

# Public financial management weaknesses can lead to corruption

## *Mauritania's experience*

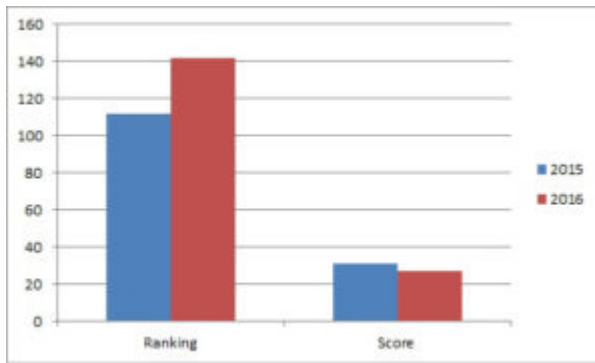


## Global corruption trends

Two recent reports on Global corruption trends highlight a number of states facing serious challenges and our analysis indicates some interesting links between corruption and standards of public financial management.

Transparency International's recently released 2016 Corruption Perceptions Index for 2016 indicates that Mauritania's ranking deteriorated noticeably in 2016 compared to the previous year. The full data set for all 176 countries is available [here](#) and the Mauritanian data is shown at Figure 1.

**Figure 1: Transparency International Corruption Perceptions Index Mauritania results 2015-2016**



The World Economic Forum's 2016 Global Competitiveness Survey, released on 15 September 2016, included the results of their annual Executive Opinion Survey which aims to measure critical concepts affecting the business environment such as the incidence of corruption. This survey shows that Mauritania was ranked 124<sup>th</sup> out of the 138 countries for corruption. The World Economic Forum's 2016 Global Competitiveness Survey report is available [here](#).

We have developed a spreadsheet showing (i) the country rankings for the World Economic Forum's Executive Opinion Survey (not publicly available) and reported corruption impediment scores and (ii) a comparison of the Transparency International and World Economic Forum survey results that are available for 125 countries. [Contact us](#) if you would like to receive a copy of our spreadsheet.

We have found that there is a significant overall negative correlation between the scores in the two surveys (a Pearson coefficient of  $-.78$ ).

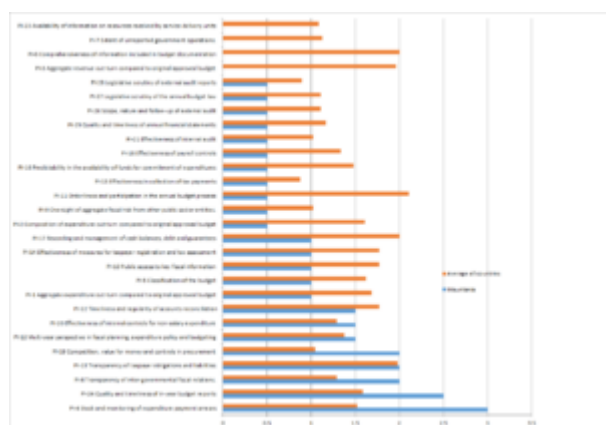
## **Mauritania's poor PFM and poor corruption performance**

Mauritania's corruption rankings in both surveys are relatively poor with scores falling in the bottom 20% of the two surveys. Many developing countries, including Mauritania, face significant challenges in addressing corruption. We have previously identified a wide range of actions that governments

(as well as the private sector) could take to assist in reducing corruption levels that include improving a range of public financial management practices in our blog [International Development and the Challenge of Public Sector Corruption](#).

Last year we examined the Public Expenditure and Financial Accountability (PEFA) results of the twenty-four countries, including [Mauritania](#), that published PEFA assessments during 2013-2015. Nine of the twenty-four countries studied, including Mauritania, had PEFA results indicating relatively weak public financial management; Mauritania was ranked 19<sup>th</sup> out of the twenty-four countries studied using a scoring system that the IMF has previously employed. Mauritania recorded relatively poor scores in a number of key PFM activities that are important in reducing corruption including payroll controls, internal audit, financial reporting and external audit; details are shown at Figure 2; this chart can be viewed in more detail [here](#).

**Figure 2: Mauritania PEFA indicators' relative performance**



Seventeen of the above-mentioned twenty-four countries feature in Transparency International's 2016 Corruption Perceptions Index. Sixteen countries (Ghana is the exception) recorded below –average scores in TI's 2015 and 2016 surveys; details of the 2015 and 2016 scores and the percentage change between these periods are presented in Table 1.

**Table 1: TI 2015-2016 scores for 2013-2015 PEFA assessment countries**

	<b>PEFA score</b>	<b>TI 2016 score</b>	<b>TI 2015 score</b>	<b>% change in 2015-2016 scores</b>
Armenia	60	33	35	-5.71%
Azerbaijan	61.5	30	29	3.45%
Belarus	49	40	32	25.00%
Bosnia & Herzegovina	50	39	38	2.63%
Burkina Faso	58.5	42	38	10.53%
Congo Republic	21	20	23	-13.04%
Gambia	32	26	28	-7.14%
Ghana	27.5	43	47	-8.51%
Guinea-Bassau	14.5	16	17	-5.88%
Kyrgyz Republic	49.5	28	28	0.00%
Macedonia	44.5	37	42	-11.90%
Madagascar	25.5	26	28	-7.14%
Mauritania	26.5	27	31	-12.90%
Mongolia	42	38	39	-2.56%
Nepal	50.5	29	27	7.41%
Papua New Guinea	21.5	28	25	12.00%
Timor-Leste	36	35	28	25.00%

With ten of the seventeen countries in Table 1 recording either no change or a deterioration in their scores in 2016 (including Mauritania), the negative Pearson correlation between overall 2013-2015 PEFA scores and TI corruption scores for these countries strengthened from -0.41 in 2015 to -0.56

in 2016 pointing to the possible impact that poor PFM may have in facilitating corruption in the public (and private) sectors.

The World Bank noted in November 2016 that “Mauritania’s PFM system remains weak”. If countries, such as Mauritania, employ robust anti-corruption strategies, including actions to address key PFM weaknesses currently influencing corruption levels, they may in time be able to make some progress in curbing corruption.

*Need to resolve a public financial management problem? [Inquire now](#) to schedule an initial online meeting.*

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## **State-owned enterprises Board**

Explore the varied issues associated with the governance and management of state-owned enterprises and the links arising between this service delivery mechanism and public financial management on our Pinterest “State-owned enterprises Board”

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## **Timor-Leste Public Financial Management Profile**



# Introduction

This note presents a series of charts which provide an **overview** of Timor-Leste's recent public financial management (PFM) performance based on this country's 2014 Public Expenditure and Financial Accountability (PEFA) assessment. Comparisons are made between Timor-Leste's performance and the performance of the other twenty-three countries that had PEFA assessments published in 2014-2015. All analyses have been prepared using results reported from using the 2011 PEFA methodology.

## Overall PFM performance

Individual country PFM performance has been determined by applying the following points scale to reported individual performance indicator (PI) scores as presented in Table 1. No points were allocated to PIs that were not scored because data was unavailable, a D score was given or the PI was not applicable.

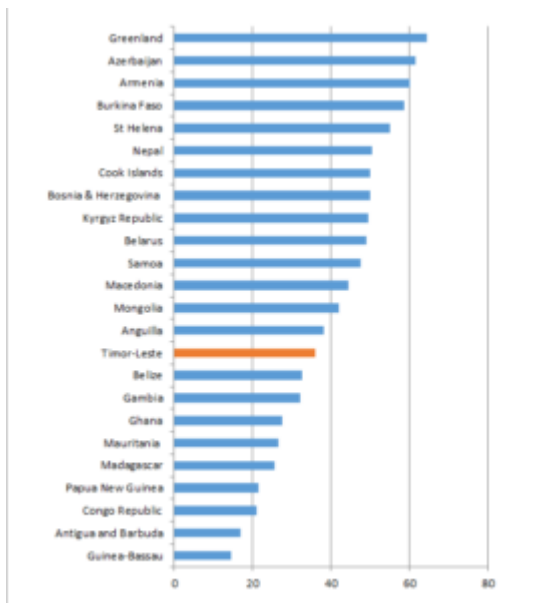
**Table 1: PI scoring methodology**

PEFA PI score	Points allocated
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A	3
B+	2.5
B	2
C+	1.5
C	1
D+	.5
D	0

The graph in Figure 1 below shows Timor-Leste’s overall score was ranked fifteenth out of the twenty-four countries.

**Figure 1: Aggregate PEFA scores for 24 countries**



Download a png version of Figure 1 [here](#) (Timor-Leste’s overall result) to review the overall scores of Timor-Leste and the twenty-three other countries in more detail.

Details of the distribution of overall country scores across PFM performance categories, as determined by PFMConnect, are presented in Table 2. Timor-Leste’s overall score was 36 points.

**Table 2: Distribution of country PFM performance levels**

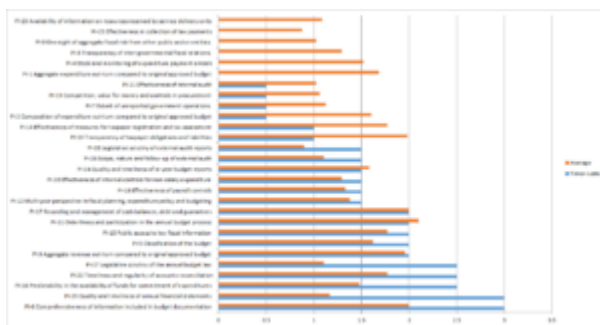
<b>PFM performance</b>	<b>Overall Scores</b>	<b>Number of countries</b>
Very strong	66.37-84	0
Strong	49.57-66.36	8
Moderate	32.77-49.56	7
Weak	15.97-32.76	8
Very weak	0-15.96	1
Total		24

Timor-Leste’s overall PFM performance is classified as “moderate”.

## PI performance

The graph in Figure 2 below shows the scores for Timor-Leste’s individual PIs compared with the average score recorded for each PI across the twenty-four PEFA assessments we have studied. Please note that no scores were recorded for the top six indicators in Figure 2 as one indicator (PI-8) was not applicable, two indicators (PI-4 and PI-15) were not assessed and three other indicators (PI-1, PI-9 and PI-23) received D scores.

**Figure 2: Timor-Leste PI score comparisons**



Download a pdf version of Figure 2 [here](#) (Timor Leste PIs) to review individual PI scores in more detail.

Twenty-seven PIs were assessed. Fourteen PIs had scores above the country average, one PI had a score equal to the country

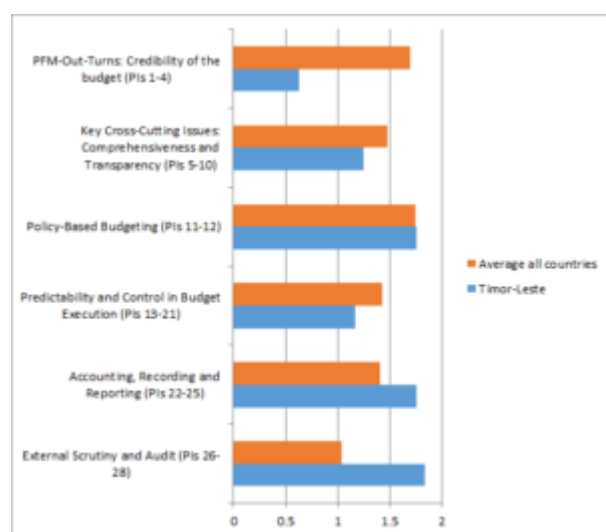


average whilst twelve PIs had scores below the country average.

## Performance across key PFM activities

The graph in Figure 3 below shows the average scores for the six key PFM activities compared with the average score recorded for these activities across the twenty-four country PEFA assessments we have studied.

**Figure 3: Timor-Leste key PFM activity comparisons**



Three key PFM activities recorded scores above the country average whilst three other key PFM activities recorded scores below the country average. Download a png version of Figure 3 [here](#) (Timor-Leste's key PFM activities) to review these scores in more detail.

## PEFA ASSESSMENT

You can download the 2014 PEFA assessment for Timor-Leste [here](#).

[Download pdf](#)

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# International Development and the Challenge of Public Sector Corruption

By David Fellows, John Leonardo and Cornelia Körtrl[\[1\]](#)



Revelations in the Panama Papers released earlier this month have focused international attention on the hidden financial structures that facilitate the transfer of assets obtained through both legal and criminal means to offshore tax havens. In a recent [report](#), the research organization Global Financial Integrity suggests that illicit financial flows from developing countries have reached the staggering sum of \$1 trillion a year.

Is corruption in developing countries of any legitimate concern to the West? The U.N. Economic Commission for Africa in its recent [African Governance Report IV](#) implicates the West when it suggests that “the role of private sector actors in fuelling corruption ... should not be ignored.” Yet Western nations are increasingly expected to act as trading partners to developing countries. They must also be accountable to their electorates for obtaining value from their aid expenditure.

Corruption concerns the use of public position to gain private advantage, such as wealth, power, or status. In the public

sector, corruption can take on many forms, ranging from the misappropriation of funds to extortion and the abuse of patronage. We provide further examples [here](#). It can reduce state revenues, increase state expenditures, diminish economic development, and impair the capacity of public services. It can also hamper the transition from aid as project-funding to aid as direct budget support. Corruption can undermine nationhood by destroying confidence in public administration and the political process, impoverishing communities and denying opportunity.

At the most recent OECD's Anti-Bribery Ministerial Meeting, the president of the International Federation of Accountants stressed the importance of strengthening public financial management (PFM) systems to combat corruption in the public sector. PFM includes budget preparation, internal control, internal audit, procurement, monitoring and reporting arrangements, and external audit<sup>[2]</sup>.

*In this short piece we offer evidence that corruption hampers government effectiveness, including the quality of public services, and economic prosperity. While serious corruption exists in both developed and developing countries, it is developing countries that can least afford the very significant cost and the collateral damage. We suggest that good PFM can help control corruption and we set out our thoughts on how this beneficial effect can be achieved.*

## **Two sides to corruption**

Worryingly, networks of corruption can normalize corrupt behaviour and offer mutual protection to those involved. In an insightful report on Indonesia in 2003 [\[3\]](#) the World Bank stresses the importance of organisational environment over salary level and suggests that political corruption usually requires the active complicity of civil servants. The international Anti-Corruption Resource Centre, U4, [has](#)

[developed a useful account of the personal and social considerations in play](#). For instance, the risk of detection and consequent penalties can be equally relevant considerations: when the risk of detection is low, corruption may thrive even in situations with significant penalties. Contrarily, corruption may be high with high risk of detection but low penalties. Similarly, Khan[4] argues that the underlying distribution of power between actors is essential to understand corruption in a particular context. Clearly, anti-corruption reforms must address the specific drivers of corruption in the national context.

Various international agencies have sought to discourage the provision of bribes by foreign nationals. [The UN Convention against Corruption](#) attempts to discourage corruption by making the payment of bribes abroad a criminal offense prosecutable in the home countries of foreign nationals. The OECD Anti-Bribery Convention takes a similar approach.

### **The empirical connection**

We have examined the consequences of corruption and the impact on PFM performance from a statistical perspective in several ways. We summarise our conclusions in this section (all correlations are significant at a 99% confidence level except where otherwise stated). We also illustrate here the [chain of events](#) implicit in the data.

Firstly, we have correlated control of corruption (capturing perceptions of the extent to which public power is exercised for private gain) and government effectiveness (including the quality of public services) for 184 countries using data from the World Bank's 2013 Worldwide Governance Indicators, together with World Bank 2013 per capita income data and Rand Corporation's Trace (bribery) Matrix risk scores for these countries (see Table 1).

<b>Table 1: Corruption Correlations</b>
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<b>Corruption measure</b>	<b>WGI Government Effectiveness</b>	<b>GDP/head</b>
<b>WGI Control of Corruption</b>	Significant correlation	Significant correlation
<b>Trace (bribery) Matrix[5]</b>	Significant inverse correlation	Significant inverse correlation

Indicators of corruption are highly subjective and therefore of questionable validity. Nevertheless we note the similarity of the significant relationships achieved from the two different indicators of corruption and hence believe in the validity of the relationships.

We also correlated some recent measures of PFM performance with measures of corruption and government effectiveness for 39 developing countries for which Public Expenditure and Financial Accountability (PEFA) assessments<sup>[6]</sup> were made available during the past three years from 2013 to 2015 (see Table 2).

This second set of correlations is more problematic. PEFA indicators are not designed to isolate activities that are most indicative of corruption and recent PEFA results together with government effectiveness, control of corruption and Trace risk scores were only available for thirty-nine countries. Despite this hindrance and the inherent weakness in the corruption data mentioned above we find some significant statistical relationships amongst the indicators that cover activities most vulnerable to corruption or concerned with its detection. This seems to suggest that PFM, or at least some aspects of PFM, is relevant to combatting corruption and securing government effectiveness.

<b>Table 2: PFM Correlations to Corruption and Government Effectiveness</b>			
<b>PFM quality assessed using PEFA Performance Indicators</b>	<b>Control of Corruption</b>	<b>Trace Risk Index</b>	<b>Government Effectiveness</b>
<b>Degree of integration &amp; reconciliation between personal records and payroll data</b>	Significant Correlation	No significant correlation	Significant Correlation
<b>Effectiveness of internal controls for non-salaried expenditure</b>	No significant correlation	Significant Correlation	Significant Correlation
<b>Frequency and distribution of internal audit reports</b>	Significant correlation*	Significant Correlation	Significant Correlation

*\*This correlation is significant at a 95% confidence interval.*

The general inference we take from this exercise is that good PFM practice is likely to be beneficial to the advancement of good public service delivery and economic performance in developing countries.

### **Effective PFM reforms to combat corruption**

Endemic corruption should be confronted through location-specific action prioritized on three factors: national detriment, effectiveness of the measures proposed, and capacity of the administration to effect the proposals.

Reform proposals should be designed to cover key weaknesses but avoid technical complexity that cannot be sustained. For instance, does the state have a sufficiently robust communications network and the necessary information and communications technology skills available to enable public sector organisations to undertake their purchasing from

private sector suppliers using internet-based systems; or, are manual system improvements coupled with greater transparency in awarding contracts preferable, at least in the short term? Next, financial regulations need to be coherent and simplified where necessary. They should be more exacting in areas of high risk and high value.

Internal audit often requires improved capacity and must have reporting access to the most senior government official. External audit reports should have full public disclosure and external auditors should have access to public accounts committees that are informed by independent expert support.

The public must be made aware of the service standards they can expect and have access to effective complaints mechanisms in order to ensure value for money. Also, business and professional associations must be encouraged to voice concerns about corruption and poor financial practices.

Transparency of policy decisions and of financial performance is imperative through government information systems, among which government websites are increasingly important. But free media reporting and comment are essential to securing all such reforms.

### **Wider supportive activities**

Perhaps some of the most important PFM reform activities are not of a strictly financial nature. Senior officials and politicians must demonstrate exemplary leadership, civil service watchdogs should underpin standards of conduct and should be invested with investigatory powers, codes of conduct should be adopted as a condition of employment, recruitment must be made on merit, appraisal and disciplinary processes must be robust, and there must be adequate standards of induction and in-service training.

Judicial systems must be freed from corruption and political interference, and consideration should be given to

establishing special courts for corruption.

Opportunities for corruption can be reduced by avoiding personal contact through the use of online service delivery (where feasible) and by eliminating unnecessary bureaucracy. Transferring services of a commercial nature from public to private sector providers should be considered, although this requires careful implementation and continuing regulation in some cases.

### **The role of development partners**

International development partners, particularly the large aid organizations, are well positioned to establish appropriate incentive frameworks, identify opportunities, and adopt the necessary long-term perspective required for PFM reforms. These situations are not suitable for pre-packaged solutions. Rather, the frameworks should include actively managed, locally focused programs requiring collaboration between governments and development partners to track progress and drive change, with ownership of the programs vested in client states.

Development partner funding for reform activities should be linked to the attainment of specific milestones previously agreed with governments and released in tranches as agreed reforms are realized. Such improvements are beginning to gain ground and must be complemented by effective advocacy for transparency in financial matters and press freedom.

### **Conclusion**

The level of corruption in developing countries, including the use of tax havens for sheltering the proceeds of top tier corruption, has become a current issue. In addition, corrupt environments threaten trade relations with developing countries and the criminalization of bribery in the home countries of foreign nationals, although an essential development, adds to the deterrent effect for foreign-based



businesses.

Economist Gabriel Zucman [estimates](#) that over 30 percent of all Africa's financial wealth is stored in tax havens, of which it may be assumed that a substantial proportion goes untaxed. The conclusion drawn from this is that even if the poor pay their fair share in taxes, the world's wealthiest often do not. Reforms of tax law and administration are clearly required as part of the PFM reform agenda.

The eradication of endemic corruption is an enormous challenge for developing countries. PFM reform has much to offer, but international development partners need to do more to support collaborative change processes and plan for the long haul.

[\[1\]](#) David Fellows and John Leonardo are Principals and Cornelia Körtrl is an Associate of PFMConnect. Their work covers development projects in Africa, Asia, and the Pacific Islands.

[\[2\]](#) A wide-ranging discussion of PFM practice is well beyond the confines of this article. We refer only to practices that are particularly relevant to the control of corruption. See Stephen Peterson 'Public Finance and Economic Growth in Developing Countries: Lessons from Ethiopia's reforms' for a thought-provoking and very readable commentary on the challenges facing those who would design financial systems for developing countries.

[\[3\]](#) World Bank: Combating Corruption in Indonesia *Enhancing Accountability for Development* 2003

[\[4\]](#) Mushtaq Khan understands corruption as a 'type of illegal rent seeking' ([Khan, 2006. State weakness in developing countries and strategies of institutional reform – Operational Implications for Anti-Corruption Policy and A case-study of Tanzania, p.9](#)). For a complete understanding of his theory on rent-seeking see Khan, M. and Jomo, K.S. (eds) (2000). *Rents, Rent-Seeking and Economic Development: Theory and Evidence in*

*Asia. Cambridge: Cambridge University Press.*

[5] The Trace Matrix assesses the risk of encountering business bribery in a particular country; higher scores imply higher risk of encountering bribery expectations (for more information see [here](#)). A discussion of the [methodology](#) employed to determine the correlations presented in Tables 1 (and 2) is available here.

[6] For the PEFA system and its findings see [www.pefa.org](http://www.pefa.org)