

MAPS

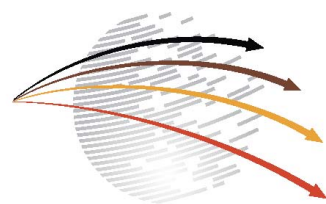
Provocateur Briefing Report

Forum on Development and Mitigation

DEVELOPMENT FOCUS

Public Financial Management

- **Date:** 28 February 2014
- **Author:** Len Verwey
- **Institution:** Independent consultant
- **Contact:** verweylen@gmail.com



M A P S

Mitigation Action Plans & Scenarios

From 27-29 January 2014, over one hundred professionals working mainly in the climate change mitigation field, in Southern contexts, gathered at the Cape Town Waterfront for the Forum on Development and Mitigation (the Forum). The event was hosted by the Energy Research Centre of the University of Cape Town, the Centre for Policy Research in New Delhi, and the international Mitigation Action Plans and Scenarios (MAPS) Programme. As a feature of the Forum nine South African development experts, the 'Development Provocateurs' were invited to participate in the event and write a short reflective piece afterwards. These briefing notes considered the discourse at the Forum from the perspective of each Provocateur's particular area of expertise, looking at shared priorities, disconnects and other points of contact.

This briefing note responds from the perspective of 'Public Financial Management' by Len Verwey. The full set of briefings have been compiled into a compendium, available at www.devmitforum.ercresources.org.za and www.mapsprogramme.org.

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PUBLIC FINANCIAL MANAGEMENT

Climate Finance and Some Lessons from Public Financial Management Reform Experiences

Over the last decade I have worked primarily on public finance and economic governance issues, as a researcher and manager for a large South African democracy organisation. More recently, I have become a Senior Associate of the Cape Town-based Climate Finance Hub. My focus area, then, when it comes to thinking about the links between mitigation and development, lies especially in the area of climate finance readiness and the role of public budgeting as a key dimension thereof.

We can assume an eventual increase in the flow of funds to Non-Annex 1 countries for mitigation actions, funds aimed at avoiding future carbon -locked- in development and funds that help current high emitters, such as South Africa, to make the painful adjustments that are required. Fundamentally, such climate financing constitutes a form of subsidisation, aimed at altering the cost-benefit determinations developing countries face in climate relevant project selection.

Such subsidisation is certainly not the only or even main form of climate finance: as we know, currently a large share of such flows is private investment in commercially viable renewable energy projects and the like. But such investments are also closely related to subsidisation. Commercial investment only becomes attractive, after all, where a regulatory framework is in place, or is expected to be put in place, that in effect imposes a fiscal cost (for example guaranteed purchases of renewable electricity) in order to make renewable energy competitive with fossil fuel based energy sources. And regulatory mechanisms aimed at levelling costs, such as a carbon tax, may impose adjustment costs on society over the short- and medium-term that put additional pressure on the fiscus, particularly in countries such as South Africa that have an established fossil fuel based energy sector. Over a transitional period of ten to twenty years the imposition of a carbon tax (assuming it is robust) will generate both increased energy prices and a shift to renewables, with the latter, more desirable supply side response coming to dominate over time. Initial higher energy costs, and their impact on poorer households in particular, can and should be compensated for through recycling carbon tax revenues. However, in practice the social benefits of such recycling may for some time be less than the social costs of abandoning cheap energy: revenue recycling would after all be subject to the usual vagaries of budget efficiency and effectiveness. In other words, carbon tax revenues plus further fiscal spending may be required if adjustment costs and benefits are to be equalised.

Substantial climate finance flows will be required then, and this is generally recognised. Given this context, ‘climate finance readiness’ focuses on the capacity, broadly understood, of developing countries to plan for, receive and effectively spend mitigation and adaptation finance, and on their ability to provide the necessary assurances that funds disbursed to them will be used effectively.

Within the broader and emerging discussions on climate finance readiness, I’m especially interested in what we have learned about what does and does not work in developing country budget reforms aimed at enhancing the effectiveness of public spending. It is useful to distinguish, when talking about public finance management, between domestically generated resources (tax etc.) and donor funding. I’ll focus here on donor funding and the related issue of aid effectiveness, since this is most closely aligned with the notion of subsidisation as I introduced it above.

We can assume that, for climate finance (or low-carbon investment subsidisation), familiar tensions will emanate from, on the one hand, the various explicit and implicit, more stringent and less stringent conditionality requirements which funders seek to establish in order to secure value for money, and on the other hand the issues of domestic sovereignty, capacity and ‘ownership’. The 2005 Paris Declaration on Aid Effectiveness is a useful summary of the current consensus on how to make aid effective:

1. **Ownership:** Developing countries set their own strategies for poverty reduction, improve their institutions and tackle corruption.
2. **Alignment:** Donor countries align behind these objectives and use local systems.
3. **Harmonisation:** Donor countries coordinate, simplify procedures and share information to avoid duplication.
4. **Results:** Developing countries and donors shift focus to development results and results get measured.
5. **Mutual accountability:** Donors and partners are accountable for development results.

Clearly, even before the stakes are raised and mitigation is conceived within a multiple benefits approach to development, these necessary conditions for aid effectiveness are only partly realised in most instances. They are, after all, goals rather than a reflection of current realities, and emanate from awareness that the impact of aid flows has been fairly disappointing. For climate finance currently, these criteria or necessary conditions are certainly not met and this must be acknowledged: we have, on the one hand, a fractured, highly complex, ever-changing finance and fund landscape, and on the other, developing country governments that have not prioritised the issue, have not done enough detailed planning that considers trade-offs or multiple benefits for various development trajectories, and that have not committed sufficient own resources to domestic adaptation (where a domestic cost-benefit argument can more easily be made), let alone to mitigation pledges. International coherence and local ownership are both lacking currently, in other words.

It is also unlikely that many developing countries are currently climate finance ready from the perspective of their own public finance management systems. Until funding escalates (hopefully) in the wake of increased climate impacts, one important low hanging fruit in addressing mitigation must be to enhance developing country climate finance readiness. What this suggests, of course, is that initial forms of support aimed at eventual climate finance will have to engage with and assess local systems and capacity, but here it is essential to not repeat budget reform mistakes that contributed to the disappointing effectiveness of general aid.

Broadly, from the 1990s onwards, a disjuncture between policy allocations and outcome in many developed and developing countries led to calls for ‘budget reform’ aimed at a greater focus on results (outcomes or impact), closer links between policy, planning and budgeting, and a higher valuation of transparency, accountability and participation as necessary conditions for better results. Accordingly, key elements of budget system reform (as one ‘missing link’ between allocation

and outcome) have included medium-term expenditure frameworks, integrated financial management information systems, formalised clarity of roles and responsibilities, budget transparency and performance or results-based budgeting. Since these reform efforts have now been around for some time, a number of evaluative studies are available. Andrews (2010) summarises the results of one comprehensive evaluation as follows:

- “Budgets are made better than they are executed; Budget preparation processes are comparatively stronger than budget execution and oversight processes across all African countries.
- Practice lags behind the creation of processes and laws; African public financial management systems generally suffer from an implementation deficit—laws and processes may be in place but seldom affect actual behavior.
- Actor concentration pays; Processes are stronger when narrower, concentrated sets of actors are involved in implementation. Processes are weaker where they involve multiple players, especially outside of central public financial management entities like the budget department or treasury. ”

Clearly these ‘lessons’ have implications for mitigation financing and the climate finance readiness debate, and to some extent they are unpalatable lessons. The first two points suggest that there has been too much focus in budget reform processes (and arguably governance more broadly) on getting the ‘form’ right rather than the substance. The public financial management reform paradigm has arguably been too technocratic and specialised, too optimistic in its assumptions about capacity in Finance Ministries and the like (or alternatively the extent to which external expert advisors can fill the gap), too information intensive, too dependent on formalised sets of rules and systems at the expense of the more messy business of muddling along, and too apolitical and naïve as regards the scope and speed of institutional transformation. Reforms have also had important, somewhat perverse implications for accountability: though reform efforts have been fundamentally aimed at better results and improved value for money, their emphasis on form has in many instances fostered a process rather than results accountability, which has at times created more bureaucracy, less discretionary decision making amongst public managers, and of course less impact.

If, indeed, these challenges have constrained what has been achievable in alleviating poverty and promoting development, they are even more likely to feature, and feature strongly, in low-carbon development strategies, where there is a less developed body of work on what works and what doesn’t, where local costs and benefit determinations are subject to the vagaries of multi-lateral decisions on mitigation funding, and where, from a political economy of transition perspective, politicians and climate champions may be vulnerable to accusations that they are neglecting goals such as poverty reduction in favour of something that is poorly understood and is associated with the concerns of the North.

The third lesson Andrews cites is also of interest: it is generally recognised that effective mitigation and adaptation actions need (and will increasingly need) both individual influential ‘champions’ and a high degree of inter-departmental and inter-sectoral cooperation and coordination within governments. What the public finance management lessons suggest is that it is all too often precisely these cross-cutting, multi-dimensional issues that governments struggle to plan effectively for, struggle to allocate the right money for, and struggle to implement, and that suffer from vague performance information and ‘accountability deficits’.

What has been called the ‘back to basics’ countermovement in approaches to budget reform may provide some useful lessons or guidelines in shaping climate finance readiness support too. In a review of Middle East and North Africa experiences with public finance management -driven reform, the ‘back to basics’ approach is summarised as follows (World Bank 2010):

- Know the value—and limitations—of political economy analysis

- Public finance management reform as means and not ends
- Context matters, so swim with the current
- The wisdom of “muddling through”— grand strategy versus incremental change
- Establish basic systems before contemplating more advanced reforms
- Whenever possible, keep reforms quick, simple and mutually reinforcing
- Be wary of large financial management information systems
- Internal challenges: leadership, coordination, skills and incentives

External stakeholders—useful, but don’t count on them

Lessons for donors: be more strategic, selective, modest and flexible

In trying to summarise the back to basics approach, we can point to a greater awareness of the risks accompanying highly ambitious, capacity-dependent reforms (such as sophisticated financial management systems), an awareness of the ‘political and social dimensions’ of budgeting and what this does and does not enable, and the importance of appropriate-to-scale interventions.

One implication of this is that climate finance flows will have to strike a balance between ‘conditionalities’ and flexibility, and that attempts to articulate exhaustive decision making matrices for project selection and financing may be of less worth than a flexible and accommodating approach. On the other hand, such flexibility should only be considered once a basic budget system that provides coherent (though not necessarily highly technical) links between planning, allocation, spending and evaluation is in existence. Put differently: an understanding of the strengths and weaknesses of the budget system is a necessary preliminary to finance flows, but such an understanding needs to avoid a one size fits all approach. Additionally, there should be a degree of realism in developing performance indicators and in the information intensity of monitoring, reporting and verification efforts. There are few if any governments, developed or developing, that do not struggle with the quantification of impacts and that do not end up with guesstimates. Of course mitigation targets are more readily quantifiable than, say, multi-dimensional poverty indices, but many projects that contribute to mitigation (and probably most that have an adaptation purpose) will not come ready-made with clear, non-contestable numbers on the extent to which they depart from ‘business as usual’ scenarios. There should, then, also be a willingness to approach impact and potential impact ‘hermeneutically’; that is to recognise an inherent interpretive dimension in both high- and low-information contexts.

It struck me during the sessions that I attended, which engaged with Nationally Appropriate Mitigation Actions and sustainable development, how strongly technocratic much of the discussion was, and how reminiscent of previous development-aid processes such as the formulation of Poverty Reduction Strategies. There too one often had a complex, expert-driven framework which set the terms of debate and then invited ‘participation’ in filling the framework. Unsurprisingly, the depth of local ownership and engagement was often small. Participation and local ownership are not only nice to have democratic perks, however. Using public finance jargon, it is worth bearing in mind that meaningful local stakeholder participation is a key dimension of allocative efficiency, i.e. spending on the right things, and that an effective degree of accountability is a key requirement of operational efficiency, i.e. as little waste as possible. It is only where both forms of efficiency occur that public donor-funded spending has significant impact. If these sorts of challenges (which are all in one form or other about who retains what degree of control over what money is spent on) have thwarted objectives which have broad political and social support, such as poverty reduction, we can expect them to be even more acute where local ‘buy in’ is largely absent, as is the case with mitigation.

References

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