Book Review

Richard Allen, Richard Hemming and Barry H. Potter (Editors), 2013. The International Handbook of Public Financial Management: Palgrave Macmillan

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This volume presents a comprehensive series of readings on the topics of public financial management (PFM) and fiscal policy. Most of these readings have drawn upon the specific experience of the contributors as PFM practitioners, academics and consultants working in both developed and developing countries. The resulting book demonstrates that while PFM has come a long way since the publications by ADB of 'Managing Government Expenditure' by Salvatore Schiavo-Campo and Daniel Tommasi in April 1999; by IMF of 'Guidelines for Public Expenditure Management' by Barry H. Potter and Jack Diamond in 1999; and by OECD of 'Managing Public Expenditure: A Reference Book for Transition Countries' edited by Richard Allen and Daniel Tommasi in 2001, there is still a long way to go.

The current volume consists of thirty-eight chapters with specific contributions covering the following PFM related topics:

Part I The Institutional and Legal Framework, i.e.: the macroeconomic framework; implementation of fiscal rules; the legal framework; the political economy of PFM reforms; the role responsibilities, structure and evolution of central finance agencies; the role of the legislature; assessing and comparing the quality of PFMs.

Part II Allocation of resources, i.e.: the coverage and classification of the budget; policy formulation; MTEFs; performance budgeting; fiscal federalism and intergovernmental financial relations.

Part III Managing Budget Execution, i.e.: budget execution; procurement; payroll management; the treasury function and the treasury single account; internal control and internal audit; and managing extra-budgetary funds.

Part IV Managing Government Revenues, i.e.: tax design; revenue forecasting; revenue and customs administration; user charging; managing non-renewable resource revenues; and managing foreign aid through country systems.

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Part V Liability and Asset Management, i.e.: public sector balance sheets; public investment and PPPs; fiscal risk; sovereign wealth funds; government non-debt liabilities; debt and cash management; and state-owned enterprises.

Part VI Accounting, Reporting and Oversight of Public Finances, i.e.: fiscal transparency; government accounting and financial reporting standards; FMISs; external audit; and the role of independent fiscal agencies.

In their introduction to this volume Richard Allen, Richard Hemming and Barry H. Potter point out that enormous progress has been made in the last ten years in developing toolkits to diagnose the strengths and weaknesses of PFM systems. However, they report that recent data from the World Bank show virtually no improvement in the performance of public financial management systems during this period. Accordingly, the stated objective of Allen et al is to create a comprehensive handbook on public financial management. A feature of this handbook is that most of the contributors have or have had some substantial association with the World Bank or IMF. These institutions are, according to Allen et al, arguably the two most authoritative sources of expertise on PFM.

The topics covered actually transcend PFM moving into the realm of fiscal policy. As Richard Hemming points out, although the objectives of PFM overlap the goals of fiscal policy, PFM and fiscal policy are not the same. The former is more concerned with expenditure than with taxation. PFM is concerned with achieving aggregate fiscal discipline and efficient government spending while the goals of fiscal policy are to achieve macroeconomic stability and sustainable economic growth. Jack Diamond comments that there is international diversity in the objectives of PFM. Ian Lienert identifies the five aims of a well-functioning PFM system as: attaining short-term macro fiscal stability and medium-term fiscal sustainability; enhancing the allocation of budgetary resources; improving the efficiency of public spending; ensuring that operations such as managing government's cash balance are efficient; and presenting high-quality budget information to the parliament and the executive on a timely and transparent basis. According to Richard Allen, it is widely agreed that a well-designed system of PFM has three primary goals: to set and control public spending within an affordable total; to allocate resources according to priorities; and to ensure the efficient delivery of individual services. Jim Brumby, Kai Kaiser and Jay-Hyung Kim identify level one, two and three objectives of PFM, namely aggregate fiscal management and control, efficiency in the allocation of resources, and technical efficiency. Paulo de Renzio notes that comparing PFM systems across countries at similar levels of income and development is problematic, as countries differ greatly in the way they organize their budget processes. Nevertheless, David Shand suggests that the PEFA PFM performance assessment tool is now generally accepted as the international standard for assessing the quality of a country's PFM system.

The handbook also contains a diversity of opinions regarding the potential role of the more popular PFM reforms currently being promoted by multilateral agencies notably the World Bank and the IMF. Richard Hemming points out that debt sustainability analyses (DSAs) become increasingly imprecise beyond a few years because of the unreliability of macroeconomic projections and policy uncertainty leading to the conclusion that DSA is comparing uncertain outcomes with fairly arbitrary debt limits. Richard Allen and Phillip Krause point to the findings of a recent World Bank study suggesting that, if well designed, medium-term expenditure frameworks (MTEFs) may have a positive effect both on aggregate fiscal performance and the allocation of resources through the budget. Jack Diamond emphasizes that strengthening of the PFM system in developing countries implies first introducing a medium-term perspective to budget formulation, typically through a medium-term budget framework (MTBF). Rolando Ossowski recommends that MTEFs in resource exporting countries include probabilistic analyses, using historical parameters of the stochastic process driving resource prices, to determine the optimal size of financial assets spending in the face of shocks. Jim Brumby, Kai Kaiser and Jay-Hyung Kim see MTEFs as a response to the problems involved in dual budgeting by helping assist in analysis and decision making regarding the appropriate levels of public investment and other spending including operating and maintenance expenditures. However, James Brumby and Richard Hemming point out that studies of individual country MTEF experiences suggest that for every country where it can be claimed that MTEFs have improved budget preparation and execution, there is another country where there has been no improvement and even a step backwards. Nevertheless, they maintain that most developing countries should still aspire to an MTBF.

The diversity of PFM and fiscal policy landscapes and the potential problems that this raises is also a recurring theme within the handbook. Murray Petrie, for instance, acknowledges that there is a very wide range of country circumstance regarding exposure, resilience and vulnerability to fiscal risk. David Heald points out that the institutional architecture differs across countries, depending in part upon constitutional arrangements. Ian Lienert argues that the impact of legislature on budget and fiscal policy outcomes varies widely from country to country. Ana Corbacho and Teresa Ter-Minassian suggest that given each countries specific institutional, legal and political features, it would be inappropriate to propose a ‘model law’ that applies in all countries. Likewise, Richard Allen and Phillip Krause note that overall, it is unlikely that any ‘good practice’ paradigm for the design of a central financial agency exists. Joachim Wehner and Paulo de Renzio conclude that fiscal design is a tricky business potentially resulting in unintended and often negative-side effects. Accordingly, they suggest that modern fiscal reformers need to become political economists. Alfonso Sanchez points out in relation to the role of procurement, a fundamental lesson learned from recent reform experiences is that reforms have to go beyond funding the machinery to transforming the culture and behavior of all involved, most importantly, policy makers and the political class. Jack Diamond notes that the audit function has always been viewed as an integral part of government financial management and increasingly as an instrument for improving performance of the government sector. Nevertheless, he emphasizes, there is no one model for the organization of the internal audit function in government. Likewise in relation to customs administration, Luc De Wulf concludes that while administrative systems are broadly similar in most countries, there is no single organization that fits all.

Another recurring theme within the handbook is to focus on the basics rather than chasing the latest fads in PFM and fiscal policy. While James L. Chan and Qi Zhang identify accrual accounting as the leading paradigm for government accounting at the international level, David Heald suggests that priority should be given to improving basic data, for hands-on financial management and for national accounts, rather than moving to sophisticated government accounting reform in countries where this is beyond financial or implementation capacities. Daniel Tommasi outlines the issues involved in the introduction of programmatic budget expenditure classification schemes. Although Marc Robinson recommends program budgeting as the most useful and relevant form of government-wide performance budgeting, he cautions that any attempt to introduce government-wide performance budgeting systems based on across-the-board use of formula funding, purchaser-provider or bonus funding could be misguided and doomed to failure.

There are, however, basic building blocks towards achieving more effective and efficient PFM systems in developing countries. As Bill Monks points out, the essentials of effective payroll management in some broader sense do not change. Mike Williams notes that the establishment of the treasury single account (TSA) should be one of the first steps in developing modern cash management systems. William Dorotinsky and Joanna Watkins suggest that implementation of a financial management information system (FMIS) provides substantial leverage for facilitating the introduction of PFM reforms in many areas including the introduction of program budgeting and MTEFs.

Lurking dangers to effective PFM also identified by contributors include unfunded policy commitments and the existence of off-budget funding. According to James L. Chan and Yunxiao Xu, the large amount of unfunded welfare benefits and other public policy commitments represent fiscal time bombs that are too controversial to be reported in audited financial statements. While Richard Allen notes that extra-budgetary funds (EBF) have a tendency to undermine PFM systems, paradoxically there is evidence mainly from advanced countries that some forms of EBF can produce services more efficiently and effectively than government ministries. Rolando Ossowski warns that bypassing the budget by diverting resources into sovereign wealth or non-renewable resource funds can have negative impacts on the development of PFM systems by transferring the natural resource volatilities to the non-resource sector. Similarly, William Allan discusses the barriers to effective fiscal management and sustainable PFM reform posed by the continuing failure to integrate foreign aid and domestic transaction flows. Jim Brumby, Kai Kaiser and Jay-Hyung Kim point out the problems associated with dual (current and capital) budgeting processes. They conclude that public investment programs whether conventionally delivered or through public private partnerships (PPPs) are flawed and can yield poor economic and social outcomes, particularly where decision making is dominated by politics and, in many cases, rent seeking. On the positive side, Peter Heller observes that emerging market economies may be less exposed to the implicit risks posed by non-debt liabilities exacerbated by the phenomenon of aging

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populations including large social insurance (public pension and medical care) obligations which in the case of the modern industrialized economies leave considerable scope for non-transparency and lack of clarity in gauging the fiscal and political economy obligations of government. Richard Allen and Sanjay Vani point to the continuing fiscal risks to the government posed by the activities of state-owned enterprises and associated government guarantees.

Some of the chapters are prescriptive, outlining some of the essential components of typical PFM systems. Daniel Tommasi, for instance, provides very detailed overviews of budget classification schemes reviewing relationships between expenditure classification, budgetary control and the chart of accounts in relation to financial reporting. In a subsequent chapter Daniel reviews the processes and controls relating to budget execution. Graham Glenday and Richard Hemming present guidelines relating to the design and implementation of efficient taxation systems. Graham Glenday follows this with a detailed and technical outline of the essential elements of revenue forecasting. Richard Highfield then focuses on revenue administration, notably improving the efficiency of revenue collection operations. Barry H. Potter examines the role of user charges as an alternative to taxation in paying for public spending. Jon Shields provides an outline of the function of sovereign wealth funds as pools of financial wealth held for future generations and the difficulties that this poses for PFM.

Many new developments in PFM are also mentioned and discussed in the handbook. Richard Allen and Philip Krause introduce an interesting distinction between the capacity and capability of central financial authorities. According to Allen and Krause capacity refers to the volume or scope of inputs, such as human resources or IT systems while capability focuses on the transformation of these inputs into better PFM performance, i.e. achieving improvements in the technical efficiency of country PFM systems. They point out that many countries have focused attention on strengthening PFM capacity to the detriment of strengthening capability or efficiency. Ken Warren discusses the concept of public sector balance sheets noting that these are relatively new phenomena and consequently their use in PFM is still premature. With the devolution of more and more responsibilities for public service delivery to regional and local governments, Jamie Boex and Roy Kelly predict that management of intergovernmental financial relationships will become a key dimension of PFM performance in the future. Richard Hemming suggests that fiscal councils are the latest trend in fiscal management reform. He notes that their principal attraction lies in the contribution that they can make in terms of promoting fiscal discipline and improving macro-fiscal outcomes.

It is hard to see this volume as simply a handbook of PFM. Many of the chapters are discursive rather than prescriptive presenting the views of the contributors based on their experiences working in developing and developed countries and also in senior positions in multilateral and government agencies. As such, the volume represents a valuable reference and guide to the prevailing ideas and perspectives of experts over a wide range of current and emerging topics in the PFM sphere. Accordingly, this volume will make a valuable addition to the bookshelves of practitioners, students, governments, legislators and teachers with a special interest in PFM and fiscal policy.

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