plan, but some concerns still arise due to the very large number of reforms included. A number of options exist to consolidate gains and ensure that Pacific PFM reform plans all include a feasible number of reforms which are tightly prioritized towards addressing binding development constraints:

- **Adequate resourcing for roadmap development.** Increasing the time and resources dedicated to developing roadmaps would be useful to ensure that they reflect country context and priorities. Allowing adequate time for in-country consultations is important, as is ensuring that the PFM reform planning team includes (local or international) economists and other country experts to ensure that PFM reforms are not considered in isolation from broader challenges. Adequate consultation at senior levels is also required to ensure buy-in and political support (PFTAC 2012).
- **Improved PEFA Summary Assessments.** PEFA assessments are frequently used as the start-point for PFM reform plans. Existing guidance from the PEFA Secretariat specifies that PEFA Summary Assessments should explain the likely impact of identified PFM weaknesses on fiscal discipline, strategic allocations of resources, and efficient service delivery. However, this does not always occur, with Summary Assessments often summarizing the full range of PFM weaknesses discussed in the document without discussion of which of these weaknesses are more relevant, given the country context. Summary Assessments that followed existing guidance and specified which PFM weaknesses were causing outcome level problems would assist the process of reform plan formation by providing a start-point for prioritization, and avoiding any perceptions that all PFM weaknesses need to be addressed.
- **Beginning planning processes by establishing a fixed resource constraint.** Once reform planning processes were underway it became very difficult for team members to resist calls from officials, politicians, and development partners to include additional reforms in PFM reform plans. This partly drove unfeasibly ambitious reform plans. Gaining broad agreement regarding the envelope of resources available for implementation at the outset might help avoid this outcome (including staff capacity as well as financial resources for technical assistance and infrastructure). Beginning with a resource constraint forces prioritization by making it clear that including additional reforms beyond a certain point can only be achieved at the cost of excluding others (Haque et al. 2013).

## **Recommendation 2: Further strengthen donor coordination and alignment**

**Country working groups could support ongoing coordination.** Development partners and governments need to continuously coordinate to manage PFM reform implementation, establish distribution of labor, and – potentially – update the PFM reform plan as country context and priorities change. A country-level

working group, led by a representative of a key government agency (likely the Ministry of Finance) and comprising other government and development partner officials, could be given responsibility for coordination of all PFM reforms. Establishing this group need not involve an additional burden, as existing coordination mechanisms could be used – for example, joint donor budget support working groups already exist in several Pacific countries with substantially overlapping membership. The working group would hold the following responsibilities:

- **Meet regularly to jointly review progress on PFM reforms and guide progress.** To guide the review, the working group should first agree on a set of 2-3 reforms to undertake over the course of the year from the PFM roadmap. Each subsequent meeting would then agree a small sub-set of actions to take before the next meeting and consider progress against the actions agreed in the last meeting. In general, there should be no support for new PFM reforms that do not address one of the agreed actions.
- **Provide a mechanism for policy-level engagement.** To build awareness and ownership among policy-makers, the working group could regularly report to Cabinet on progress and constraints, and to seek guidance on policy priorities.
- **Update and adjust the reform plan.** While the overall path for reform should be ideally set by the PFM roadmap, the working group could play an important role in updating and adjusting the reform agenda – while maintaining a tightly prioritized approach – as country conditions and political priorities change. This will inevitably involve difficult choices regarding the reforms that should not be pursued or continued if more-urgent priorities emerge.
- **Coordinate with other related reform activities.** An important opportunity may arise from the same working group taking responsibility for PFM, budget support coordination, and broader economic reforms. This could ensure development partners and government agree on relative priorities and constraints across different areas of engagement, build understanding of the capacity burden arising from different areas of reform, and also ensure that donor conditionalities were aligned with prioritized PFM actions.

### **Recommendation 3: Ensure implementation approaches reflect Pacific realities**

**PFM technical assistance models could be altered to provide greater emphasis on outcomes rather than policy, legislative or process changes.** Case studies demonstrated that the large number of reforms that impose additional capacity burdens often leads to recommendations not being implemented or implemented for only a short period of time (for example, the rules governing membership of SOE boards in Kiribati and new processes for fiscal transparency in Tonga). There have been growing calls for international organizations to offer support for institutional reforms based on improved outcomes rather than delivering pre-determined outputs such as new rules, procedures, policies, and laws. In practical terms, such approaches in relation to Pacific PFM reform might mean:

- **Ensuring short-term assistance is coordinated with implementation support.** There were no clear examples from case study countries of short-term assistance leading to substantial reform or improvements in outcomes without subsequent implementation support. In some cases expectations that government would implement recommended reforms without additional assistance led to long delays before pressing problems were resolved (for example, technical assistance advice on improving RERF management was delivered several years before any reforms were implemented following the mobilization of additional implementation support from a different development partner). Development

partners could seek to ensure that resources for such implementation support are available before mobilizing short-term technical assistance, or simply combine analytical and implementation phases of assistance.

- **Innovative approaches to contracting.** Consultants could be provided with greater leeway to change their approach and planned outputs as reforms develop as long, as overall goals remain consistent. Calls for such flexibility are increasingly common in international literature under titles such as ‘Problem-Driven, Iterative Adaptation’, ‘Doing Development Differently’ and ‘Thinking and Working Politically’ (see Andrews et al 2014, Williamson 2015; Gulrajani and Honig 2016; Carter 2016).<sup>4</sup> Consultants could be given more time to understand context and adapt their approach accordingly. In some cases, consultants could be contracted to solve a particular problem or improve the functioning of an existing process, rather than to necessarily introduce policy or legislative reform or overhaul existing formal systems. Management frameworks could specify outputs and monitor indicators of progress over short time horizon (e.g. quarterly) to allow reforms to adjust using new information about the context or political environment.
- **Investigating the use of financing instruments that increase focus on results.** Development policy operations have proven an effective and useful means of supporting PFM reforms in Pacific island countries. Development policy financing might be usefully complemented by financing mechanisms that allowed a closer focus on results, rather than on significant institutional and policy reforms. Providing financing against results (e.g. reliable supply of pharmaceuticals to clinics) would open space for development partners and governments to discuss on the most context-appropriate means of achieving the targeted result and reduce the temptation to reach for “packaged” reforms. Focus could be moved towards simple improvements to (or increased enforcement of) existing systems when more ambitious overhauls of policies and procedures was unnecessary and might impose an excessive capacity burden. A focus on results, rather than changes to the formal PFM system, might also encourage development partners and government to consider interactions between PFM systems and broader problems of public sector management. Targeting results could magnify the impacts of PFM reforms by incentivizing complementary process and management improvements beyond the PFM system.<sup>5</sup>

**Previous work has emphasized the potential benefits of regional approaches and outsourcing in relation to Pacific PFM.** Given that some Pacific island countries may not be able to maintain specialized capacities required for all PFM functions they seek to have fulfilled, capacity supplementation and capacity substitution can play an important role, alongside traditional capacity building. Pacific governments may wish to outsource particular functions to the private sector or regional institutions. Case studies showed the potential positive benefits of outsourcing and regional capacity sharing. In-line technical assistance to tax administration in Tonga and the Kiribati budget office generated fiscal savings of likely much greater value than the costs of the assistance. Long-term technical assistance to RERF management in Kiribati supported important reforms that were well beyond government’s technical capacities. Such capacity supplementation and capacity substitution can be delivered sustainably if costs are acknowledged and planned for. Advanced economies often outsource certain government functions to enable civil servants to focus on core government roles and responsibilities. Such outsourcing and capacity sharing arrangements need to be

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<sup>4</sup> Despite an emerging consensus on these issues, much less has been offered to explain clearly how it might put into practice (Gulrajani and Honig 2016; Carter 2016).

<sup>5</sup> The World Bank’s Program-for-Results instrument may hold potential in this respect.

considered carefully, however, and previous work has provided a framework for judging when and where such approaches may be appropriate (Haque et al. 2013).

### **Box 8: Eight questions for those developing PFM reform plans**

#### **For the plan:**

- Does the reform plan explicitly identify main development problems and how weaknesses in the PFM system contribute to those problems?
- Taking into account time requirements of everyday work and reform processes already underway, are there sufficient numbers of people with sufficient knowledge and skills to implement and sustain the proposed reforms?
- Is sufficient technical assistance and financial support reliably available from development partners to support all listed reforms?
- Does the plan identify relative priorities between different reforms and reform objectives?

#### **For each reform:**

- Is there a clear causal logic between the reform and desired improvements against outcomes that citizens and policy makers are most concerned about?
- Does this causal logic still hold when existing non-compliance with formal rules, limited enforcement capacity, and potentially limited engagement and influence of civil society, citizens, and parliamentarians are taken into account?
- Who will benefit and who will lose from the reform, and how will resistance from losers be overcome?
- Is there a simpler way to achieve the desired outcome?

*Source: Adapted and expanded from PFTAC 2012 and Haque et al. 2013*

### **Recommendation 4: Deepen country-specific knowledge**

**Case studies showed that PFM reforms are sometimes predicated on intervention logics that do not hold in Pacific countries.** Case studies showed that PFM systems exist within and depend on the broader institutional and political environment.<sup>6</sup> Reforms to strengthen public and parliamentary transparency were based on the assumption that the public could and would hold policy makers to account for poor performance and corruption, and that policy makers could – in turn – drive corrective change within the bureaucracy. But PEFA assessments for both countries had noted that action was not taken on audit reports. Civil society lacked the capacity and knowledge to leverage budget transparency towards policy change. Ministers and senior civil servants were often unable to drive change within bureaucracies where personal relationships, informal institutions, and cultural norms exerted strong influence. Similarly, absence of effective tax enforcement through the legal system in Kiribati (due to weaknesses in tax division and justice sector capacity and political economy factors) may have given cause to question the relative effectiveness of efforts to change formal systems compared to working to see existing formal rules better enforced. While the dominance of informal institutions is often understood as a defining characteristic of developing

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<sup>6</sup> This point has been made in general terms by Schick (1998) and Andrews (2010)

countries, and therefore a common issue encountered by those working on PFM reforms, such institutions may operate in unique ways in Pacific countries and require particular analysis (Khan 2011; Anckar 2006).<sup>7</sup>

**Better understanding the political economy of Pacific island countries might support more holistic and effective interventions.** Further political economy and institutional analysis could be undertaken to ensure that expectations regarding the likely impact of standard accountability and transparency measures in Pacific island countries are accurate. Such work might also usefully inform the design of less conventional mechanisms by which sought-after accountability relationships between policy-makers, the bureaucracy, and citizens could be established over time. Previous evaluations of political economy analysis suggest that it would likely be most effective if integrated into the PFM reform planning process (Booth, Harris, and Wild 2016), perhaps through the inclusion of a governance expert (either local or international) with a specific mandate to consider political economy issues as a member of PFM reform planning teams.

**Regional bodies could play an important role in developing context-specific approaches to PFM.** Bodies such as the University of the South Pacific (USP), Pacific Island Center for Public Administration (PICPA), PFTAC, the Pacific Island Forum (PIF), and the Pacific Association of Supreme Audit Institutions (PASAI) play an important role in capacity building through training and peer learning. They are also mostly staffed by Pacific islanders with deep country and regional knowledge. Development partners could further support these institutions in developing and disseminating context-specific solutions to common PFM problems, including through: i) facilitating representation on PFM reform planning teams; ii) sponsoring knowledge exchange with countries beyond the Pacific at similar levels of development or facing similar challenges; and iii) linking such agencies with leading global academic and policy institutions developing (and providing training on) innovative approaches to PFM reform.

#### **Recommendation 5: Adopt coordination mechanisms to support good practices**

**Case studies demonstrated that institutional incentives can drive proliferation and excessive complexity of PFM reform interventions.** Development agencies and staff sometimes individually face incentives to implement more projects that adhere to internationally familiar designs, even when a smaller number of context-specific interventions might have the greatest positive impact. The collective goal of improved Pacific PFM systems might therefore be served by instituting mechanisms to bind development agencies to collective restraint and coordinated action.

**Development partners could jointly adopt a set of good practice principles.** In June 2014, a number of Pacific donors agreed ten “Good Practice Principles for Multi-Donor Budget Support”. This document codified existing productive working practices and helped ensure institutional buy-in and commitment. Similar good practice principles for PFM reform could be introduced. The principles could draw on collective experience and focus on three broad areas: coordination, prioritization and implementation. Coordination principles could commit development partners to practices that promote better information sharing between donors and strengthen the dialogue between development partners and the government. Prioritization principles could commit development partners to developing reforms that are realistic, appropriate and solve real problems. Implementation principles could commit development partners to longer-term engagement, flexibility to adapt to changing priorities and problems and a greater variety of

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<sup>7</sup> A recent literature on “islandness” suggests that small island states have particular governance and political economy characteristics, including small populations and resulting closer personal relationships between individuals that exacerbate challenges associated with establishing an ‘impersonal’ bureaucracy (See Anckar 2006).

reform interventions for governments to choose from. A draft of these principles is attached as an annex to this report.

**Under these principles, development partners could commit to providing opportunities for mutual review of project design documents, consultant terms of reference, and training plans.** Through mutual review, development partners can seek to ensure coordination and broad agreement on the appropriateness of reforms being pursued. Development partners could collectively consider whether or not the proposals adequately reflected the priorities agreed in the country working groups and the capacity of the government to support or implement the proposed deliverables.

**These principles could be discussed, adopted, and monitored at the annual ‘Heptagon’ meeting of major donors.** Alternatively, and more formally, the principles could be submitted to the Pacific Islands Forum for formal endorsement, with the Pacific Island Forum Secretariat playing an ongoing role in monitoring compliance. This would help ensure shared commitment to the principles among donors and governments.

### Box 9: The Pacific Financial Technical Assistance Centre and Pacific PFM Roadmap Development

PEFA assessments have been carried out in fourteen Pacific island countries since 2005, with many of these undertaking repeat assessments. On the basis of these assessments, at least ten governments in the region have now prepared PFM roadmaps to address the challenges highlighted in the PEFA reports. The IMF PFTAC has responsibility for providing coordination and quality control under a strategy for PFM in Pacific Island Forum member countries adopted by the 2009 Pacific Island Forum Economic Ministers' Meeting (FEMM). In a 2012 update to the regional Public Financial Management Reform Roadmap, PFTAC provided several recommendations regarding the development of country PFM roadmaps. Messages from this PFTAC document are entirely consistent with this reports recommendations regarding roadmap development, and include:

- **It is important for countries to take ownership of the PEFA assessment and PFM Roadmap.** This will ensure that the assessments contribute to the reform process. This requires engagement from senior and middle level staff in their preparation – not just as information providers, but as partners in the preparation of PEFAs and Roadmaps. This not only creates ownership, but also provides an educational opportunity, developing country staff so that over time they will be able to take more responsibility for driving PFM reform.
- **This requires time and careful planning.** PEFAs and Roadmaps should only be started at a time of the year when key staff will be least distracted by other matters. A PEFA will require at least 4-5 weeks (2 weeks for a self-assessment and 2-3 weeks for a formal assessment) of fairly intense staff involvement.
- **Formal assessment teams should be appropriately staffed.** Teams should be composed of around 3-4 people, with at least one member from the Government and one from a regional agency or peer country. Two experts will also normally be required (one of whom will probably have facilitated the self-assessment exercise). Additional expertise may also be required for additional assessments in areas such as procurement.
- **Consultation with donors is also important.** It should come both beforehand, through review of the terms of reference and team briefing, and also at the end of the process. The government should be in the lead in the consultation process.
- **A “low” PEFA score does not necessarily require action.** PEFAs only tell a government how they are performing relative to what is generally considered best practice. Countries may not consider it appropriate to move to better practice across the whole range of PEFA scores. This may be because of constrained resources/capacity or because a country does not consider a higher PEFA rating to be desirable.
- **Roadmaps should be about much more than just raising PEFA scores or meeting a donor requirement.** They should not become just another plan-- created, published, and delivered to fulfil a donor requirement. Roadmaps should only be prepared if Government believes that improved PFM is important to improved delivery of public services; and they are committed to implementation. A properly prepared Roadmap will clearly indicate the actions that can and will be taken to arrive at the desired state and the timing of those actions. It should also identify the type of development partner support that will be required to achieve sustainable improvements—engaging key partners during drafting is therefore critical.
- **Sound and disciplined PFM is not just a technical matter.** Many of its most significant aspects hinge on how Cabinets and Legislatures deliberate on fiscal and policy issues, and in particular on how they integrate thinking about public service policies, budgets, and revenue constraints in arriving at decisions. PFM Reform Roadmaps should address these issues and should be formally approved by Cabinets.

## Annex 1: Proposed PFM Good Practice Principles

Public financial management (PFM) is a core part of the state, and its capability to deliver public services to citizens. Effective PFM systems help support macroeconomic stability, the efficient allocation of resources, and efficient use of those resources for service delivery. Effective PFM also provides assurance to donors that aid delivered through country systems will be used for its intended purpose. For this reason, countries across the Pacific are implementing reforms to address weaknesses in their PFM systems with financial and technical support from development partners.

The following principles are intended to capture what we have found to work best when developing and implementing programs that support PFM reforms. These ‘good practice’ principles will guide our actions in future so that lessons do not have to be relearned and positive impacts can be maximised.

1. **All development partners support a common set of PFM reforms agreed jointly with the government.** Experience from budget support is that the prioritisation and implementation of reforms between the government and development partners works best when a single process is used to negotiate actions, monitor and verify progress and coordinate technical assistance. This ensures coordination and avoids large costs of dealing with different development partners. Any exceptions, to allow parallel PFM support from development partners, would be on the basis of principles agreed as part of this same process.
2. **PFM diagnostics are considered together with evidence of problems with macroeconomic management and service delivery.** PFM diagnostics, such as the Public Expenditure and Financial Accountability (PEFA) framework, are good high-level indicators, but should be accompanied by a short note clearly explain which scores matter, and why. The government and development partners should discuss how these relate to broader challenges with macroeconomic management and service delivery, before PFM reform actions are agreed. To the extent possible, this should include consultations with the providers of politically important public services.
3. **Options for reform are jointly examined and the government and development partners share a clear understanding of the theory of change.** Development partners and governments need to work together to ensure proposed reforms are addressing a relevant and high priority problem. The government and development partners should examine the problem, options for addressing the problem, and the space for reform.<sup>8</sup> Where other countries are serving as a benchmark, the institutional context and history should be explained. The theory of change for the reform should be clearly understood, and monitored during implementation.
4. **The number of PFM reforms requiring strong coordination between government entities is limited.** Reforms are more likely to be successful if they are more “concentrated”, with fewer actors involved, even within a relatively small government establishment. In contrast, coordinative,

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<sup>8</sup> Adapting from Andrews et al. (2015), key questions in examining the problem include: What is the problem? Why is it important? To whom does it matter? Who needs to care more? Why don't they care more? How do we get them to give it more attention? What will the problem look like if it is solved? Who has the authority to engage? How much acceptance is there to engage among those affected? Is there capacity to support reform?

integrated reforms are more difficult to implement successfully. Therefore, governments need to consider carefully how many coordinative reforms they can take on at the same time. The experience from OECD countries suggests that even in capacity-rich environments, governments rarely carry out one or two complex reforms in the same sector, outside of major national crises (Hood et al, 2014). It is not possible to state definitively how many is too many, but as a rule of thumb, any more than one affecting the same ministry, and any more than three overall, should be carefully scrutinised.

5. **Timetables for reform are realistic.** For institutional reforms in PFM to take root, experience from advanced countries suggests that decades or even longer time periods are the unit of measurement, not months or years. Even more specifically targeted technical reforms often take 5, 10, or 15 years, usually involving processes of iteration. Furthermore, it is the nature of public finance that many processes are based on regularity and repetition, usually based on the annual budget. For certain processes, such as a new way of calculating the annual spending envelope to be “in use” for three years, may still only mean it has been practiced three times. While it is not realistic or helpful to try and impose time limits or artificial schedules on reforms, great care should be taken to approach timetables with realism and humility. It would also be advisable to consider “cooling off” periods of at least three budget cycles (or even five), in areas of PFM where significant reforms have taken place, so that changes can become somewhat embedded, before other major changes in the same area are undertaken. Such a limit would also incentivise stakeholders to consider prioritization more carefully.
6. **Consultants have time to understand the local context and flexibility to adapt their inputs.** A large proportion of PFM assistance is delivered through contractors who need time to understand the context they are working in and the problem that is being addressed. Without this space, there is a greater incentive to replicate activities from previous assignments. Development partners and the government should support regular opportunities for feedback from consultants and those affected by any reforms.
7. **Development partners are given the opportunity to scrutinise terms of reference and other materials produced by other development partners.** Through mutual review, development partners can seek to ensure coordination and broad agreement on the appropriateness of reforms being pursued. Comments will focus on whether or not the proposals adequately reflect the priorities agreed in the country working groups and the capacity of the government to support or implement the proposed deliverables.

## Annex 2: List of meetings

Kiribati	Tonga
<ul style="list-style-type: none"> <li>• NEPO Director, MFED</li> <li>• NEPO, MFED</li> <li>• SOE Unit, MFED</li> <li>• Treasury, MFED</li> <li>• Internal Audit, MFED</li> <li>• Acting PS, Ministry of Education</li> <li>• Accounts Section, Ministry of Health</li> <li>• Ministry of Internal Affairs</li> <li>• Auditor General</li> <li>• Kiribati Fiduciary Support Unit</li> <li>• Public Service Office</li> <li>• Technical Advisor, Asset Management</li> <li>• Deputy Mayor, Abiang Council</li> <li>• Councillors, Abiang Council</li> <li>• Principal, Missionary Secondary School, Abiang</li> <li>• Principal, Missionary Secondary School, Abiang</li> <li>• Principal, Junior Secondary School, Abiang</li> <li>• Police Officer, Abiang</li> <li>• Assistant Treasurer, Abiang</li> <li>• Radio Operator, Abiang</li> <li>• Island Clerk, Abiang</li> <li>• Primary School, Tarawa</li> <li>• Accountants Section, Ministry of Women, Youth and Social Affairs</li> <li>• Cabinet Secretary, Office of Te Berititenti</li> <li>• Accounts Section, Ministry of Education</li> <li>• Assistant Secretary, Ministry of Education</li> <li>• Chief Pharmacist, Ministry of Health</li> <li>• Financial Secretary, MFED</li> <li>• Copra Section, Ministry of Commerce</li> <li>• Donors - Australia, New Zealand, Asian Development Bank</li> <li>• Former technical advisor, Treasury</li> </ul>	<ul style="list-style-type: none"> <li>• Minister of Finance, MFNP</li> <li>• Treasury, MFNP</li> <li>• Procurement, MFNP</li> <li>• Budget, MFNP</li> <li>• Aid Coordination, MFNP</li> <li>• Planning Department, MNFP</li> <li>• CEO, MNFP</li> <li>• Debt Unit, Treasury, MFNP</li> <li>• Corporate Services Unit, MFNP</li> <li>• Prime Minister's Office</li> <li>• Ministry of Infrastructure</li> <li>• Public Service Commission</li> <li>• Ministry of Education</li> <li>• Ministry of Health</li> <li>• Ministry of Revenue</li> <li>• Public Accounts Committee</li> <li>• Office of the Auditor General</li> <li>• Australian High Commission</li> <li>• Government School</li> <li>• Chief Pharmacist, Ministry of Health</li> <li>• Technical advisor, PFM</li> <li>• Asian Development Bank</li> </ul>

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