

# **Some Observations on Public Financial Accountability and Integrity in Pacific Island Countries**

*Savenaca Siwatibau*

## **Impetus for Improvement in Public Financial Management**

There is a groundswell of frustration in the Pacific Island countries (PICs). Economic growth has, on the average, barely kept up with population growth in most PICs, despite high aid-to-GDP and investment-to-GDP ratios. Unemployment, particularly among the young, is very high. Social problems associated with high unemployment have emerged, and are of increasing concern.

Unsustainable budget deficits resulting in internal and external financial instability are now common. Most PICs have witnessed and are witnessing unsustainable balance-of-payments deficits, dwindling external reserves, escalating government debt, crowding out of the private sector, loss of consumer and investor confidence, declining public- and private-sector investments, and slow growth.

Accordingly, there is a growing feeling among the people that national resources have been wasted or have certainly not been used efficiently. Public confidence in the government's ability to engage in sound, decisive fiscal management to address the poor economic performance and

associated social ills is rapidly eroding. Demand for efficiency, transparency, and accountability in government and in public financial management in particular is on the rise.

Almost all PICs are in the midst of difficult stabilization, adjustment, and reform exercises. Most of these are aided and supported by the ADB. Central to these exercises is the overhaul and improvement of the public financial management systems in these countries.

## Economic and Social Impact of Corruption

Corrupt practices are likely to have the following effects:

- selection of unsuitable and more expensive equipment and projects;
- substantial increase in the contract price during implementation if a favored contractor is involved;
- shoddy work, leading to expensive repairs and high maintenance costs, which are borne by the recurrent budget;
- forgone future revenue streams; and
- diversion of government services away from those in need to those who can afford to make the illegal payments demanded by corrupt officials.

In small, open, fragile economies, the economic and social impact can be very serious. Budget deficits are likely to widen with direct negative impact on the balance of payments, external reserves, liquidity in the banking system, and ultimately on confidence, investment, and growth in the economy. Unsuitable or unnecessary expenditures at inflated prices on equipment and projects result in much reduced returns in terms of GDP generated for each dollar of public-sector investment, i.e., in very high average ICOR for the government's Public Sector Investment Program. To the extent that those who benefit from corrupt practices are likely to be economically better

off and powerful, corruption is likely to worsen economic and social inequity within the country. Even more seriously, corruption saps and erodes the moral authority of the political leaders and renders them impotent and ineffective in marshaling the energies of all sectors of society in the pursuit of national development.

## **Improving Transparency, Accountability, and Performance**

Fiscal transparency and accountability requires, among other things, ready access by legislators, the media, and the public to complete information about fiscal targets, objectives, forecasts, and fiscal sustainability and vulnerability assessments. Detailed budget documents and audited financial statements should be made available to them, as should statements confirming compliance by the authorities with statutes and rules governing open procurement and contracting, employment, access to services, tax expenditures, and taxpayer treatment by the income-tax and customs administrations.

In a parliamentary system, the organization of the opposition party should be strengthened and given technical support to enable it to analyze the budget and policies effectively. The finance secretary and the governor of the central bank should hold briefing sessions on the budget for all legislators, including members of the opposition, before the budget debate.

## **Budget Formulation**

As mentioned in other chapters, a carefully prepared macroeconomic framework is critically important for budget formulation. This framework should be prepared by an economic policy group or macroeconomic committee made up of the heads

of the central bank, the treasury, and the national planning and statistics bureau.

In the case of the PICs, a simple approach would do to start with. A simple model should be used as follows:

$$M_3 = NFA + C_g + C_p + OIC$$

where  $M_3$  = money supply  
 $NFA$  = net foreign assets  
 $C_g$  = claims on government  
 $C_p$  = claims on the private sector  
 $OIC$  = other items, net

Working committees, composed of officials of the four government departments mentioned earlier plus outside experts, would project the major macroeconomic variables: GDP, balance of payments, revenue, government expenditures, external reserves, and price movements. Demand for money could be calculated simply as the sum of nominal GDP growth and a modest estimate of growth in monetization. Within the limits of the targeted  $M_3$ , iteration would be done to protect a reasonable growth in bank credit to the private sector, and an optimum level of overall deficit and government borrowing requirement would finally be arrived at.

Projections of government expenditures and revenues would take into account existing and proposed policies, programs, and measures. The proposed fiscal, monetary, income, and exchange-rate policies that underpin the budget would be formulated as part of the exercise. The macroeconomic framework to be approved by the cabinet and ultimately the legislature would clearly show targets, assumptions, statistics, and projections; policy proposals and objectives; assessments of fiscal sustainability, debt-to-GDP ratio, revenue-to-GDP ratio, and fiscal vulnerability; maturity schedule of government debt; and usable reserves. The recommendations of the macroeconomic committee would help

determine the overall size of the current and capital budgets and the budget financing program.

After the macroeconomic framework is approved by the cabinet, the budget committee, made up possibly of the heads of treasury, planning, and public service, should set the sectoral ceilings within the overall budget ceiling. But the formulation of sectoral policies, projects, and programs and the determination of expenditure priorities are the responsibility of the spending ministries, departments, and agencies. Spending agencies must undertake micro analysis, questioning the merits of ongoing programs and targeting the reduction of expenditures that benefit narrow groups of richer people, as well as expenditures with only a slight impact on large sectors of the population.

More sophisticated techniques for economic projections could be progressively adopted as the economic policy group gains technical capacity.

## **Multi-year Expenditure Programs (MYEPs)**

MYEPs consistent with the macroeconomic framework need to be adopted and/or strengthened. Public-sector investment programs (PSIPs) should be well thought out and priority should be determined by the assessed social and economic returns of projects. The responsibility for the formulation and execution of sectoral PSIPs belongs to the relevant ministries.

PSIP or medium-term capital expenditures and multi-year recurrent expenditures should cover three-year periods and be rolled at the end of each year. The multi-year recurrent expenditures should incorporate current expenditures associated with the PSIP and the consequences of current and ongoing policies. The planning office should assist the ministries in project preparation and help ensure consistency between selected projects and sectoral and national policies.

Aid should be treated as a financing item. The careful preparation of forward programs would help reduce the

possible distortion of priorities by donors and strengthen the government's effective control over aid allocation.

The macroeconomic framework, the annual budget, and multi-year expenditure programs should be examined, discussed, and endorsed by a subcommittee of civil-service heads of ministries before being submitted to the cabinet. This ensures that the ministers will be better briefed, agreements easier to arrive at, and decisions made more rationally.

## Oversight and Control

The constitutions of most PICs require all monies coming to the government to be paid into the consolidated fund, from which releases can be made only through legislative appropriation. This provision should be strictly observed as it forbids the establishment of extrabudgetary funds, such as those that could come from aid receipts.

All proposed sectoral policies or draft legislation with financial implications must be analyzed by the finance ministry before they can be discussed by the cabinet. A provision to this effect could be embedded in the cabinet procedure handbook or in the finance act itself.

The power to negotiate government loans should be vested exclusively in the minister of finance. Government borrowing, which must be tied to the financing of the approved budget expenditures, should require a legislative act or at least a legislative resolution, and foreign loans entered into by government statutory bodies and other entities must be subject to central-bank oversight. Government guarantees or lending should require similar parliamentary authorization.

Limitation transfers, or "virements," between personnel expenditures and other current expenditures need to be controlled, and the number of staff members by broad categories should be shown in the budget. Transfers within budget categories may be approved by the minister concerned but

transfers between budget categories should require higher approval or supplementary appropriations.

Expenditures by spending ministries and agencies have to be authorized through warrants issued by the minister of finance. Such warrants should be based on the projected cash-flow position of the government to optimize its borrowing program and minimize the overall costs of borrowing.

The head of the treasury should be empowered to levy surcharges. Under this provision, accounting officers who do not collect revenue due, overspend appropriated amounts, neglect tendering procedures, or violate any other financial regulations could be made to pay a surcharge up to the total sum lost, which would be deducted from future salary payments.

### **Financial Statements to the Legislature**

The minister of finance, on behalf of the government, should report to the legislature on changes in the budget resulting from changing economic circumstances, and also on progress in budget execution (i.e., budget outcomes against objectives). The treasury should complete the following financial statements within three months from the end of the fiscal year:

- financial position on the balance date;
- statement of revenue and expenditures, covering the annual appropriation and supplementary appropriations;
- statement of borrowings, accumulated debt, debt service, and contingent liabilities;
- statement of emergency expenditures during the year; and
- comparative actual figures for the previous fiscal year.

## Auditor General/Commission of Audit

This is a constitutional post, responsible to the legislature. It should be endowed with wide investigative and reporting authority over government and the operations of government entities. In consultation with the treasury, the auditor general should establish accepted accounting practices for the preparation of government financial statements. The auditor general must have right of access to all information held by ministers, departments, and government entities and the right to copy information, to require explanations, and to enter premises.

The auditor general should have the power to direct officers or employees to:

- provide information;
- appear before the auditor general; and
- grant access to anyone authorized by the auditor general.

I would recommend a provision, similar to that in the Philippine Constitution, which gives the Commission of Audit discretion and authority *to disapprove* any disbursement of public monies if deemed *unwise* or *unreasonable* by the Commission. This is a considerable extension of power beyond that of merely ascertaining the correctness and legality of expenditures or simply bringing to the attention of officers expenditures that were irregular, unnecessary, or extravagant in the opinion of the auditors.

## International Financial Scams

International scams are promoted aggressively in the PICs. These present enormous risk as the amounts involved are generally multiples of a country's annual budget or external reserves. They have worked, in a number of cases, mainly through the active involvement of corrupt leaders within a country.

The approach is standard. The promoters of a scam insist on secrecy and on negotiating only with political leaders and ministers, keeping out central bank and treasury officials, lawyers, and accountants, who tend to ask searching and awkward questions. Typically, the scams promise much but ask for certain payments upfront. Scams so far attempted and over which substantial sums have been lost include:

- the promise of substantial external loans on ridiculously soft terms, with promoters demanding and receiving upfront fees for “services to be rendered”;
- the promise to build a multimillion-dollar power plant as a gift with the issuance of promissory notes by the central bank to the promoters when the agreement is executed; and
- the issuance of letters of guarantee by the government and the central bank to enable the promoters to raise hundreds of millions of dollars and invest the proceeds in highly lucrative investments, the income from which will be shared with the government.

Measures for countering these scams which have been recommended to governments in the PICs include:

- the establishment of a committee of officials with technical expertise to vet and negotiate with the promoters of such schemes;
- instructions from the cabinet to all ministers to refrain from dealing with such promoters and to refer them instead to the committee of officials.
- the vetting of promoters by international companies that provide such services for a fee; and
- cooperation among central banks and between central banks and other relevant bodies in establishing and regularly updating a databank of relevant information to assist in vetting promoters of scams who come into the region.

## The Ombudsman

A number of constitutions in the PICs provide for the establishment of the constitutional post of Ombudsman. To allow independence for the post, the appointment is made by the head of state in consultation with the government and selected leaders. The powers vested in the post vary considerably from country to country.

The case of Vanuatu presents a useful model which other countries could adapt for their own use. A comprehensive Leadership Code spells out in some detail the standards of behavior for leaders. The powers of the Ombudsman are provided in the Constitution and in a separate legislation, the Ombudsman Act. The Ombudsman administers and polices the Leadership Code, and investigates leaders, including ministers, politicians, public officers, directors, and executives of statutory bodies and public-sector enterprises. Investigations can be initiated either upon the receipt of complaints from the public, or at the Ombudsman's own initiative. The Ombudsman's reports are submitted to the Prime Minister and the Director of Public Prosecution. Sanctions imposed as a result of these reports include:

- loss of position;
- criminal proceedings; and
- civil action by the state, members of the public, or other entities.

As elsewhere in public financial management, having comprehensive legislation is certainly important, but the effectiveness of the post of Ombudsman depends critically on the person who occupies it and the strength and integrity of the police, the office of the Director of Public Prosecution, and the judiciary. This leads us to the next part.

## Other Issues

A well-thought-out legislative framework is a necessary condition but is not sufficient for sound public financial management. Legislative provisions are not always complied with, either because of ignorance or because of simple lack of enforcement by the political leaders and public servants.

Public officers, particularly heads of ministries and departments, are required to know the financial rules and to administer them firmly and strictly. They have the duty to tell the ministers what they can or cannot do under the law. This brings to the fore the need for constitutional provisions that entrench the independence of the public service from political interventions.

Training of legislators, and particularly the members of the legislative committee on audit, is critically important.

The treasury and the auditor general's officers need to have terms and conditions that recognize the urgent need for acquiring qualified and experienced accountants. Training programs also need to be emphasized not only in these departments but also in the budget and accounting sections of the spending ministries and agencies.

The accounting and treasury operations of the government should be progressively computerized. And the bureau of statistics needs to be strengthened to assist in the formulation and ongoing review of the macroeconomic framework and the formulation of sound economic, financial, and social policies for the government.

These are only some of the many possible measures to strengthen public financial accountability and reduce the opportunities for corruption, particularly for small, open island economies such as in the Pacific. It is quite clear in any event that problems need to be diagnosed openly and realistically, and a range of actions taken to address those problems that are particularly important in the country concerned. Many countries now recognize this, and it is hoped that this recognition will expand with the assistance and encouragement of the international community.