Asian Journal of Economics, Business and Accounting

Volume 23, Issue 1, Page 1-11, 2023; Article no.AJEBA.94838
ISSN: 2456-639X

A Theoretical Approach of "Invisible Hands" in Public Finance Management: An Urgent Need for Fiscal Policy Sustainability in Developing Countries

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Authors' contributions

This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.

Article Information

DOI: 10.9734/AJEBA/2023/v23i1911

Open Peer Review History:
This journal follows the Advanced Open Peer Review policy. Identity of the Reviewers, Editor(s) and additional Reviewers, peer review comments, different versions of the manuscript, comments of the editors, etc are available here: https://www.sdiarticle5.com/review-history/94838

Policy Article

Received: 15/10/2022
Accepted: 23/12/2022
Published: 02/01/2023

ABSTRACT

The selfish interest of some government officials affects the smooth functioning of the pillars of public expenditure and accountability (PEFA) in public finance management (PFM) through their ''invisible hands", which deprive the government from achieving its objectives of fiscal policy. This study examines the shortcomings of the pillars of public expenditure and accountability (PEFA) in developing countries and its effects on public finance management (PFM) using a theoretical approach. The study critically examined the functionality of the pillars using a comparative regional and income analysis and why it has not been effective in developing countries. The paper ends up by suggesting key policies that can be used to avoid the selfish interest of individuals in PFM.

Keywords: Accountability; development; developing countries; transparency; public expenditure.

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1. INTRODUCTION

The growth and development of a nation depend on the functionality of the pillars of public expenditure and accountability (PEFA) for effective implementation of public finance management (PFM). Hence, the government of every nation must design resilient and adaptive policies that have to strengthen the pillars for the transparency and accountability of the nation's resources. Contrary, developing countries over the years have scored worse marks in public expenditure and accountability (PEFA) due to the selfish interest of some government officials who extort the nation's resources to the detriment of others. The idea that human beings are self-interested is a long time history [1]. It was originally initiated by Adam Smith who believes human beings are naturally self-interested in a free market economy, which leads to the common good [2]. To Smith's self-interest economic theory, capitalism fueled by self-interest is ultimately the best way to a thriving economy [3]. Hence, the “invisible hand” is a base on how; self-interested individuals in a free market economy operate through a system of mutual interdependence. His idea can be applied in the public sector economy where the self-interest motive of government official through their “invisible hands” in corruption and embezzlement affects the functioning of PFM, which retard growth. In the public sector unlike in the capitalist economy, individuals who take advantage of the lawless economy motivate self-interest motive. Thus, [4] theoretically considers redistribution of income, allocation of public goods, and stabilizing the economy as key functions for public expenditures. Consequently, the government must put in place firm and respectable laws for the effective implementation of the pillars of PEFA to match policies with action. Without responsible PFM, taxes will be wasted living the government unable to deliver essential services to the public. Hence, PFM is a catalyst for the development of nations that shows accountability for their investment. It involved all government activities that incorporate the mobilization, allocation, and expenditures of revenue to various activities and account for spent funds [5]. Every stakeholder both private and the public has a role to play in public finance management through the principles of budgeting, expenditure, and reporting. The improvement and effectiveness of a public finance management system have long-lasting benefits that make the economy stronger by reducing poverty, equality of nations' resources, and sustainable growth [6]. Hence, public finance management reforms are considered an essential panacea for ensuring public resources of a country are accounted for while maintaining fiscal stability and appropriate management of public assets [7]. The accountability and sustainability of PFM can better be assessed using Public Expenditure and Financial Accountability (PEFA). Since its creation by global partners such as World Bank and the European Commission, the PEFA framework has become the goal standard of assessing public finance management performance. Thus, strengthening the public financial system has become the prime objective of every nation. Approximately 150 countries had undertaken at least one PEFA report as of early 2017 to assess the status of PFM in their respective countries and put more efforts into sustainable financing [7]. A robust PFM system can safeguard advanced and more funding flows, anticipated budget allocations, timely budget execution, reduced fragmentation in revenue streams, and better financial accountability and transparency [8]. The PEFA framework uses its pillars to accurately rate the performance of PFM systems as well as trace the performance of the changes over time. Each performance system belongs to one of the seven pillars of PEFA and when assessed individually, the PEFA framework can provide insight into three desirable outcomes; aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery. The government must initiate strategies for these objectives to be met simultaneously.

- **Aggregate fiscal discipline**

Fiscal deficits and rising public debt are and remain key setbacks in the economic development of less developed countries (LDCs). It is often an indication of adverse domestic and external shocks that affect budgets directly. However, the persistent fiscal deficits and inevitable rise in public sector indebtedness especially in LDCs is an indication of fiscal indiscipline, which stems from the imprudent use of preference in formulating and implementing budgetary policies [9]. Fiscal discipline requires that governments maintain fiscal positions that are consistent with macroeconomic stability and sustained economic growth [9]. The government must have the ability to sustain smooth monetary operation and fiscal policy sustainability by maintaining stability in macroeconomic variables, decreasing vulnerabilities, and improving aggregate economic performance. However, most developing nations suffer from the policy of personal gain, which emanates from corruption, embezzlement, poor budgeting, non-sustainable fiscal policy, and the crowding-out effects [10]. With these ills, the PEFA pillars cannot function smoothly, which derails resource allocation and economic performance.

- **Strategic allocation of resources**

Resource allocation highly determines the economic development of a nation. If resources are not allocated strategically, the outcome is evidenced through poor economic performance. Strategic resource allocations should be firmly rooted in principles of equity, strategic planning, and results-based budgeting while being guided by basic economic questions; What to produce, how to produce, and for whom to produce. A PFM system should ensure that public resources are allocated to agreed strategic priorities. Thus, the optimization and utilization of resources in proper locations ignite economic growth and development. However, in LDCs, the government does not follow the guideline of resource allocation by matching them with set priorities. The principle of equity and strategic planning is not respected. With a rising population and high rate of unemployment, resources are mostly allocated based on nepotism, which ends up being misused leading to inefficient utilization of resources. It is usual in these countries for people to work where they do not have the necessary expertise or for resources to be allocated based on influences. Hence, due to this correlation, time and materials are wasted with high corruption and embezzlement in the use of resources, which leads to poor service delivery.

- **Efficient service delivery**

Time, effort, material use, and efficiency are significant factors in service delivery. The ability of a nation to avoid waste of time and materials as much as possible, while still producing a high-quality service is pivotal in nation building. Effective delivery of public services should be aimed at achieving maximum use in the value of money to assist with poverty reduction and boost growth. Countries with strong, transparent, and accountable PFM systems tend to deliver services more effectively and equitably and regulate markets more efficiently and fairly [11]. PFM matters for service delivery, as it can enable the implementation of governments' key policy objectives for better services [12]. Despite significant increases in resourcing, public service delivery is still failing in many developing countries due to Political market imperfections, Policy incoherence, or contradictions, lack of effective performance oversight, and Moral hazard [13].

In most countries, PFM has key steps, which are normally structured around the annual budget cycle after policy design; ranging from budget formulation, budget approval, budget execution, budget accounting and reporting, and external auditing (see Fig. 1).

- **Policy design**

The budget life cycle starts with policy design that reflects the future goals and aspirations of a nation and provides guidelines for carrying out those goals. The government must take specific decisions to solve social issues and adopts strategies for planning and implementation. Public policies are efforts made by government to alter aspects of the economy to attain certain objectives [14]. Different sectors of the economy are involved in the formulation and development of a policy. In developing countries, the sectors that play the role of public policy-making are; Cabinet, legislature, opposition political parties, civil society, and citizens. The design of a policy should involve cost-benefit analysis and economic forecasting to help policy makers opt for the maximum net benefit to the nation. Just as the rational choice theory indicates, the “logical decision-making process should take into account the costs and benefits of various options, weighing the options against each other” [15]. The government of developing countries should adopt policy output analysis by identifying potential policy options that can address problems and comparing them with other options to choose the most effective, efficient, and feasible one.

- **Budget formulation**

The policy objectives of the government cannot be attained without budget formulation. The budget provides a breeding ground for the government economic agenda. With the use of fiscal policy, she can deliberately manipulate the budget to influence macroeconomic policy objectives. This is usually by government objectives for the upcoming year, which usually involves making macroeconomic predictions to help define what level of total government expenditure will be feasible and allocated to each of the sectors based on strategies and policy priorities [16]. This is usually in accordance with the approved budget based on the respective ministries.

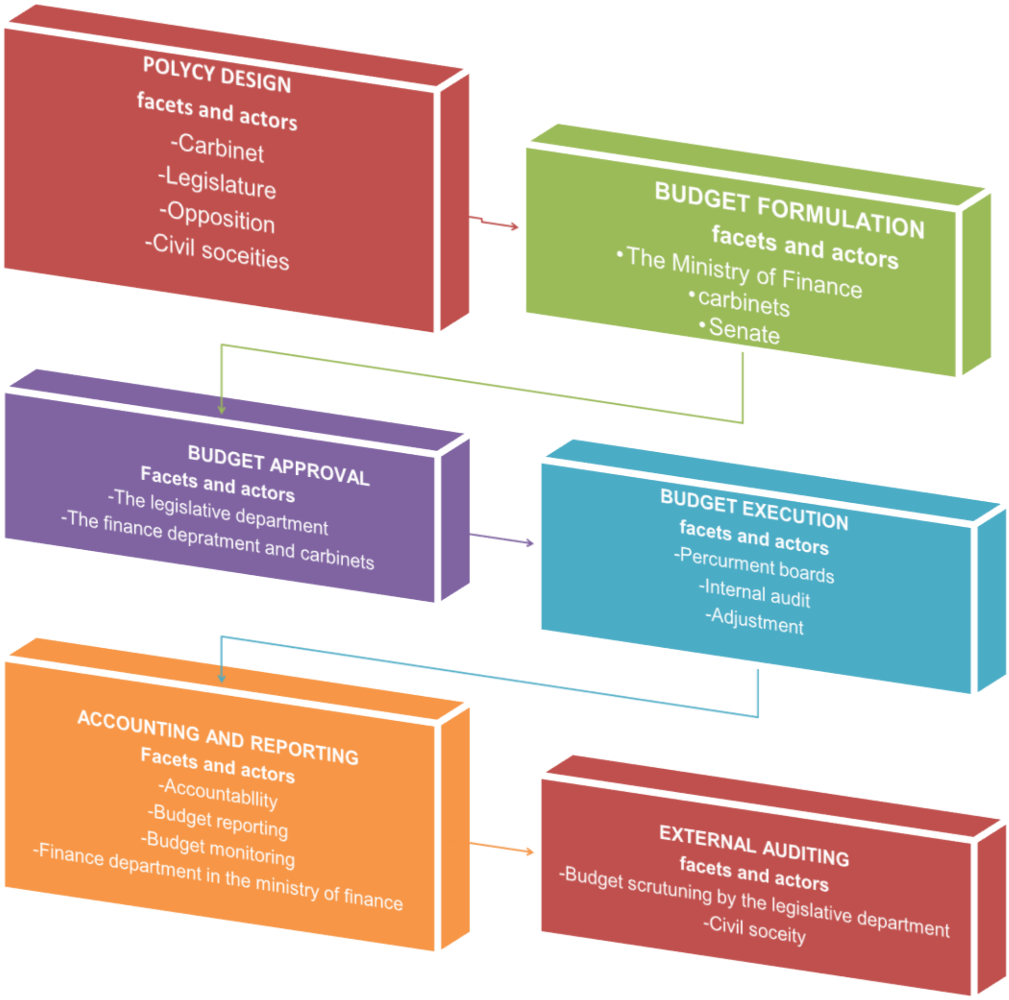


Fig. 1. PFM Steps
Source: Computed by authors, 2022

- **Budget approval**

Budget approval is a critical public finance management process that enables the government to spend money prudently and stay within the expenditure margins. Budget approval demands annual estimates of public revenues and expenditures made by the government. This entails planning budget policies and justification by each ministerial department for approval by the legislative department in consultation with the ministry of finance.

- **Budget execution**

The budget execution process, which broadly covers cash management, procurement, and revenue management, is a fertile ground for corruption. Weak internal and management controls and oversight of public spending increase the risk of corruption during budget execution [17]. Budget execution involved monitoring, adjusting, and reporting on the current year's budget. This is to ensure that spending agencies and entities comply with laws and regulations put in place by the state to achieve budgetary objectives and the implementation of good financial management systems with consistent financial reports, internal controls, and audits. Once the budget has been approved, it is executed at the beginning of the financial year and monitored by the Ministry of Finance, which constantly examines the flows of funds for any adjustment to comply with PFM. The goal of budget execution is to maintain transparency, accountability, and predictability as well improving alignment between expenditure and government priorities

[8]. Thus, the government must put in place strict laws to combat corruption, by all means, to realize government plan objectives through the execution process. [18] states that corruption is a ‘‘natural result of efficient predatory behavior in a lawless world’’. In most developing countries, the budget hardly meets its target objectives due to the ‘‘invisible hands’’ of some government officials who realized the weak nature of state laws. Fostering budget transparency and accountability through anti-corruptions laws is a vital ingredient to promoting integrity in public governance, which is badly needed in developing countries.

- **Accounting and reporting**

As the budget is being executed throughout the financial year, each spending department or agency records an account of its expenditure, which shall be handed to the Ministry of Finance to, reveals how the budget was executed. The timely and adequate information on the stream of expenditure and debt levels fortifies the capacity of the government to decide and control budget totals as well as to manage long-term fiscal sustainability. Financial accountability and reporting are essential tools in PFM and the overall development of a nation.

- **External auditing**

The evaluation and verification of a nation’s financial statement to make sure it complies with fiscal policy reforms is a wake-up call for project executors. Several external control mechanisms such as Parliamentarians, legislature, and civil society scrutinized the budget to make sure it was utilized in specific domains, ideally control this evaluation. The final decision of government budgeting and implementation is taken by the auditor general who accesses the quality of the budgetary processes and sanctions await all those who fail in their project execution.

2. CORRUPTION PERCEPTIONS IN BUDGET EXECUTION IN DEVELOPING COUNTRIES

With the above objectives of PFM, there is no doubt that the objective of every nation is to effectively implement the fiscal policy objectives, which highly depend on the execution and implementation of the budget. However, this is not the case in most developing countries due to self-interest motives in which the selfish actions of individuals who have access to public resources result in the complete misused of limited resources [19]. The pursuit of this individual self-interest is often not good for social efficiency. The phenomenon exists in most developing countries as individuals only care about private consumption and ignore that they create a negative externality by reducing the quantity available for others. In these countries, when a state employee is given a post of responsibility, the ecstasy and contentment is not the post but rather the amount of income the individual will embezzle at the end of the contract. Thus, there is no x-efficiency in the use of resources in the public sector. This leads to poor project utilization and the accumulation of national debt. It is usual for these countries to loans from international financial institution like World Bank or receives foreign aid or grant from advanced countries to finance their projects but the money does not get to the target objectives due to corrupt minds who do not care about the welfare of the society. Corruption and embezzlement have become the slogan of most of these countries such that they forget the doctrine of PFM. The negative consequences are visible through budget deficit, huge external debt, and poor economic performance as there is no linearity between theory and practice. Several reviews of PFM performance in developing countries show that countries score significantly better on budget preparation than on budget execution [20]. Even their growth and development visions are the best in the world like the Cameroon vision 2035, the 2025 Nigeria development plan, Vision 2025 of Burundi, and Congo vision 2025. These development plans, which will hardly be accomplished in full capacity lieu them in loaning huge sums from international financial institutions like WorldBank with heavy interest. For instance, in October 15, 2019, the World Bank Country Director for Cameroon, Abdoulaye Seck, signed a $200 million Development Policy Credit (DPC) which aims to strengthen fiscal sustainability, enhance competitiveness and protect the poor and most vulnerable [21]. However, even with 2035 fast approaching, poverty is dominant in all regions of the country with most citizens living on less than a dollar a day, the accumulated national debt of 46 percent of the country's Gross Domestic Product in 2021 [22], and a trade deficit of 136.03 Billion francs in March of 2021 [23]. The Corruption Perceptions Index for 2020 by Transparency International ranked Cameroon 149 out of 180 countries (where a higher ranking means more perceived corruption). This makes Cameroon one of the highest corrupt nations on planet earth just like other developing countries. This is the more reason why good development policies are designed in developing countries but lack implementation due high rate of corruption.

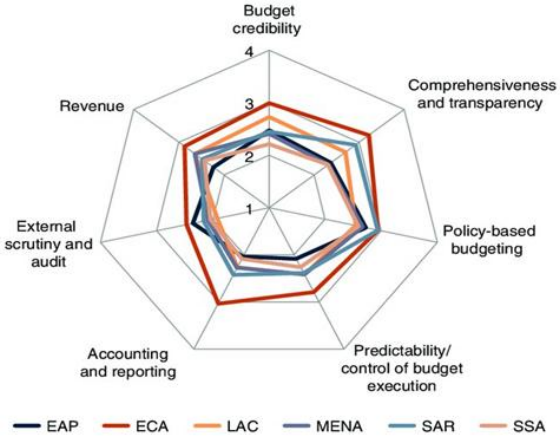
With this high ranking in the corruption index of developing countries, there is no doubt, why these countries are rank worst in terms of PEFA. The public expenditure and financial accountability (PEFA) in Fig. 2 indicate Sub Saharan Africa (SSA) is the worst region while Europe and Central Asia (ECA) is the strongest region as it outperforms other regions in all dimensions except policy-based budgeting where special administrative region (SAR) the second strongest aggregate perform better. There is not much difference in aggregate performance between LAC (Latin America and the Caribbean), and MENA (Middle East and North Africa). Though Sub-Saharan Africa is the worst region, it outperforms LAC in external scrutiny and audit and EAP (East Asia and pacific) in predictability and control of budget execution. Its performance in budget credibility, transparency, accounting, and reporting is more than that of SAR, ECA, and MENA.

In addition, looking at the PEFA performance by income group in Fig. 3, Low-income countries (LIC) perform lower in all dimensions than the lower middles income countries(LMIC) and upper middles income countries(UMIC). Generally, looking at both figures, the SSA region has the highest number of developing and low-income countries with high rates of corruption and embezzlement. This is caused by the poorly controlled commitment of government resources,which often results in the accumulation of arrears due to excessive borrowing [24] (see Fig. 4).

Table 1. Corruption perceptions index for some developing countries

Country	Score	Rank	Country	Score	Rank	Country	Score	Rank
Ukraine	**33**	117	Paraguay	**28**	137	Chad	**21**	160
Zambia	**33**	117	Angola	**27**	142	Comoros	**21**	160
Niger	**32**	123	Djibouti	**27**	142	Eritrea	**21**	160
Bolivia	**31**	124	Papua New Guinea	**27**	142	Iraq	**21**	160
Kenya	**31**	124	Uganda	**27**	142	Afghanistan	**19**	165
Kyrgyzstan	**31**	124	Bangladesh	**26**	146	Burundi	**19**	165
Mexico	**31**	124	Central African Republic	**26**	146	Congo	**19**	165
Pakistan	**31**	124	Uzbekistan	**26**	146	Guinea Bissau	**19**	165
Azerbaijan	**30**	129	Cameroon	**25**	149	Turkmenistan	**19**	165
Gabon	**30**	129	Guatemala	**25**	149	Democratic Republic of the Congo	**18**	170
Malawi	**30**	129	Iran	**25**	149	Haiti	**18**	170
Mali	**30**	129	Lebanon	**25**	149	Korea, North	**18**	170
Russia	**30**	129	Madagascar	**25**	149	Libya	**17**	173
Laos	**29**	134	Mozambique	**25**	149	Equatorial Guinea	**16**	174
Mauritania	**29**	134	Nigeria	**25**	149	Sudan	**16**	174
Togo	**29**	134	Tajikistan	**25**	149	Venezuela	**15**	176
Dominican Republic	**28**	137	Honduras	**24**	157	Yemen	**15**	176
Guinea	**28**	137	Zimbabwe	**24**	157	Syria	**14**	178
Liberia	**28**	137	Nicaragua	**22**	159	Somalia	**12**	179
Myanmar	**28**	137	Cambodia	**21**	160	South Sudan	**12**	179

Source: Transparency International, 2020



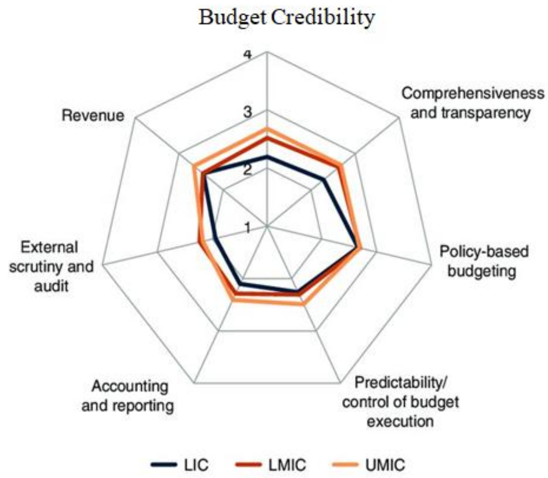


Fig. 2. PEBA by region **Fig. 3. PEFA by income group**

Source: Fritz et al. [7]

Note: A score of 4 = A; 3 = B; 2 = C; and D = 1

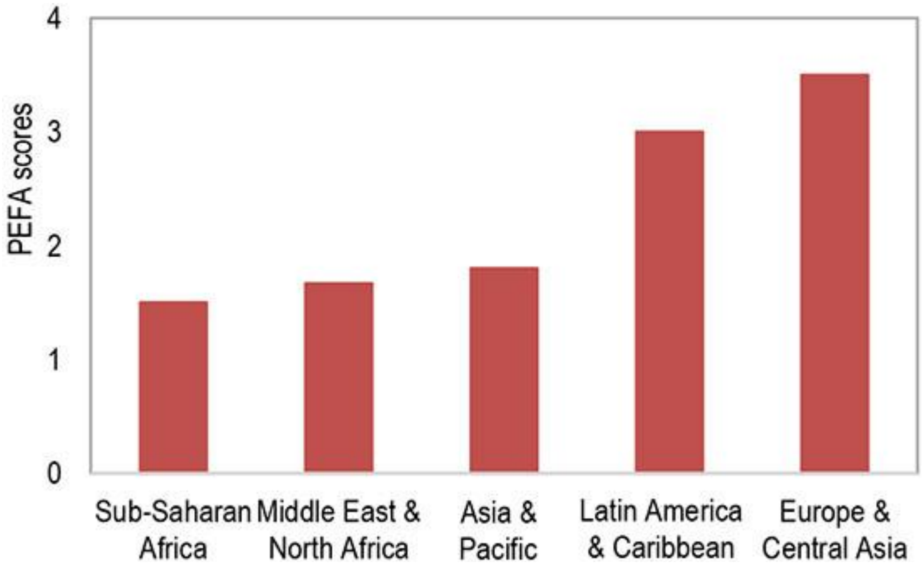


Fig. 4. PEFA Scores for domestic arrears stock

Source: Massara, et al. [25]

Note: lower score indicates higher stock of arrears

3. POLICY RECOMMENDATIONS IN IMPROVING ALIGNMENT BETWEEN THE PFM SYSTEM AND DEVELOPMENT

Efficiency and sustainability of the pillars of PEFA for effective management of public finance are paramount. PFM system and development can be effectively aligned when the link between all pillars of PEFA and PFM is geared toward development. Thus, PFM and development financing reforms can reinforce one another to achieve more effective and efficient use of public funds for better financial accountability and transparency in LDCs. Hence, there should be detailed financial regulations for greater flexibility in the use of funds to meet up with target objectives of the government. The misalignment between the PFM system and development can be caused by operational challenges in the implementation of PFM improvements, such as poor budgeting, illicit capital flows, corruption, and differences in policy objectives. This makes it difficult for the pillars of PEFA to function effectively in developing countries. Simply put, the mindset of most government officials involved in the budget execution phase is to fill up their private pockets. Opportunities for corruption emerge when policy objectives, sector plans, and budget allocations are misaligned [26]. If the budget is not drawn from a strategic plan, there is room for corruption because the budget will not be based on policy but instead on the personal preferences of those in power [27]. This creates obstacles to the effective implementation of fiscal policy. Just as the Political systems theory postulates pressure should be put on policy makers to act and lead to policy outputs and outcomes [28]. The key question is, therefore, what policies should the government adopt to improve its PFM system? The following policies can be used to strengthen the link between the PFM system and development in developing countries.

- **Matching theory with practice**

Setting laws, visions, and policies while respecting them at the same time is vital for the growth and development of nation. Hence, the development of a nation strictly depends on how well they respect and apply the policies and laws it set. Thus, matching theory and practice is a significant ingredient for economic performance. However, this is contrary in most developing countries who have the best visions and policies but fail in practice. Failing to practically implements policies set, retard growth and development. Thus, it is imperative for nations of developing countries to respect their policies and visions to advance in development.

- **Improvement in project monitoring and evaluation**

Most LDCs have not yet recognized the importance of project monitoring and evaluation, especially in public sectors. This is while more than 50% of their projects are usually delivered in low quality because the original amount approved is not always the amount implemented as greedy individuals usually snip a percentage. Project monitoring and evaluation are, therefore, important to measure a project's progress and control deviations from the project plan. It also provides evidence for the short-term, mid-term, and complete results assessments as well as beneficiary-level impact analysis. Hence, it is key to completing a project on time, on budget, and within scope. This allows the project team to provide robust evidence for all their actions and decisions to stakeholders, donors, and community members. Hence, it is highly recommended that developing countries monitor and evaluate their projects for better service delivery.

- **Improving Results-based financing**

Matching results with payment will be a pivotal instrument in PFM in developing countries. Results-based financing provides rewards to individuals or institutions after agreed-upon results are achieved and verified [29]. The rationale for this approach is to establish a link between finance and outputs. This will increase accountability and create incentives to improve work performance in public sector contracts. Results-based funding programs were initially implemented in social sectors such as health and education. However, pilot programs have been utilized in the environment, energy, and government sectors [30]. With high corrupt nature of developing countries, matching results with payment will be the best tool for the pillars of PEFA to function smoothly in PFM.

- **Improvement in Transparency and accountability**

Accountability and transparency are key factors in PFM. They can be improved through information acts, corruption reforms, and public service legislature law. The objectives of the Right to Information Act are to empower the citizen’s access to information, contain corruption, and promote transparency and accountability in government sectors by making the process of government decisions more democratic [31]. The Act was adopted in India in 2005 to promote transparency in government institutions, after sustained efforts of anti-corruption activists. By empowering the citizens to question the government, the agencies or officers concerned are disciplined with a monetary fine if failed to provide information within 30 days. A nation can only be changed by the citizen that habit it. Thus, governments of developing countries should provide reliable, complete, and transparent accounts of their financial position to the Parliament, donors, and the public to boost transparency and accountability in government sectors. Transparency should be based on the belief that the citizens have "a right to know’’, a right to receive openly declared facts [32]. In addition, the public service legislature law should be established with a jail term to set time-bound delivery for various public services rendered by contractors or civil servants to citizen and provides a mechanism for punishing them should they fail to render such services on time and at the right quality. This will reduce corruption, increase tax revenue, and makes public expenditure policies more effective for achieving fiscal policy objectives.

- **Respect for the rule of law**

Respect for the rule of law as established by the judiciary is one of the most crucial fundamentals of good governance. There must be a match between policies that have been design by the state and practical implementations. Many countries throughout the world struggle to sustain the rule of law where everyone is treated equally under the law, no one is above the law, and everyone is answerable to the same laws. However, this is not the case with most LDCs as some politicians are against the law such that they can easily syphon and flight out government revenue and goes cut free. Advance countries have gotten to their level of development due to the respect for the rule of law. Hence, the law is an essential part of government action, a system on which government administration is based. The rule of law, therefore, fosters participation, ensures transparency, demands accountability, and promotes efficiency [33]. Judicial control and punishment are vital for ensuring that the pillars of PEFA are effectively and efficiently implemented. Once every individual is aware of the punishment for corruption and embezzlement, poorly delivered service, they will avoid such crimes. The problem with developing countries is respecting the laws they set. It is usual for politicians to embezzle billions without being held accountable for it. This explains while there is a lot of capital flight and cash syphoning in developing countries with most top government officials having multiples account in foreign banks, money, stolen in the execution process. The government of developing countries must initiate laws and takes them seriously to prevent such misconduct by a jail term. With respect for the law, the pillars of PEFA can function efficiently.

- **Improvement in public sector audit.**

The public sector audit has proven to be ineffective in many developing countries due to failure to utilize an independent public sector audit as a benchmark standard for enhancing public sector accountability [34]. A commonly used practice is paper audit, which is subject to bribes. Sometimes, there is a prohibition for releasing public sector audit results, which shows evidence of lack of transparency. Thus, the creation of an efficient audit system, sanctions for late submissions, and manipulation of audit results are critical conditions to fighting corruption. The incremental theory of decision making postulates that “decision makers use previous activities and policies as the basis for their decisions and focus their efforts on incrementally increasing, decreasing, or modifying past activities and policies” [35].

- **Adopting financial management information system (FMIS)**

Using a computerization public expenditure management processes in areas of budget formulation, budget execution, and accounting with the use of an integrated system will increase the efficiency of PFM. The budget execution and accounting processes in most developing countries are still manual or supported by very old and inadequately maintained software applications, which affects the functioning of their PFM system. The lack of reliable data on revenue and expenditure for budget planning, monitoring, expenditure control, and reporting has negatively impacted budget management [24]. [34] “states that access to information on the actions and performance of government expenditures is critical to achieving government accountability”. Hence, it is important for developing countries to adopt FMIS projects to strengthen their PFM systems through the decentralization of fiscal responsibilities. This has become the target for most countries budget reform objectives, which is a requirement for achieving effective management of budgetary resources. The FMIS reforms improve the recording and processing of government financial transactions and allows prompt and efficient access to reliable financial data to Parliament, the public, and other external agencies, which stimulates transparency and accountability of public budget. It will also strengthen financial controls, facilitating a full and updated picture of commitments and expenditures on a continuous basis as well as ensure improved efficiency and effectiveness of government financial management.

4. CONCLUSION

The success and prosperity of a country depend on the transparency and accountability of fiscal policy. Thus, every stakeholder both private and the public has a role to play in public finance management through the principles of budgeting, expenditure, and reporting. Fiscal indiscipline has led to persistent fiscal deficits and an inevitable rise in public sector indebtedness in developing countries due to the spurious formulation of budgetary policies. The objective of this study was to review the shortcoming of PFM in developing countries by critically examining the functionality of the pillars of PEFA and emphasizing the emergency of fiscal policy sustainability. The study proposed policies for improving the alignment between the pillars of the PFM system and Development for long-term benefit.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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