مركز البيان للدراسات والتخطيط

Al-Bayan Center for Planning and Studies

Designing a Successful Approach to Public Financial Management Reform in Iraq

By Ali Al-Mawlawi

Al-Bayan Center Studies Series

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The path to recovery and reconstruction in post-conflict Iraq is fraught with pitfalls. The new government will need to tread carefully if it is to maintain macroeconomic stability and fiscal discipline, while trying to address the urgent needs of citizens through improved service delivery, job creation and protecting security gains. As a result, there is little doubt that the government will be forced to expand public spending on essential services, re-open the public sector job market to absorb rising unemployment, and continue to invest in the security sector to ensure that the Iraqi Security Forces are adequately trained and equipped to counter the resurgent threat of terrorism.

Indeed, these necessities will likely be reflected in the 2019 federal budget. The initial draft of the budget that was submitted to cabinet reveals a 23% rise in total spending compared to 2018, while total government revenues are projected to increase by 16% at approximately $90 billion. The number of budgeted public sector employees will also expand by 46,000 people. Given the higher than expected rise in oil prices, it seems that austerity measures will be relaxed to some extent.

Iraq will likely end this year on a budget surplus. The country is now generating nearly $8 billion in oil revenues each month, compared to just over $2 billion in January 2016. According to Ministry of Finance data, a budget surplus of $12.6 billion was achieved by the end of July 2018 and if current trends continue, the surplus could exceed $24 billion by the end of the year.[1]

Public financial management reform

In order to avoid wasteful spending, the government will need to ensure that its financial resources are allocated in a strategic manner based on a prioritised approach. Last month, the European Union signed an agreement with the World

1. Ministry of Finance, Public Financial Reports, July 2018
https://goo.gl/NQBavJ

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Bank to finance a three-year program to assist the Iraqi government in enhancing its public financial management (PFM) system. The EUR 15.6 million will be implemented by the World Bank and will offer technical assistance and capacity building to Iraqi counterparts.[2]

The program builds on an existing $41.5 million World Bank-funded project that was launched in 2017 that seeks to modernise public financial management systems in Iraq by enhancing transparency, cash management, public investment and procurement systems.[3]

PFM reform has emerged as one of the key priorities for both the international donor community and the Iraqi government because it addresses a fundamental issue related to trust and good governance. The vast scale of the challenge to rebuild towns and cities destroyed during the war against ISIS requires the efficient and effective allocation of limited financial resources. While it is estimated that some $88 billion will be needed for reconstruction efforts, the international community pledged $30 billion in loans and grants during February's Kuwait conference.[4] Trust needs to be established between government authorities (both local and federal) and the international donor community. Without assurances that funds will reach their intended destination, international lenders and investors will be reluctant to follow through on their commitments.

Understanding the components of public financial management

Broadly speaking, the public policy focus on PFM has grown alongside the expansion in public spending in industrial countries since the mid-20th century. PFM is concerned with the "laws, organisations, systems and procedures available to governments wanting to secure and use resources effectively, efficiently and transparently."[5] PMF mainly focuses on expenditure management and seeks to enhance the way public budgets are organised.

2. World Bank, Press Release, 16 September 2018
http://www.worldbank.org/en/news/press-release/2018/09/16/world-bank-and-european-union-support-iraqs-public-financial-management-systems-and-institutions
3. World Bank, Modernization of public financial management systems project, December 2016
http://projects.worldbank.org/P151357?lang=en
4. Reuters, Allies promise Iraq $30 billion, falling short of Baghdad's appeal, 14 February 2018
https://www.reuters.com/article/us-mideast-crisis-iraq-reconstruction-ku/allies-promise-iraq-30-billion-falling-short-of-baghdads-appeal-idUSKCN1FY0TX
5. Allen, Richard et. al., International Handbook of Public Financial Management, Palgrave Macmillan

The new EU/World Bank program is predicated on 3 pillars and 9 sub-components that seeks to enhance coordination of multiple actors towards PFM reform; strengthen accountability and oversight of how public resources are managed; and confront corruption by improving the legal and regulatory framework in a manner that enhances transparency. These objectives have defined a number of tangible goals including the following:

- Establishing a Donor Coordination Committee to ensure that all PFM reform efforts are conducted under the auspices of the central government;
- Expanding coverage of the payroll information system and ensuring that all federal civil servants are issued a unique identification number to root out ghost and duplicate employees with the goal of implementing electronic payments to all employees by the end of 2020;
- Introducing technological tools to develop an e-procurement system to root out waste and mismanagement;
- Improving budget transparency through enhanced disclosures and more interactive public reporting on the federal budget;
- Raising the capacity of audit officials from the Board of Supreme Audit to improve oversight over spending;
- Enhancing anti-corruption mechanisms by introducing tools such as a national corruption baseline to help prioritise anti-corruption efforts.[6]

Learning lessons from past experiences

It is important to note that addressing PFM in Iraq is not a new endeavour. The World Bank had approved a similar project back in 2009, and earmarked some $18 million with the stated objective of “supporting the Government of Iraq’s efforts to develop a more effective, accountable and transparent public financial management system.” But by the time the project ended in 2013, it was clear that many of its desired goals had not been met. An independent review commissioned by World Bank concluded that the outcome of the project had

6. World Bank, Strengthening Public Financial Management Oversight and Accountability Institutions in Iraq, 2017

been "moderately unsatisfactory". It further goes on to state that "ownership of the reforms is the prerequisite of any progress in the execution and oversight of any public financial reform program. If you don't have key reformers in the government and an identified constituency supporting the reform agenda throughout the implementation process, there is a risk that PFM reforms will not be initiated and achieved."[7] In this respect, it is important to identify some of the key lessons from that experience that should be taken on board:

1- Project goals should be realistic and achievable: Several of the project components were overly ambitious, and unrealistic timelines were set for completion. Key to avoiding this pitfall is to invest resources during the initial planning phase to undertake a thorough institutional capacity analysis, in order to anticipate future obstacles and roadblocks. In the case of this project, performance indicators were amended towards the latter stages in a retrofit manner to cover up some of the shortfalls.

2- The traditional approach to capacity building needs to be revised[8]: Training workshops that are non-technical with vague objectives have consistently shown to fail in enhancing overall institutional capacity. This is partly due to design flaws with the training modules, but also because often, there is no follow up with the training cohort. In many instances, the language barrier between conveners and participants results in poor training exercises and trainers often lack a deep contextual understanding of the challenges. An overreliance on foreign consultants also burdens budgets with inflated security and transportation expenses, as highlighted by the independent review. But beyond the weaknesses in the training sessions, there is a more fundamental problem. While it is important to address individual capacities of employees, the bigger problem relates to the organizational dynamics of the government departments. Understanding the political economy of PFM reform is essential to designing an effective strategy.

3- Donors must lead by example: Corrupt and unethical practices are by no means limited to state-run institutions. Questionable hiring practices are commonplace within donor organisations, and there is often little accountability for the failure to deliver on projects. For example, a key

7. Independent Evaluation Group, ICR Review: Iraq Public Financial Management Review, February 2015 http://documents.worldbank.org/curated/en/830901475115948554/pdf/000012394-20150309080111.pdf

8. Center for Global Development, Memo to Aid World: Drop "Capacity Building", 24 March 2014 https://www.cgdev.org/blog/memo-aid-world-drop-capacity-building

component to the World Bank's project was to develop and test an integrated financial management information system (IFMIS) prototype, however, the contract was inexplicitly negotiated with a single company (which ultimately fell through), rather than with multiple sources, as is standard practice. Ironically, the goal of this component was to improve Iraq's procurement system.

4- Poor monitoring and evaluation practices: Any reform program requires timely assessment of whether the work is heading in the right direction. Often, this component is lacking, and lessons are not learned from failed projects, leading to a repetition of the same mistakes in future endeavors.

Any successful effort to undergo significant reform requires political will and local ownership. Champions of the reform process need to be identified and incentivized through legitimate means. Reforms cannot be imposed without a receptive constituency that is willing to take responsibility for maintaining the gains after international consultants have left the country.

Towards a new approach

An alternative approach is to adopt what is commonly known among academic circles as a "problem-driven iterative adaptation" (PDIA) approach. Its Harvard University-based architects describe it in the following way:

"The PDIA approach argues that we don't need more 'experts' selling 'best practice' solutions in the name of efficiency and the adoption of global standards; we need instead organisations that generate, test and refine context-specific solutions in response to locally nominated and prioritized problems; we need systems that tolerate failure as the necessary price of success."[9]

Solving problems that are largely logistical in nature does not take much planning. For example, the international coalition's provision of weapons and ammunition to Iraqi Security Forces during the war against ISIS helped address a pressing need that did not require excessive planning. Another example is the humanitarian relief effort that responded to the needs of millions of Iraqi IDPs. While context-specific adaptations are still important, it is possible for readymade

9. Andrews, Matt et. al., Building capability by delivering results: Putting Problem-Driven Iterative Adaptation (PDIA) principles into practice, OECD, 2015

interventions to yield significant results. The difficultly lies in addressing "non-simple, non-technical problems that are implementation intensive".[10] These are typically the sorts of endemic problems that Iraqi institutions have suffered for decades including corruption and mismanagement of resources.

Critics of traditional development approaches have argued that not only is understanding the context (including political economy) central to addressing the problem, but that the solution lies in a problem-driven approach whereby the *process* of solving problems creates a cycle of institutional learning and adaptation.

The PDIA approach is based on four principles:

First, local problems require local solutions rather than attempts to transplant the approaches of other countries. This encourages Iraqi stakeholders to lead the way in prioritizing problems and discovering solutions.

Second, creating an environment that encourages people to push the boundaries and experiment with new approaches without fearing the consequences of failure.

Third, ensuring that organizations are able to adapt according to the learning experience of experimentations.

Fourth, engaging a network of champions that cut across sector and departments to ensure that the reforms are viable. Here, it is important to acknowledge that reforms cannot be driven by a single individual alone, but senior and mid-level officials need to be empowered so that they have sufficient authority to take the necessary decisions to bring about real change.

The capabilities of state institutions are more than just the sum of its employees' individual capacities. We need to understand what is standing in the way of real reform and design solutions that address these obstacles. Public financial management is a key asset to combat corruption and root out inefficiencies within the system of public spending, but as the experiences of the past decade have shown, if the new government is to successfully tackle the intractable problems within its state institutions, it will need to adopt some radical approaches.

10. Ibid.