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Centre for Aid and Public Expenditure

Tales of the unexpected: Public financial management reform in difficult environments

CAPE Conference 2007 – Conference Report

Tales of the unexpected: Public financial management reform in difficult environments CAPE Conference 2007

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Tales of the unexpected: Public financial management reform in difficult environments

CAPE Conference 2007 – Conference Report

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Abbreviations

ACSR	Administrative and Civil Service Reform
AFROSAI	African Organisation of Supreme Audit Institutions
CAPE	Centre for Aid and Public Expenditure
CPIA	Country Policy and Institutional Assessment
CSR	Civil Service Reform
DFID	Department for International Development (UK)
EUSM	Expected Utility Stakeholder Model (World Bank)
HIPC	Heavily Indebted Poor Countries
MEF	Ministry of Economy and Finance (Cambodia)
MTEF	Medium-Term Expenditure Framework
NGO	Non-Governmental Organisation
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OED	Operations Evaluation Department (World Bank)
PBB	Performance Based Budgeting
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PREM	Poverty Reduction and Economic Management (World Bank)
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
SIDA	Swedish International Development Agency

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Further information about the conference can be found online at:
www.odi.org.uk/events/CAPE_conference_2007

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Executive summary

The Centre for Aid and Public Expenditure (CAPE) held its fourth annual conference on 14–15 November 2007 at ODI. The theme was to investigate research and policy links between public financial management (PFM) reform, and governance and political economy. This report details the conference discussions and conclusions.

PFM — the institutional system for mobilising, allocating, spending and accounting for public finances — is crucial to governments' capacity to provide effective and high-quality public services. Thus, reform of this system is vital to ensuring better governance.

Ensuring the success of such reforms is not straightforward. Despite massive international and national investments and efforts, PFM systems in many developing and transition countries are weak. By contrast, most OECD countries have in the past few years rapidly improved the quality of their PFM systems. This suggests that a high quality of governance and successful PFM outcomes are linked. Yet, successful PFM reform has also happened in low-income and transition countries without a demonstrable high standard of governance. Although the reforms in these countries are often slower and smaller scale than in developed countries, and the impact on PFM outcomes is typically less pronounced, they have succeeded nonetheless. Understanding why reforms succeed in poor governance environments could offer key insights into factors crucial to successful PFM reform and elucidate the relation between governance and PFM reforms.

The apparent disconnect between governance and PFM reform raises several questions: do we need to rethink how we define governance? how do we measure the success of a reform? what political environment is needed for reforms to flourish? what lessons can we learn from countries with successful reforms that are relevant to other countries? and what roles do key players such as donors, NGOs, civil society groups and the media have in influencing reform?

This conference discussed these questions in five sessions:

(1) How are PFM and governance related?;

(2) What do 'successful' PFM outcomes and performance mean?;

(3) What kind of PFM reforms have succeeded and why? reflections from country reformers in Bangladesh, Cambodia and Chile;

(4) What are the key explanatory factors underlying successful PFM reform? and;

(5) The implications for policy-makers and researchers.

Key points and conclusions

The following key points arose from the conference proceedings:

- There are complexities in defining 'governance' that make it difficult to establish the relationship between governance quality and successful PFM reform. Aggregate governance concepts and broad typologies for groups of countries may disregard important country-specific differences that influence PFM reform progress. Equally, formal interpretations of governance may exclude the informal accountability relationships that are prevalent in many developing countries.

- A lack of consensus exists about how to define 'successful' PFM reform and identify its occurrence. Progress towards substantive PFM reform is a journey rather than a destination, and 'success' is often declared too early without due regard to the substance and sustainability of the reform. The notion of success may also be viewed differently by different stakeholders in the reform process.

- Despite the difficulties with defining success and categorising governance contexts, there is demand for a more sophisticated framework to explore the influence of different types of governance environments on the feasibility of different PFM reforms. Moving beyond simple typologies, it is important to understand country-specific complexities and to focus on the combination of positive governance conditions that is 'good enough' for a particular set of PFM reforms to succeed.

- The role of politics in motivating and sustaining PFM reforms is integral to their successful implementation. Political leadership of the reform process is an important driving force that may be harnessed by making more explicit the political gains from a particular PFM reform path. Senior technocrats can play an instrumental role in highlighting the political benefits of reform and in proposing the sequence of those reforms.

- Greater attention should be directed to domestic 'demand-side' actors in the reform process, such as the taxpaying electorate, the legislature and civil society groups. The influence of these actors remains weak in many developing countries, but they have the potential to play a forceful role in motivating reforms, especially when they form alliances with reformers in the executive.

- International 'donor' agencies have a beneficial influence in developing countries when they act coherently as providers of technical advice to domestic reformers. However, they may be most effective when they stimulate enhanced domestic accountability by placing information on PFM performance in the public domain and helping to strengthen public expectations for improved PFM outcomes.

- The ultimate success of PFM reform is dependent upon making progress with corresponding civil service reform. The two types of reforms are integrally linked and must proceed in parallel for there to be real changes in PFM outcomes such as fiscal sustainability, more efficient resource allocation, and improved service delivery. As providers of technical advice, donor agencies can help to ensure better alignment between these two sets of reforms and greater overall reform coherence.

- The development of the PEFA framework for measuring PFM performance has resulted in significant positive benefits, most notably the wide international consensus over a single set of indicators. However, as the framework continues to develop greater attention may need to be focused on whether the normative assumptions underlying the framework undermine neutral dialogue on PFM performance and reform objectives.

- Better analytical tools are needed that can go beyond establishing a technical understanding of PFM reform and attempt to understand more fully the political and institutional dynamics of reform in a particular country context. This needs to include robust, systematic and deeper examination of a range of cases of both stronger performance and weaker performance.

Overall, it was agreed that further research is required to better understand the complex nature of public financial management reform in poor governance contexts so that clear implications may emerge for policy-makers and practitioners.

Introduction

Public financial management (PFM)[1] concerns the institutional arrangements for mobilising, allocating, spending and accounting for public finances. The performance of PFM systems critically affects the capacity of governments to fund and deliver high-quality public services that are affordable and responsive to the needs of the population. An effective system that produces good outcomes — i.e. aggregate fiscal discipline, efficient resource allocation and efficient service delivery — is therefore an important requirement for well-functioning and accountable government. Reform of PFM systems and processes to better achieve these objectives is central to the broader development of more effective public sector governance.

Despite high international investment and significant domestic effort in reforms, PFM systems in many developing and transition countries remain relatively weak. By contrast, most countries within the Organisation for Economic Co-operation and Development (OECD) have succeeded in transforming rapidly the quality of their PFM systems. This suggests a correlation between a high quality of governance and achievement of successful PFM outcomes. Yet, successful PFM reform is also apparent in some low-income and transition countries without a high demonstrable standard of governance. The reforms in these countries are often slower and smaller scale than in developed countries, and the impact on PFM outcomes is typically less pronounced, but reforms have still occurred. This suggests an unclear relationship between the quality of formal governance and the success of PFM reform which warrants closer attention.

Governance is a complex concept. Attempts to define it remain contentious. The standard of PFM is usually a component of governance assessments, but the relationship between PFM and wider governance quality is unclear. In particular, current 'good governance' or 'good enough governance' agendas may not allow for all the factors that motivate and sustain successful PFM reforms. Also, the drivers of PFM reform might be independent to some degree of the quality of governance as defined by these prevailing agendas. Certainly, informal institutions and political economy factors could have just as strong a motivating influence and impact on the quality of PFM systems as formal governance factors.

The importance of understanding the political economy of reform processes and the problems that political challenges present to these reforms is now better understood by donors and consultants involved in reforming PFM and public administration. It is widely accepted that technical solutions which ignore political realities cannot lead to sustained reform success. However, there is little guidance on how technical reform processes can become more 'politically astute' in operational terms. Some attempts by donors have gone a long way to bringing politics into reform processes, but they remain unsatisfactory.

One approach, driven by technical strategies, has highlighted the importance of politics by equating it with 'ownership'. But the risk here is that reforms might be designed first and political commitment sought afterwards. Donors such as the UK Department for International Development (DFID) and the Swedish International Development Agency (SIDA) have been investigating the political dimensions of reform processes more closely. They advocate a deeper understanding of political processes, including both the formal and informal rules of domestic systems. However, their work stops short of offering operational implications and guidelines. Emerging attempts to apply political analysis to PFM reform, such as the World Bank's Expected Utility Stakeholder Model (EUSM), remain a 'work

1 For the purposes of the conference and this report, public financial management is defined as synonymous with public finance management.

in progress' and carry the risk of being used only as internal donor strategy tools.

Clarity is also needed on how politics interacts with the process aspects of PFM reform: the sequence, timing and type of reforms. Strategic management and technical leadership; organisation and human resources capacity; pressure from domestic forces of accountability; and pressure or inducements from international (or regional) organisations have all been identified as key to reform, but researchers have not identified the relative importance of each factor or how they interact with each other. The existing literature on PFM reform assumes that effort should be directed at introducing and strengthening additional factors, rather than exploring more selective approaches based on the country governance context and specific reform objectives. It is time this approach was re-examined.

The fourth CAPE conference, in November 2007, attempted to further the debate. It explored what types of PFM reforms have taken place in countries where features typically associated with good governance are weak, and sought to draw out lessons for ensuring successful reform. The conference considered the factors that motivate and sustain PFM reform progress, drawing on both country case-studies and theoretical frameworks to explain successful reforms in difficult governance contexts. It also considered how to define and measure success in such environments: does success mean stronger budgeting and financial management processes or improved fiscal outcomes? Can we count statutory changes as successes or only when such legislative changes lead to sustained reform implementation?

The central question of the conference was whether attempts to understand and address such factors more widely across countries without apparent reform pre-conditions would also make it possible to contemplate an acceleration of improvements in PFM systems and processes in those countries.

To help draw out the implications of these questions for both country reformers and future research, this conference brought together experts who have been leaders of PFM reforms in several countries (including Cambodia, Bangladesh, Chile, Yemen, Nepal and Pakistan), with donor agency representatives, PFM consultants and researchers. Each session was structured to address particular aspects of the central conference question: **Can PFM reform succeed in difficult governance contexts?** This report summarises the speakers' presentations and the ensuing discussions.

The relationship between governance and public financial management reform

Session 1

Chair: Alison Evans, ODI

Speakers: Sanjay Pradhan, World Bank
– *The relationship between governance and PFM*

The presentations for this session can be found in Appendix 2 or online at:
www.odi.org.uk/events/CAPE_conference_2007

Introduction

The first substantive session sought to grapple with the complexities of the concept of governance. It addressed the relationship between governance and PFM and investigated the opportunities for PFM reform in different types of governance environment.

The common definition of governance has come to be closely associated with the 'good governance' agenda and its emphasis on lowering transaction costs and limiting the wastage associated with rent seeking. In turn, the application of this agenda has become embedded in efforts to inspire growth and reduce poverty in developing countries. However, there remains a significant amount of uncertainty surrounding this framework and its particular conceptualisation of favourable governance. A key critique has been on its push for a standard package of reforms when there remains ambiguity as to which institutions matter most to development and which kinds of governance interventions are most likely to promote development in individual countries and regions.

How we define governance has important implications for how we view its relationship with PFM reforms. The lack of clarity in our understanding of good quality governance and the factors which contribute to it have resulted in a lack of clarity over which governance factors affect PFM reforms and in what ways. It is also not clear whether improvements in PFM systems, as part of the standard package of reforms proposed to improve governance, drive improvements in the governance environment of a country.

Main issues and the presenter's arguments

A framework of governance and public financial management

Sanjay Pradhan noted there is no consensus over the definition of 'governance'. He set out a preferred definition as: the manner in which the state acquires and exercises its authority to provide public goods and services to achieve societal goals. It can be systematised as the capacity of the executive branch of governance and how it is accountable, bringing in both a supply side and a demand side. PFM is a sub-set of governance. It covers the institutional arrangements for the mobilisation, allocation and use of public finances to achieve aggregate fiscal discipline, strategic priorities and operational efficiency.

Pradhan emphasised that PFM is integral to good governance. He presented a paradigm of governance, organised to show groups of key actors and institutional arrangements. This World Bank framework includes:

- Rules and incentives that govern the behaviour of political actors (e.g. broad based political parties, nature of political competition, transparency and regulation of party financing);
- Bureaucracy (including issues of public finance management and civil service pay);
- Formal oversight institutions;
- Civil society and the media;
- Private sector; and
- Decentralised government and local participation.

The framework shows the directions of accountability between the various groups of actors. There are implied checks and balances, but in some contexts (e.g. neo-patrimonial societies) these may not exist or function effectively. The framework helps to explain the governance context, but it is important to recognise the challenges to achieving high standards of formal governance in many countries. The focus of reforms should therefore be upon achieving 'good enough' governance rather than 'ideal' governance.

He noted that countries differ with respect to their trajectories and starting points of governance reform, but both factors are driven by domestic and international political forces. Some countries tackle the quality of bureaucracy (e.g. technical PFM and civil service reforms) first and only then the quality of checks and balances (e.g. enhanced transparency and participation). Pradhan used examples of the early periods of reform under President Suharto in Indonesia and under President Museveni in Uganda to illustrate progress with bureaucratic reform (i.e. reforms to public finance management and public sector management) before efforts to improve the quality of institutional 'checks and balances'. He also discussed the examples of Nigeria, which since 2000 has seen the processes happening in reverse sequence, and Mozambique in the 1990s, which made relatively steady progress on both processes simultaneously. He argued against delaying progress in one area for too long or moving too strongly along only one dimension.

How do we monitor the reforms that countries are pursuing?

Pradhan presented World Bank data from Country Policy and Institutional Assessments (CPIA) showing that reform progress has been made between 2001 and 2006 at an aggregate average level across all low-income countries, including all African countries, in terms of PFM, public administration and control of corruption.

An interesting finding from the World Bank Operations Evaluation Department (OED) analysis is that PFM operations tend to perform relatively satisfactorily regardless of the governance starting point (again as measured by CPIA ratings); while Administrative and Civil Service Reforms (ACSR) have performed much better in countries with higher CPIA ratings. Specifically, World Bank PFM reform projects appeared to out-perform ACSR projects in poor governance environments. The Highly Indebted Poor Countries (HIPC) initiative tracking indicators for PFM improvements paint a more uncertain picture of PFM reform progress. They show that, for the period 2001 to 2004, 13 countries achieved a net improvement against the HIPC indicators, eight countries had a net decline, and one country showed no net change. The overall evidence is therefore mixed.

The more recent Public Expenditure and Financial Accountability (PEFA) framework allows a finer assessment of the status of PFM systems, covering six key aspects (and 28+3 individual indicators, with a larger number of sub-dimensions). Seventy countries are now using the PEFA indicators, although less progress has been made over public disclosure of the results. There is now a set of indicators, good or bad, which the international community has agreed on. This offers real scope for harmonisation, but there is a risk of complacency around the progress already achieved. The PEFA reports in fact show that PFM systems still look rather weak in many countries. Now that we have better measures of performance, the challenge is how to achieve better progress with reforms.

How can we tailor PFM reforms in different governance contexts?

Reform must be tailored according to a country's particular governance context. A possible typology could distinguish between fragile states, reforming states and capable states. Each has particular types of PFM challenges. The 'platform' approach adopted in Cambodia is one attempt to avoid over-ambitious reforms in a country with complex governance challenges by applying a series of reforms that address basics first. This implies an initial focus on budget credibility in terms of aggregates and input controls, before addressing linkages between policy priorities and spending plans, and targeting greater accountability later on. This approach is the most advanced model of a sequenced approach to PFM.

Following these developments in thinking about sequencing, Pradhan highlighted the need to think about progress with reforms such as Medium Term Expenditure Frameworks (MTEFs). Donors have been suppliers of many PFM reform ideas and MTEFs are notable among those. There is, however, a question about when in the sequence of reforms it makes sense to tackle an MTEF. Such reforms are highly complex both technologically and institutionally; and across Africa attempts at introducing MTEFs have not been widely successful. Good implementation requires: a credible macro framework; an ability to set priorities; acceptance of a central coordination role; gate-keeping discipline for management of bids and baseline control; and enforcement control in budget execution, among other things.

The conclusions from a multi-country World Bank study on MTEF implementation (Le Houerou and Taliercio, 2004) indicate that there has been little progress in Africa. South Africa and Uganda are two countries where success has been achieved, but in South Africa there were two attempts. The first exercise, a largely technical one, failed; the second had strong political support and resulted in much better outcomes. When MTEFs are introduced but ultimately fail to take root, they can lead to the existence of two parallel systems: the MTEF as a separate budget projection device and the annual budget where the real energy is focused. The World Bank study also found that political and institutional conditions had not been adequately taken into account.

Pradhan presented a framework that considers the implications for PFM reform efforts in different types of governance environments. Drawing on Grindle's (2007) typology this framework distinguishes the characteristics of states at five stages of governance development: collapsed (e.g. Iraq), personal rule (e.g. Turkmenistan), minimally institutionalised (e.g. Kenya), institutionalised non-competitive (e.g. Vietnam), and institutionalised competitive (e.g. Chile). The framework attempts to consider what types of PFM reform are appropriate for what type of country context.

What are the drivers of PFM reforms in different contexts?

Pradhan argued that we need to move beyond issues of technical implementation, to think additionally about political economy issues and the drivers of reform. He proposed that we consider the nature of political leadership that is required as PFM reforms are attempted across this range of governance environments. This involves analysing the political 'wins' and 'losses' as PFM reforms proceed in different contexts. He raised questions about the political space required for reform, the role of instrumental bureaucratic leadership, and the importance of coalitions within and outside of government. He suggested that strong political leadership is required throughout PFM reform processes. Coalitions are less necessary for PFM reform at the early stages, although these become vital as more complex reforms are attempted in more competitive political governance contexts.

As an example, Pradhan spoke about Uganda in the 1980s, where Museveni provided the political leadership and gave Tumusiime-Mutebile the space to lead technical reforms. In the early stages, political leadership and centralised control were needed to make the budget more credible; this gave power to the Minister of Finance and Permanent Secretary to restrain the defence ministry expenditure through the supplemental budgeting process. In the later phases, wider reform coalitions were needed to build consensus for next stage reforms.

He also emphasised the importance of demand-side factors at various stages of PFM reform. In various cases, technocrats have forged alliances with demand-side coalitions. He cited the examples of Uganda, where money was not reaching schools and citizens were empowered with information which led to financial leakages from schools being reduced, and the Philippines, where reform-minded technocrats formed an alliance with a civil society organisation to reduce the theft of school textbooks.

The challenge is to think about politically-astute PFM reforms, marrying technical sequencing with political economy considerations. We need to consider the incentives of different actors at different stages in the reform process, and link that with politically-informed design and sequencing of reforms. Finally, we must also tie PFM reform in with sectors and with service delivery in order to maximise the political gains from reform. From a political perspective, that is where the greatest pay-off lies.

The debate among the participants

The integrated nature of PFM reforms and political governance reforms

It was argued that political leadership should not be taken as an exogenous 'given'. Pradhan agreed and emphasised the need to make politics an endogenous part of the reform process. He noted that politicians often view the budget as a given rather than understanding that the MTEF/budget is a powerful political tool for driving better results in the medium term. There is a critical role for instrumental technocrats in making the case for PFM reforms.

In terms of the PFM-governance framework diagram, one participant noted the risk of concluding that certain PFM reforms are only possible in contexts of competitive political governance. A more dynamic framework could be conceptualised, relating reforms to increased transparency and accountability (e.g. improving presentation of a budget, making information on budgets available to the public, giving the legislature more time and capability to assess a budget, giving civil society actors more opportunity to have an input), with more technical reforms (e.g. improved forecasting of revenues, improved costing of programmes, integrated financial management systems). One hypothesis is that countries with non-competitive political systems will permit technical reforms but will prevent corresponding reforms to transparency and accountability. For PFM reforms to succeed and be meaningful, simultaneous progress must be made along both axes. Pradhan agreed with the need to build both the supply-side and demand-side of reforms (i.e. transparency, participation and accountability), avoiding imbalanced progress on one side.

During the plenary discussion it was also noted that trajectories of governance reform are not linear and that change does not occur in a progressive sequence. Informal accountabilities do not necessarily give way to more formal constitutional accountability relationships as development proceeds. This creates some questions for a framework that shows a trajectory of governance reforms. Uganda was cited as an example of where earlier successful PFM reforms have started to become undone over the last ten years in part as a consequence of political liberalisation (i.e. introduction of multi-party political systems).

Another participant commented that important inter-linkages between PFM reforms and other reforms relating to the broader governance environment are sometimes disregarded. Yet some reforms that are not directly about PFM, such as transparency and disclosure of information, can support or facilitate technical PFM improvements. The examples of success from Uganda and the Philippines showed that non-PFM reforms had a direct bearing upon improvements in PFM. The participant cited Mexico as another case, in which improved transparency and access to information by civil society created domestic pressure for reform and improvement of audit processes. We must avoid 'silo' approaches to reforms.

The dangers of fragmented approaches to PFM and governance reform

One participant pointed out that the role of donors in governance-strengthening programmes risks being neglected in the analysis of how to succeed with PFM reforms. The framework suggested by Pradhan does not explicitly address the role of donors, but one of the greatest challenges to successful reform is the high degree of fragmentation in donor PFM policies and projects. In many cases there are two types of fragmentation, with separate assistance packages being designed for aspects of governance reform (e.g. PFM, Civil Service Reform, parliamentary strengthening) or else different donors focusing on different aspects of PFM (e.g. MTEFs, Supreme Audit Institutions, tax authorities). The challenge is to organise donor support to reforms more coherently.

The Poverty Reduction and Economic Management (PREM) governance paradigm shows PFM embedded in one place and other types of governance reform embedded elsewhere. However, intergovernmental fiscal relations are an important area where PFM and wider governance issues intersect and interact. The example of improvements in education sector PFM in Uganda may also have been a case of excessively rapid decentralisation. Lines of accountability to the centre were broken before new lines of accountability to local citizens were established. This shows the possible tensions and inconsistencies across certain reforms. The issue of fragmentation is not only important for donors but also for different domestic reform entrepreneurs who may not be pursuing a coherent package of governance reforms.

The coexistence of formal and informal accountability relationships

With reference to Pradhan's framework of governance actors and accountability relationships, a participant noted that there are types of accountabilities beyond the formal ones depicted. There may be more informal clientelistic relationships that drive the interaction between various groups. We must consider the relative importance of these 'other' accountabilities (i.e. accountabilities of political leaders to their client bases of various kinds). Although they are not part of the formal governance paradigm envisaged, they are not necessarily anti-developmental and may in fact have some positive aspects. Pradhan agreed that clientelistic forms of accountability can be very important and noted that another version of this framework also depicted the informal governance relationship typically present in neo-patrimonial societies.

Political versus technical sequencing of PFM reforms

The platform approach suggests that the reforms in early platforms should be completed before progress is attempted in later reform 'platforms', but there may be the political need and opportunity to address some more complex issues at the same time. Pradhan agreed that political leadership may not get much pay-off from Platform 1 and thus for reforms to gain momentum and support, they must demonstrate relevance to improved service delivery outcomes. Budget credibility matters politically when it supports better services. He gave the example of decentralisation in Karnataka, India, where reforms focused on a few urban services and demonstrated the political benefits of budget credibility and meritocracy in certain agencies so that support could be built for broader PFM reforms.

When considering the progress of countries against the HIPC tracking indicators, it is important to understand which aspects of PFM are improving and which are worsening. Evidence from a World Bank evaluation shows that, typically, budget reporting has improved the most, whereas strengthening of budget formulation has been less apparent, and auditing has been the area of least improvement. This may be because reporting is a relatively technocratic change that is also a strong requirement for budget support, whereas improving budget planning is more politically challenging and strengthened auditing is linked to corruption issues. Countries with less politically-competitive environments are likely to make better progress with technocratic reforms that do not involve political economy issues.

The need to avoid blueprints for reform in different contexts

A concern was raised by one participant that the framework presented by Pradhan risks becoming a blueprint for how to address PFM reform in different governance concepts. The chair noted a strong link with work by Phil Keefer at the World Bank on the problems with aggregate governance concepts and how there is considerable heterogeneity among countries with similar governance characteristics which makes the reform implications for each distinctive. Pradhan agreed that these devices have their limitations, but argued that some form of generic analytical framework is necessary if we want to avoid the conclusion that everything is country case specific.

The possibilities for PFM reform in fragile states

The governance-PFM relationship framework suggests that progress with PFM reform cannot be made in failing or collapsed states. However, Haiti was a failing state in 1996-2004 and offers a positive example. It received significant support with technical improvements during that period and then achieved a quantum leap in terms of PFM following the end of personal rule in 2004. It could be that the prior technical work formed the basis for quite significant progress once a more politically-competitive system started to emerge. We must therefore give further thought to the typology or governance categories and consider what is actually implied by those labels. The chair noted the connection with data presented in Pradhan's presentation that suggested significant PFM reform progress in countries with governance scores below CPIA 3.0. This appeared to support the notion that reform is possible in countries without competitive political governance systems. Another participant agreed that it would be useful to investigate further the characteristics of different types of fragile states and the reforms that might be feasible in those different contexts.

Using PEFA to stimulate domestic demand for reform

There was a question about how much the PEFA assessments completed to date had been able to influence the domestic demand side for PFM reform. Pradhan agreed that PEFA needs to be used more for domestic accountability purposes, but there is a necessary prior step of establishing greater disclosure of reports and results. A senior country official involved in PFM reforms noted that the PEFA assessment process is sometimes used superficially for domestic political gain rather than as a means to focus on the content of necessary PFM reforms. In other circumstances, it is viewed purely as a mechanism for securing greater donor funding by demonstrating improvements in scoring.

Session 1 conclusions

- There is a clear lack of consensus over the definition of governance, which complicates greatly any attempts to analyse the implications for PFM reform in different governance environments. Some working principles are required that resist the risk of generalised typologies that fail to capture country-specific nuances, but which allow a broad framework for analysis.

- Politics should be viewed as an integral part of the reform process and not an exogenous variable that can be abstracted from the design and implementation of technical reform processes.

- Further work is needed to analyse what types of PFM reforms may succeed in fragile states. This will require a deeper understanding and clearer definition of the characteristics of different types of collapsed, failing and fragile states, as well as the contributory factors in each case.

- A better understanding is required about the complex relationship between technical PFM reforms, progress with improving transparency and accountability, and the governance characteristics of particular states. The further development of a 'heuristic' framework for examining these relationships will be an important first step.

- Domestic demand-side actors can have a powerful role in influencing PFM reform progress in certain contexts, but often lack access to the information necessary to exert greater pressure.

- Approaches to PFM reform need to be better integrated with wider improvements in the quality of public sector governance. Donor agencies and domestic reform entrepreneurs both need to ensure greater coherence in the way they envisage, design and implement reform programmes so that links between technical reforms and public sector performance improvements are strengthened.

- Reform trajectories are typically not linear. Progress towards competitive political governance systems may result in temporary deterioration in some aspects of PFM. This may especially be the case where informal accountability relationships are prevalent and dominate some of the more formal constitutional accountabilities.

What defines successful PFM outcomes and performance? How do we measure aggregate PFM reform progress?

Session 2

Chair: Andrew Lawson, Fiscus

Speakers: Paolo de Renzio, Oxford University
– *Measuring progress in budget outcomes and reforms*

Carole Pretorius, Independent PFM Consultant
– *Good practices in PFM reform*

The presentations for this session can be found in Appendix 2 or online at:
www.odi.org.uk/events/CAPE_conference_2007

Introduction

In order to understand the relationship between governance and PFM, we need to define effective PFM outcomes and measure the performance of systems that affect those outcomes. First, how 'success' is identified and measured precedes any debate on which factors lie behind that success. Second, a key challenge is measuring success in the context of informal systems, which underlie PFM in weak governance environments. This is especially problematic when the tools available focus on the functioning of formal PFM systems alone.

Main issues and the presenters' arguments

The focus of Session 2 was on exploring how successful PFM reform is defined, identified and measured. Current definitions are accepted and widely calibrated but contain significant measurement challenges. As a result, international comparisons of PFM performance rarely go beyond issues of fiscal discipline and budget sustainability. In order to overcome an excessively narrow conception of PFM performance, attempts have been made to benchmark the quality of PFM systems and processes. One initiative has focused on identifying those practices that are most likely to promote effective PFM outcomes, using this model as a point of comparison for assessing actual practices. However, such initiatives suffer from difficulties of aggregation and data scarcity. A further more fundamental issue arises from the complexities involved in attempting to compare budget outcomes. Assessment of PFM outcomes at a wider level is determined not only by the outputs of budget process but with the interaction of these outputs with the broader governance environment. Data on budget processes and institutions tends to conflate outputs of budget processes in terms of the nature of the budget process and outcomes such as the effectiveness of budget accountability mechanisms.

These issues were examined in Session 2 from two different perspectives. Paolo de Renzio from Oxford University focused on the issues and challenges involved in measuring aggregate PFM reform progress. He explored how different definitions of PFM outputs and outcomes can affect their measurability and described the practical problems with using PFM indicators to make international comparisons. Carole Pretorius, an independent consultant, presented the approach of a World Bank study to identify and examine instances of successful PFM reform. She focused principally on practical issues of identifying and measuring successful PFM reforms. She also covered the problems of bias and inconsistency associated with standard PFM assessment and 'diagnostic' tools.

Measuring progress in budget outcomes

De Renzio placed the challenges faced in measuring PFM in the context of a broader framework which incorporates issues of budget governance. Most current initiatives that measure PFM performance, including the HIPC tracking criteria and the PEFA performance measurement framework, focus on formal PFM systems. Informal processes exist in parallel, however, and influence the working of those formal systems. De Renzio argued that, although PFM systems are intended to deliver budgetary outcomes, there is little systematic measurement of the three levels of PFM outcomes: fiscal sustainability, better resource allocation and more efficient resource use. Analysing the performance of PFM systems across these three levels is key to identifying the effectiveness of both the formal and informal systems.

De Renzio described the current status of various initiatives aimed at measuring PFM performance. Information on PFM performance is scattered, he said. Even the most systematic of these initiatives differ from each other in methodology, scope and sample, whilst time series data is scarce. De Renzio described his work as part of an exercise that is attempting to compile cross-country time series data from HIPC and PEFA initiatives to track PFM progress from 2001 to 2006, and he presented his preliminary findings.

De Renzio concluded that existing measurement frameworks should look at PFM performance in the context of the broader governance environment. Frameworks that measure PFM performance need to combine cross-country analysis with detailed case studies. To be useful, these frameworks need both better quality data and greater transparency in their findings.

Identifying success

Carole Pretorius' presentation drew on her recent involvement in a study being led by the World Bank to identify examples of successful reform across PFM systems in developing and transition countries. The core of her presentation focused on the challenges involved in the identification of success.

First, Pretorius argued that the term 'good practice' is misleading in the context of PFM, as so much of reform is locally specific. There is also no end point to good practice as an objective for PFM since improvement will always be possible. She warned against the temptation to try and transplant good practice from one country context to another.

She then examined the concept of success. In her view, success is not just limited to improvements in PFM systems as measured in PEFA. Success can also be viewed in terms of more subjective concepts, such as whether enough capacity was developed during the process. Pretorius also argued that it was necessary to consider the cost-effectiveness of a reform in order to judge its success. She noted that successful reform should be viewed as 'a journey, not a destination', and that the World Bank study suggested that declaring success before real consequences were realised risked creating disincentives for further reform efforts when necessary work remained. She also said that since success would be viewed differently by different stakeholders, it was important to consider its relevance to each.

Pretorius then examined the challenges in verifying success. These included: a lack of baseline data; the problems of attributing success in the context of Public Sector Reform; and differing interpretation of success from different stakeholders. She outlined the approach taken in several case studies (desk based and a combination of stakeholder correspondence and literature review), and the problems and contradictions faced in undertaking the studies.

She concluded with initial observations on lessons from the group of successful case studies. Those lessons included: the importance of people in each story of success; the fact that success was achieved by adapting norms to local situations; and that they involved small steps and not giant leaps.

Consensus and disagreement between presenters

The presentations covered different issues, but there was general consistency and agreement between them.

There is paucity of PFM performance data

Both presenters noted that a key constraint was the paucity of information on PFM performance, which makes it difficult to identify success objectively. However, efforts have recently been made through HIPC and now PEFA to systematise the collection and measurement of performance information on PFM systems around the whole budget cycle. Pretorius pointed to examples of contradictions and inconsistencies between the findings of different PFM measurement frameworks used by donor agencies.

The presenters were generally supportive of the PEFA framework, which has the potential of generating time series data and tracking the progress of reforms. Yet both acknowledged that the key limitation of a framework like PEFA is that it is largely focused on measuring the quality of formal PFM systems. This means it fails in two main aspects:

- It does not generate an understanding of the local context in which PFM systems operate, and the importance or functioning of informal systems.
- It does not adequately measure the sustainability of PFM outcomes. It focuses instead on intermediate formal outcomes rather than broader budget outcomes. This precludes an assessment of the effectiveness of improvements in PFM systems in generating improvements in resource allocation and resource use.

Need for improved transparency

De Renzio said there was a need for greater transparency in the publication of the results of PFM assessments, whether PEFA or the CPIA. Pretorius agreed that this could help build pressure for reform, especially in PFM processes, which can often be neglected.

Caveats to how we interpret results

One observation was that aggregate country analysis of PEFA scores does not reveal very much — the data shows few discernable trends of improvement in aspects of PFM reform overall, beyond improvements in the preparation of annual financial statements. De Renzio's presentation made clear that some aspects of PFM in countries improved while others worsened. A key conclusion was that the trajectory of reform at the country level is not smooth.

Successful reforms in one area of PFM can have unintended negative consequences in another. For instance, the establishment of a central payment process may improve efficiency but might also introduce the opportunity for corrupt practices. Whilst some stakeholders may consider a reform successful, others may not. For example, tight central controls by the ministry of finance may improve fiscal discipline but also result in line managers facing rigidities in service delivery, which result in inefficiencies. Successful reform takes place in small steps so success may only result in progress on one dimension of one PEFA indicator. Pretorius pointed out that there is a danger of declaring success in PFM reforms, as measured by an instrument such as PEFA, too early. This may dilute the pressure for actors to continue reform, before the real consequences of such reform processes have been realised.

Given the shortcomings of current PFM systems, there is a need for an approach that uses information on the status of formal PFM systems in combination with case study analysis of successful reforms to generate a more complete understanding of where progress in reforms have had an impact on PFM outcomes, and why they have been successful. To overcome the narrow focus on budget outcomes, it was also suggested that simple objective measures, which are indicative of outcomes relating to resource allocations and resource use, could be used to improve our focus. Meanwhile a more factual basis for measuring outcomes needs to be developed.

Attribution of success is difficult

Due to measurement difficulties and inconsistencies in defining budget outcomes, the attribution of success remains difficult. Initial observations from Pretorius' work suggest that the successful reforms were almost always people-related, whether individuals or networks. The technical solutions appeared to be of secondary importance. Moreover successful reforms were achieved not by applying a blueprint, but by adapting conventional wisdom to local situations.

Donors were not a contributory factor to success in PFM reforms. She argued that conditionalities were related more to the achievement of discrete activities rather than to concerns with broader budget performance. This reinforced a point from De Renzio's preliminary findings that there appears to be little correlation between bilateral donor support to PFM reform and improvements in PFM outcomes.

The debate among the participants

Support for performance measurement and the PEFA framework

Many of the participants supported some of the messages from the presenters around the usefulness of the PEFA framework. Participants agreed with the need to measure PFM outcomes, to make PEFA reports more transparent and user friendly, and to derive policy implications from the use of PEFA framework advice.

However, the dangers of taking performance measurements in the PEFA at face value were highlighted — a good PEFA score does not always mean good performance. For example, the timeliness of financial statements may have improved in many countries, but in doing so the quality may remain very poor or have even deteriorated. In one country, the Accountant General produced accounts on time, but refused to vouch for the quality of the information. This supported a point raised in Pretorius' presentation that budget support conditions associated with PFM may be interpreted as complied with, when actually such compliance may be superficial. In addition, the set of PEFA indicators may not be applicable in all countries at all times. For example, a country such as Yemen, which is dependent on natural resources for revenue, is likely to score badly on the predictability of aggregate revenues, even in the context of sound fiscal management.

One suggestion, which was supported, was to have a series of reports on different themes of PEFA to help those working in that area. Such a report would help institutions such as the African Organisation of Supreme Audit Institutions (AFROSAI) to learn from the experience of PEFA assessments and could support their work on improving PFM standards and practice.

Questioning normative assumptions

A key concern raised by one of the participants was that the efforts to measure progress in PFM reforms were based on a set of normative assumptions that have not been open to debate. For example, there are several assumptions about what constitutes the good PFM practice that underlies the PEFA framework. The applicability of these normative assumptions, which are based on formal PFM systems, needs to be opened up for debate, especially in the context of weak governance environments. This argument lent weight to Pretorius' findings that success often involves the adaptation of conventional wisdom to local situations.

Understanding success and failure

Much of the discussion amongst the participants focused on the problems of identifying success and failure, and understanding success. Some concern was raised that the emerging World Bank study finding – that successes are people-related – would make it difficult to derive implications for reform. The importance of understanding the factors that cause reforms to succeed was widely endorsed, and the substantial time and effort needed to do so was widely acknowledged. Another key point, endorsed by the presenters and participants, was the importance of identifying and understanding failure. Whilst successes are often specific, failures may turn out to be more generic, and so be easier to learn lessons from. In addition, initial successes are not always sustained, and it is important to understand why they are not.

PFM performance and donor programmes

Participants raised concern with respect to an observation from De Renzio's presentation that there was no apparent correlation between bilateral support to PFM and improvements in HIPC/PEFA indicators. Another participant countered this by citing a published report from the OED of the World Bank, which found that two thirds of countries being supported by a Bank PFM project showed an improvement in PFM systems. It was agreed that this issue needed to be investigated in more depth.

Session 2 conclusions

Evidently, PFM reform is complex. Successful reform tends to take place incrementally, and progress in some areas may result in a deterioration in others. Reform is not just technical — people and the local context are important. However, there is a clear need to continue to deepen our understanding of successful PFM reform.

- Better data is needed on PFM performance. Initiatives to measure the performance of PFM systems such as PEFA are proving valuable and should be maintained. Data and objective methodologies for measuring PFM outcomes need to be developed.

- It is important to debate the importance of the normative assumptions that underlie PFM performance measurement, with a view to understanding how formal and informal PFM systems contribute towards PFM outcomes.

- How success is viewed needs to be analysed in closer detail taking into account various definition of success; success from the perspective of different stakeholders; the opportunity cost of such success and whether it is sustainable and therefore replicable.

- In parallel, deepening understanding of why reforms are successful is crucial. It is equally important to understand and draw lessons from failures as well as successes.

- The contribution of donor programmes towards PFM performance needs to be questioned in more detail.

What kind of PFM reforms have succeeded and why? Reflections from country reformers

Session 3

Chair: Malcolm Holmes, Independent PEM Specialist

Speakers: Mario Marcel, Politeia Public Solutions, Chile
– *PFM reform in an expansionary environment: The case of Chile*

Sok Saravuth, Ministry of Finance, Cambodia
– *The Cambodia experience: Four platforms towards international standards*

Ranjit Chakraborty, Ministry of Finance, Bangladesh
– *Experiences from Bangladesh*

The presentations for this session can be found in Appendix 2 or online at:
www.odi.org.uk/events/CAPE_conference_2007

Introduction

This session used country case studies to explore the history of successful PFM reforms in challenging environments. It addressed several questions relevant to policy-makers and researchers: Which PFM reforms have succeeded in those countries with a challenging governance environment? In what sequence were the reforms pursued? Why were those particular reforms initiated and pursued? What factors enabled the reforms to succeed? To what extent did those PFM reforms directly motivate wider-ranging PFM reforms and lead to improved PFM outcomes? And how far did the reforms contribute to wider public sector reform and improvements in governance?

PFM reforms are at the centre of current international efforts to support the development of more effective states. Yet despite high and increasing levels of spending on support to PFM reforms, the systems are still very weak in many low-income and transition countries. Although there has been no comprehensive cross-country comparative analysis of PFM reforms, there is at least a realisation that outcomes have not tended to be commensurate with the level of investment. The lessons learned here are applicable to a wide range of countries.

Main issues and the presenters' arguments

PFM reform in an expansionary environment — the case of Chile

The Chilean experience, as presented by Mario Marcel, has been marked by a long-term and highly successful reform project driven by a powerful Ministry of Finance (and Budget Office) operating at the heart of Chile's highly centralised government. Particularly in the past few years, Chile's reform has taken place in a macroeconomic and fiscally 'expansionary environment', which, while not a 'challenging governance environment' as such, is not necessarily conducive to reforms and sometimes makes reform management more difficult. Chile's political landscape has been characterised by strong political continuity and a highly unitary state. Fiscally, the government has a strong record of prudence, running overall surpluses in 16 of 20 years partly as a result of strong revenue growth. The volatility of revenues, primarily due to fluctuations in the price of copper, has led policymakers to place a strong emphasis on stabilisation.

Among the drivers for PFM reform in Chile has been the centralisation of power within the executive (members of Congress cannot initiate legislation for example). In addition, the expansionary environment has been seen as a threat to fiscal discipline, as exemplified by unsustainable commitments made by governments in earlier expansionary periods and which made a more rational resource allocation more difficult. Political change, with the election of a new president in 2000 and a major corruption scandal in 2003 has meant that the need for PFM reform has been very strongly felt. The population's expectations regarding the role of the public sector have been raised, coupled with a more inquisitive media and pressure from investors.

There are essentially four constituent parts to good PFM: (i) macro effectiveness; (ii) efficiency in allocation of resources; (iii) efficiency in use of resources; and (iv) increased transparency (i.e. the ends do not justify the means). Taking each in turn, macro effectiveness was given a major boost by the introduction of a structural balance fiscal rule in 2000 which built in an annual structural surplus of 1% of GDP (now 0.5%) once the cyclical component of revenue is corrected for. This marked a transition from discretionary prudence to a more formal approach. Indeed, this sort of rule is better than the European "Growth and Stability Pact" budget deficit rule as it can be monitored and controlled in real time throughout the year, rather than being measured after the event. The rule does not, however, have a firm basis in the constitution or in legislation.[2] Regarding allocative efficiency, this element is addressed through performance-based budgeting. Here, there are four conditions. Firstly, the collation of performance information via rigorous monitoring and evaluation (impact-evaluation and benchmarking). This is a necessary condition, but not sufficient. Thus, secondly, it is crucial to adapt budget processes so that they actually use performance information, using the budget as a decision-making exercise. Thirdly, output is not generated by the Ministry of Finance but by agencies and ministries, and thus, performance management must be built into these organisations. Finally, management flexibility is key to achieving results. This is not a reform that has happened overnight in Chile. Its roots go back at least to 1975 with the adoption and use of rigorous project appraisal for investments, with a later set of reforms building on this in the second half of the 1990s, adding a further five tools to Performance Based Budgeting (PBB).

One aspect of the reforms is that when the budget was discussed in Congress, it was apparent that many of the questions that politicians raised did not have clear answers or were not addressed properly by recourse to the numbers. It was therefore agreed to introduce a signed "budget protocol", which collected together issues raised during the budget process and through which the government would commit with Congress to take action; this has generated a useful dialogue between politicians and bureaucrats. Even though the executive promotes most of the ideas, the fact that it arises during the budget process is important.

Overall, the reforms have been highly successful, with a financial management system now in place that is sufficiently flexible to allow extensive reallocation to support government priorities. As a result, important government commitments are no longer blocked by a lack of funds. Use of PBB by a wide range of actors has changed the managerial culture in government and helped the government to respond to unforeseen events (such as political scandals).

There have also been failures, however. Introducing indicator-based performance pay has proved particularly difficult (with around 98% of public servants in the top performance pay bracket) since the Ministry of Finance had no way of checking whether the goals were really challenging. Sub-institutional team-based performance pay has also foundered. Some key obstacles include the continuing use of outdated pre-audit controls in external audit, which have lead to conflicts of interest and reduced effectiveness. Ministerial involvement has also been limited as line ministries were squeezed out by the powerful Ministry of Finance and executive agencies.

2 The fiscal rule is based on a 2006 bill that requires future governments to generate a decree defining the type of fiscal policy they will follow and calculating the structural balance.

A particularly important issue in future will be building a constituency for change and bringing politicians on board more comprehensively. This has already been done to some extent in that the Ministry of Finance approached Congress and agreed that the budget committee would work throughout the year and play a role in reviewing performance information. This is helpful in the dissemination of ideas and has generated dialogue.

The Cambodia experience: four platforms toward international standards

Sok Saravuth addressed the reasons behind Cambodia's adoption of a platform model of PFM reform. He sought to show what has been achieved in the first 2.5 years of implementation, emphasising lessons learnt and challenges encountered. Cambodia is in the middle of a transition phase between the first and second platforms, so this is a good point at which to take stock of progress and also to plan ahead.

On technical issues, there are three key areas that characterise strong PFM systems: (i) fiscal sustainability; (ii) prioritisation of resource allocation; and (iii) efficient and effective use of resources for service delivery. Cambodia's PFM system, like most other countries', has weaknesses in these areas. Previous reform efforts had attempted to address these three technical issues in an ad hoc and uncoordinated manner since 1995, under weak government ownership. This made it difficult for the Ministry of Economy and Finance to see the overall picture and gauge where things were heading. Indeed, there was no clear relationship between the amount of donor spending on PFM reform and progress.

To address these problems in a more systematic way, Cambodia adopted the 'platform approach', using international standards in PFM as benchmarks to define what the country needed. The first platform focused on budget credibility, which entailed a streamlined process of budget execution, improving the use of the banking system, cash management, improving the treasury single account and consolidating the government bank accounts, arrears management and procurement reform. It also involved a capacity-development programme and the introduction of a merit-based pay initiative. Early results suggest that revenue administration and collection has improved significantly, as has budget formulation and execution.

Government ownership, leadership and commitment have been crucial in achieving these gains. Saravuth questioned for whom measurement indicators were most useful: if the reform is truly government owned, the indicators should be for the benefit of the government alone. A common understanding between government and development partners of the problems and the strategy to address them is also crucial. The platform approach is founded on a clear vision of where the process is going and how to get there, with commonly agreed performance measures.

A further challenge is that of sequencing reforms. At times, reforms in Cambodia have happened in the wrong order, for example, the development of a good macro-fiscal model without having any data. Donor funding comprises about half of the government budget and yet much of this operates outside of the treasury, which undermines the government's ability to analyse spending patterns. The new Chart of Accounts is sufficient for government to introduce accrual based accounting, yet the components required to do this are not yet in place. In particular, institutional and motivational reforms cannot advance in the absence of an overall civil service reform policy.

What is next for Cambodia? The government has prepared a consolidated action plan, which is currently under review. The transition to the second platform will require a number of alterations to the management structure, with the government committee on economic and financial policy taking the lead and the establishment of reform working groups in all line ministries.

In conclusion, success has been based on a clear and common understanding of the objectives, articulated through a strategic plan. Having achieved significant results, the reform programme is gathering support. Key determinants of success include sustained commitment, leadership, ownership, capacity development and motivational measures.

Experiences from Bangladesh

This presentation by Ranjit Chakraborty set out the guiding principles behind PFM reform in Bangladesh, establishing the background, highlighting achievements, constraints and challenges and looking forward to planned PFM reforms.

The two key guiding principles behind PFM reform in Bangladesh have been, first, it is a home-grown initiative championed by the finance ministry and, second, the government has followed an incremental rather than a 'big bang' approach.

Concerted PFM reform in Bangladesh began in 1989 when the government constituted the Committee on Reforms in Budgeting and Expenditure Controls and its recommendations fed into a phase of reform in 1989–90. Subsequent reform efforts have been somewhat patchy, with a second set of reforms under the Reforms in Budgeting and Expenditure Control Project (1993–2002), and a third from 2003 onwards known as the Financial Management Reform Project. A key challenge has therefore been in maintaining impetus for reform and minimising the gaps between reform programmes (the first of which was caused, one participant suggested, because donors were not able to coordinate their support to PFM). With the latest batch of reforms, the first phase focused on technical improvements, including consolidation of financial data, streamlining of budget administration and effectiveness of external audit while the second phase of reform focused on improvements to resource management brought about largely by the MTEF.

A central component of reforms has been a strong emphasis on automation of financial information and the use of information technology to do so, with a robust IT system rolled out to district level. This automation, along with training and capacity-building (around 16,000 civil servants have received some form of training under the current reform programme), has been regarded as a crosscutting component of the reform programme. Indeed, the computerisation of budget and accounting processes is seen as one of the big achievements of the Bangladeshi reform programme, improving the consolidation and presentation of financial information. The MTEF approach to budgeting (being developed at line Ministry rather than national level and covering only 50% of expenditures) is being introduced as a tool to introduce the PRSP at line ministry level.

Constraints include an archaic regulatory framework with old rules and regulations and a largely manual accounting system, large numbers of staff to train and high transaction volumes coupled with poor infrastructure. As an example, the Controller General of Accounts Department is vast, employing over 6,000 people and processing roughly 3 million transactions per month. On top of this, some institutions have not yet bought into the process. For example, the Planning Commission has an ethos developed under a command economy, which is hard to alter. Ownership of reforms by the 'political masters' is also a weak area and will take time to develop, with careful 'tutoring' from public servants required. Also, complementary and parallel reforms in different areas are essential in order to take things forward, in particular in the restructuring of the Bangladeshi civil service.

In summary, previous reform efforts have been led in a somewhat opportunistic way and have been heavily reliant on the recommendations of the Committee on Reforms in Budgeting and Expenditure Controls. On the future direction of reforms, the Government's PFM Vision, developed in 2006, commits Bangladesh to maintain fiscal discipline, promote the efficient use of public resources, encourage better budget execution and enhanced transparency. It also aims to broaden the constituency and coverage of reform rather than focusing narrowly on the finance division, and engage civil society and parliament more proactively.

Consensus and disagreement between presenters

A key area of consensus amongst the presenters was the emphasis placed on the need for (and difficulty of achieving) parallel civil service reforms alongside, and coordinated with, PFM reforms. In all three countries, this was identified as a constraint on progress in PFM reform, which has proved difficult to address.

Precisely because civil service reform is not progressing in Cambodia, the Ministry of Economy and Finance is using a merit-based pay initiative to top-up high-performing staff salaries and to push the implementation of the PFM reform programme. There was also a broad consensus regarding the centrality of macroeconomic balance and fiscal discipline to good PFM and the importance of budget credibility in delivering on the latter.

There were – understandably so given the diversity of the countries under discussion – differences regarding the types of PFM reforms that were prioritised and the timeframes over which reforms had taken place. Chile's reform programme has a long legacy dating back at least to the mid-1970s. It emphasised the development of a cadre of highly skilled technicians within the Ministry of Finance (together with a supporting network of external evaluators later on) who were later armed with a set of analytical tools that allowed them to improve the allocation and efficiency of public expenditures. While capacity development also plays a key role in Cambodia and Bangladesh, it is concurrent with other systemic reforms. The very strong role of the Ministry of Finance and the relatively weak role of Congress in Chile also meant that securing buy-in from line ministries for quite substantial reforms that sought to alter incentive structures has been less of a challenge than in the other two cases (with the exception of Chile's Ministry of Defence). Finally, despite the depth and success of Chilean reforms, they were actually developed without explicit strategic planning for PFM reform. In Cambodia and Bangladesh, which have numerous donors, good strategic planning had been essential for organising donors — as evidenced by the piecemeal and uncoordinated efforts in Cambodia prior to the introduction of the platform approach.

Cambodia has a much shorter record of concerted reform to draw on than Chile or even Bangladesh, having only started to address PFM reform in a genuinely coherent way two and a half years ago. It has also adopted a more ambitious set of reforms than Chile originally took on at the outset of its reforms in the 1970s, although its platforms are probably more focused than the Bangladeshi reform programme, which has elements addressing all stages of the budget cycle. A strong defining feature of the Bangladeshi reform programme is the strong emphasis placed on technical reforms such as the adoption and roll out of strong IT systems and very comprehensive training programmes. While Chile has by far the strongest Ministry of Finance of the three countries, the Ministry of Economy and Finance (MEF) also has quite a powerful role in Cambodia.

The debate among the participants

The main point of consensus amongst participants was that the presenters had tended to provide highly technical accounts of reform, with relatively little emphasis placed on the facilitating or hindering role played by political actors and politics more generally. Many participants therefore attempted to provide more detail on the political economy context within which the country reforms had taken place, particularly in Chile and Cambodia.

In Chile, the presentation was seen as incomplete on the link between politics and public reform. By 1990, even by the standards of military dictatorships, there was an extreme concentration of executive power in Chile. 1974–89 saw a major restructuring of Chile's public sector, with massive reductions of staffing and the introduction of a culture that valued the private sector over the public. This political environment provided a space for the introduction of technical cadres, particularly in economics, into the heart of the public service and particularly the Ministry of Finance, who were to drive the project evaluation methodology that was adopted. Indeed, a whole range of PFM reforms were pioneered under the protection of military dictatorship, including project appraisal, education vouchers, public-private partnerships and targeted benefits.

In 1990, the generation of politicians who came to power after General Pinochet were extremely cautious about doing anything that could trigger economic instability, political conflict and ultimately a military coup (Pinochet continued as chief of the general staff and many judges and senators remained loyal to him). They therefore continued to provide a great deal of space to technocrats. Unsurprisingly then, it has been a very slow and gradual process that has seen confidence grow among civilian politicians to be able to take on a larger and more robust oversight role. The key message is that many technical reforms in Chile emerged and were consolidated under military dictatorship.

The extent to which the Chilean reforms were genuinely 'home-grown' was also discussed. That they were 'home-grown' is true in the sense that they were neither donor-driven nor based on IMF conditionality. However, it was recognised that key officials had sought to learn from experience in many other countries, with visits to the UK and Australia amongst other countries. There are also genuinely innovative elements to the Chilean reforms. The strong emphasis on management performance and the structural balance rule are cases in point (although the latter drew on ideas developed by the IMF, it had not yet been implemented by any other government —Sweden and Switzerland now use them).

In Cambodia, the fundamental political equilibrium changed in the late 1990s. The first elections after the civil war were held in 1993, and resulted in a complex power-sharing arrangement, which paralysed government activity. There was also a peacekeeping mentality amongst donors whereby nobody sought to challenge the new order for fear of triggering conflict. Following a coup in July 1997, elections were held which provided the winning party with a far stronger mandate to govern. As a result, while there are still power-sharing arrangements in place, there is now a much stronger central regime than in the past which has given an ability to take stronger moves to address concerns about an undiversified economy, attracting Foreign Direct Investment, the need for basic infrastructure. Some key people, including the Minister of Finance, have been pushing the latter. Donors are now becoming more demanding now that a stable government is in place.

There are complicating features however. Different powerful actors within the ruling party have control over different aspects of reform. While the Minister of Finance is one of these, the person primarily in charge of the Council on Administrative Reform is from a different faction within the ruling party, which explains why civil service reform has been allowed to remain separate. This division also serves other actors both amongst donors and domestically, with extensive off-budget expenditures. Thus, there is a high-profile PFM reform programme moving forward at the same time as high volumes of donor aid is being channelled through projects associated with particular sectoral ministries that allow the donors to be able to operate unencumbered by the requirements of the PFM reforms. Part of the strategy the Prime Minister has used to deal with the donors involved is to bring in young, western-educated, reform-minded people in to replace the old guard of bureaucrats in all the senior civil service positions. The proactive Minister of Finance, relatively powerful within the party and with influence over the Prime Minister, was able to get a new generation of technocrats introduced who are now leading PFM reform from within the Ministry of Economy and Finance (MEF) (albeit still subject to some of the old political constraints).

By helping line ministries get their money on time, the reforms have won over actors beyond the MEF through demonstrating clear benefits of reform. Cambodia still lacks a clear policy on staff retention. MEF is pushing for a more comprehensive Public Sector Reform policy, with support from development partners, but the Council for Administrative Reform is responsible for this effort, which has stalled.

Despite the many phases to reform in Bangladesh and the substantial donor support, the country scored low on the 2005 PEFA assessment. Is Public Expenditure and Financial Accountability (PEFA) measuring the wrong things or is Bangladesh missing something in its reform efforts? Is reform likely to move at a faster rate in the future? Overall, the results of reforms are not that spectacular in Bangladesh. For the future, previous reforms have laid the foundations. What is now required is a cultural change, for example in using the Medium-Term Budgetary Framework in line ministries. The government is trying to address this through vocational training. Civil service reform and reform coordination in Bangladesh is difficult. Successive reform commissions have delivered their recommendations but these could not be implemented. In particular, in the line ministries capacity is still a constraint to more thorough reform.

Session 3 conclusions

A great deal can be done towards delivering technical level PFM reforms without explicit political support or buy in, but only up to a point. A key challenge is to ensure that PFM reform is coordinated with concerted reform efforts in other areas of government policy, and in particular in the area of public sector reform. This has been a key stumbling block in all three of the countries under discussion.

Further, while reform in Cambodia and Bangladesh to date has undoubtedly involved a high degree of managerial effort, it has arguably not incurred a high political cost. Making the budget credible (i.e. balancing revenues and expenditures) in a context of fast growth does not involve real political costs. While much more thorough reforms were delivered in Chile, these were crucially dependent on the support (and legacy) of a military regime which provided an almost unprecedented degree of centralised control and a significant amount of space and support to technical cadres in the public sector.

Three themes recur: (i) a strong and politically engaged middle class; (ii) the role of the donors; and (iii) the 'freemasonry' or informal networks of influence within the senior public service. Neither Cambodia nor Bangladesh has a large or demanding middle class. Donor support can essentially be regarded as a given failing a massive deterioration in governance quality. This means that the only tractable issue seems to be the issue of the freemasonry of senior officials within government.

There was a disconnect between the technical focus of the presentations and the political economy issues raised by participants in plenary session. Aclearer picture is needed of how the successes and failures on the technical side have been shaped by political economy considerations and the roles played by political actors. Further, given the limited scope for meaningful interventions at a political level and the absence of large and engaged middle classes in Cambodia and Bangladesh, future investigation might therefore focus in particular on the role played by senior technocrats. What do these individuals do to make these reforms sustainable? Is it a question of one or two particular people in key positions or is there a deeper-rooted culture at work?

What are the key explanatory factors underlying successful PFM reform?

Session 4

Chair: Andrés Mejia Acosta, Institute of Development Studies

Speakers: Nick Manning, World Bank
– *Good budgetary institutions and a good Civil Service: Two sides of the same coin?*

Ian Lienert, International Monetary Fund
– *Influences on PFM reforms other than that of the executive branch of government*

Carlos Scartascini, Inter-American Development Bank
– *Fiscal reforms in Latin America: A 'new' political economy perspective*

The presentations for this session can be found in Appendix 2 or online at: www.odi.org.uk/events/CAPE_conference_2007

Introduction

Country evidence from session 3 suggests that PFM reform has been successful even in 'unfavourable' governance environments. Session 4 explored the factors that facilitate and sustain such reform in a variety of contexts, and the role of actors in affecting the progress and success of reforms. The range of actors includes those in the executive and bureaucracy, as well as various domestic political actors, each of whom can influence the initiation and progress of PFM reforms in difficult contexts. Key external actors include: interest and pressure groups; the external audit office; independent inspectorates; opposition parties; the legislature and non-government parliamentarians; civil society and NGOs; business and the private sector; donors agencies; and the media. The session examined what combination of factors or sequencing might enable a country to successfully reform its budgetary system.

The session examined the pressure that these various groups can exert on PFM reforms. Presenters drew on the experiences of successful and unsuccessful PFM reforms in different governance environments, and on analytical frameworks, to explore why change was rapid in some countries but not in others. They considered the impact of domestic accountability mechanisms and institutional checks and balances in sustaining reform progress and in preventing the quality of reformed PFM outcomes from regressing, among other things.

Main issues and the presenters' arguments

The relationship between civil service reform and effective PFM

Nick Manning focused on the link between PFM reforms and wider civil service reforms. He pointed to a distinction between the capacity-building focus of civil service reform initiatives that typically deal with central government ministries, and the fiscal weight associated with public liability for the salaries of a much larger group of public sector employees.

Manning emphasised that there are different starting points for reform and gave examples of some PFM reforms that could be undertaken in isolation from wider civil-service reform or had to precede civil-service reforms. However, if these PFM reforms were not matched with complementary civil service reforms, they would be pointless. He cited, for example, the success in improving budget reporting across many countries but noted that these reforms often sat alongside an inability to grapple with chronically low pay and over-extended public employment. Reforming core budget machinery is only a starting point because the civil service management issues must be dealt with eventually for such reform to be meaningful. In terms of budget preparation, Manning noted that the wage-bill is a significant determinant of expenditure allocation and thus public finance policy. Where this is excessive and uncontrolled, good PFM outcomes are unattainable. Effective service delivery is also impossible without addressing public sector employment, irrespective of whether there are hierarchical public administration or quasi-contractual public management arrangements in place.

Manning presented World Bank CPIA data showing that, in low-income countries, improvements in PFM have typically not been followed or matched by improvements in public administration. He argued against the tendency of many donor-led PFM reform initiatives to focus exclusively on building up finance ministry capacity because the effectiveness of the strengthened finance ministry would be undermined by larger forces. He cited negative examples from Brazil, Honduras and Peru; although he did also note that a PFM-led approach has apparently proven successful in Chile and Guatemala.

Thus, PFM reforms can be a starting point, but civil service reforms must follow; and the failure to address civil service management issues is often a brake on progress. This has two main implications for the way we approach reform.

First, civil service reform must be implemented in the most appropriate technical way. This does not necessarily imply the best possible technical solutions, but rather ones that are most likely to work. In fact, introducing advanced technical solutions (such as quasi-contracts) in institutionally weak environments is unlikely to be useful because of problems with distorted information, gaming and cheating over performance, and credibility of contract enforcement. Traditional hierarchical contracts will be more effective in weaker institutional environments.

Second, political economy analysis needs to inform strategies to stimulate the demand side of reform. Political leadership should not be treated as a given, and a better understanding is required of the factors influencing senior-level political motivations and exchange. It may be necessary to demonstrate the benefits to the public of improved public services in order to change public expectations and thus influence political incentives for reform by stimulating domestic demand pressure. Manning presented data for Latin America showing that economic policy has resulted in little benefit for the poor, tax policy has not reduced inequality, and there is little confidence in governments' fiscal wisdom. He concluded that work is required to change public expectations about what governments actually deliver.

Influence of demand side actors on PFM reform performance and sustainability

Ian Lienert addressed the relative influence of parliaments, external audit offices, independent agencies (e.g. anti-corruption commissions), civil society groups, media and donors to see how actors outside the executive branch of government could influence the nature and progress of PFM reforms.

He noted that the influence of parliaments may be determined in part by the powers that they exercise over the constitutional system, and he contrasted the independent role and strength of the legislature in the USA with the UK system. Based on a typology of different states from Westminster-type parliamentary through to US-style presidential, he hypothesised that the budgetary powers of parliaments in OECD countries may be highly correlated with their PFM reform capability and thus potential influence. Budgetary powers of the legislature typically centre on budget approval, budget reporting and external audit follow-up, with considerable variations existing between countries. Through these functions, there may be opportunity to influence change.

In advanced countries, the executive tends to be the dominant force in initiating PFM reforms, especially with regard to macro-fiscal stability, reorganisation of budget management responsibilities, internal control, performance and transparency. However, the legislature can also be an influential actor in some these same areas of reform (e.g. France and the USA). It can have the power to impose stronger accountability on the executive, to restrict flexibility through the appropriation process, and to require greater transparency around fiscal objectives and information. In practice, evidence from OECD countries suggests that substantive PFM reforms (as reflected in changes to budget system laws) are rare. With the exception of the USA, the balance between executive and parliamentary influence is strongly skewed towards the former.

Lienert suggested that the legislature's potential influence over PFM reforms in OECD countries is equivalent to international donor influence in developing countries. Although developing-country parliaments are starting to become more influential, fundamental weaknesses in their capacity and effective powers thwart their capability. External audit offices, anti-corruption agencies and financial inspectorates, and other external domestic actors all have a similarly weak influence. There is a strong mentality of "serving the president" within the executive and that may counteract other domestic pressures for reform.

Donors have a strong influence on PFM systems and budgetary practices, but there are strong contradictions within their approach: they are promoting the development of democratic institutions (including that of parliaments), while at the same time influencing government budgets through dialogue, expenditure reviews and conditionalities. Lienert questioned the need for donor conditionalities, arguing that they are not always implemented effectively, and even when implemented, the reform might have been one the government would have put in place in any case.

In summary, most systems in developing countries tend to be dominated by the executive body. Although the role of parliaments and civil societies in reform processes is increasing, they remain relatively uninfluential. Parliament could initiate PFM reforms to strengthen its own budgetary powers, but changing the internal control of parliament has not yet been on the agenda for developing countries. By contrast, donors seem to exercise considerable influence on reform processes. Lienert asserted that the main research question is to investigate the relative influences of the political executive and the civil service on PFM reforms.

The political economy of fiscal reforms in Latin America

Carlos Scartascini provided an analysis of fiscal reforms in Latin America since 1990, focusing especially on the role of budgeting institutions: numerical rules such as fiscal frameworks and debt constraints; procedural rules in the form of norms and regulations governing the prerogatives of actors in the budget process (e.g. discretionary powers of the Minister of Finance); and transparency rules governing public presentation of budget-related information that provide a check on circumvention of other rules.

This typology is a useful framework, but risks defining reforms only in terms of formal rules rather than actual practices. It is also based on a normative construct linked to fiscal sustainability, which assumes this to have been the purpose of the reforms. The evidence from studies on the USA, EU countries and Latin American countries is that strong budget institutions are associated with smaller deficits and robust fiscal performance.

Scartascini summarised three main stages of reform: financial management information systems in the 1990s to increase transparency; numerical fiscal rules linked to broader fiscal responsibility laws in the early 2000s; and performance budgeting reforms even more recently that have sought to improve public confidence in resource allocation and service delivery. All Latin American countries have undertaken some fiscal reforms and these have been concentrated on the period after 2000.

Despite extensive literature on the determinants of economic and fiscal reform, the need remains for a more comprehensive framework to explain the reforms and in particular why some have not prospered.

Evidence suggests that some countries have not improved their fiscal balance despite the introduction of fiscal rules. Scartascini showed a comparative analysis of Argentina, Brazil, Chile and Peru — all of which had introduced numerical rules in order to improve fiscal sustainability. Chile has achieved greatest success using the least stringent type of reform (i.e. political commitment rather than legislative change) and has met the structural balance target of 1% of GDP surplus. Brazil's success lies in changes to the incentives of actors. In Argentina, the deficit limit in the Fiscal Solvency Law was consistently overshot between 1999 and 2003 despite upward revision of this limit. The fiscal balance has ostensibly been met since 2003, but the structural balance (after adjusting revenues for commodity prices) shows a deficit of –3.4% in 2006. The effect of the fiscal sustainability legislation is apparently paradoxical since Argentina was running a positive structural balance prior to the introduction of the law. In general in Latin America, laws and restrictions have been frequently circumvented by changes to revenue projections immediately before legislative appropriation; reallocation of expenditure from earmarked items; and variance of expenditure allocation in budget execution.

Scartascini highlighted some lessons from this experience. First, measuring reforms is complicated and institutional reforms occur frequently as presidents gain or lose bargaining power in relation to other actors (especially the legislature) because of changing political opinion polls. Second, it is difficult to measure the success of fiscal reforms. Third, advanced financial management systems may not be necessary for fiscal reforms to succeed.

Scartascini proposed a new framework of analysis that takes the political economy of PFM reforms into account. This framework would recognise the budget process as being part of the core of general policymaking process and would analyse the incentives of actors from a general equilibrium perspective. Reforms need to be understood as the outcome of a bargaining process between many actors with different incentives. Scartascini argued that substantive reforms can only occur if domestic actors change the status quo or adapt to an exogenous change in status quo. Changes introduced by external actors would not be sustainable unless they changed the incentives for each stakeholder, the number of actors, the discount factors they placed on time, or the arena in which they interact. The most effective reforms have been those that were either introduced endogenously or that modified the incentives of those in power. The main policy implication of this analysis, Scartascini argued, is that reformers need to have an in-depth knowledge of countries before instigating reform.

Consensus and disagreement among the presenters

All three presenters acknowledged that addressing political economy issues is an important challenge, especially for practitioners involved in work on PFM reform.

Role of politics

The speakers discussed how politics could best be 'endogenised' within reform processes. Scartascini said reforms introduced in Latin America only had an impact when there were changes in the incentives to actors involved in reform processes.

Lienert suggested that because the executive remained the dominant actor in PFM reform processes, research is needed more to understand the interaction between actors within the executive than to investigate the link between the executive and other domestic and external actors. Manning, on the other hand, argued that more could be done on the demand side. Ways need to be found of changing public expectations so they can influence political decision-making processes.

Limitations to technical solutions

Manning and Scartascini both emphasised that while technically sound reforms were important, there are limitations to their success. For instance, Manning argued, building capacity in finance ministries is important but only a temporary fix, and not a sustainable approach, because such efforts could be undermined by the behaviour of other agencies. For example a credible budget might not guarantee efficient service delivery.

Scartascini argued that reforms that appeared technically sound in some countries may not work in others where they could be undermined by informal practices. For example, fiscal limits have not always been binding in some Latin American countries. There seemed little correlation between the level of sophistication of reforms introduced to financial systems and their success — some outcomes could be achieved with even the most rudimentary of changes.

The importance of transparency and accountability

All three speakers emphasised the importance of accountability when considering which approach to PFM reform was likely to be successful. Scartascini highlighted the importance of transparency rules — without these, numerical or procedural rules could not be enforced as the relevant actors would not be held accountable. Lienert cautioned that a lack of transparency of the budget — essential to providing parliament with the power to scrutinize the budget — could lead to excessive executive power. The importance of transparency raised the question of how countries with weak institutional environments could successfully reform. Manning argued that holding public servants accountable had different implications in different institutional settings. In weak institutional environments, a hierarchical structure could work, whereas contractual arrangements might be preferred in strong institutional environments.

Role of donors

Both Manning and Lienert expressed concern about the role of donors. Manning warned that the emphasis on a political economy approach to PFM reform had translated into a weakening of the quality of technical advice on reform processes. Lienert noted the contradictory positions of donors that influenced recipient governments' budgets and also insisted upon stronger democratic processes. The implementation of conditions and technical assistance had led to mixed results in the past. He argued that ensuring donor coordination and local ownership of the reforms would lead to more success donor efforts. However, Scartascini emphasised that in Latin America, many reforms would have taken place regardless of donor involvement. And some countries, for example Bolivia, were unable to improve their fiscal balance despite substantial donor support.

The presenters each offered different thoughts on the way forward for PFM reform agendas. Scartascini warned that the advice on reforms from International Financial Institutions must change substantially. Donors must avoid using the same system for all countries, relying instead on in-depth country knowledge. Manning suggested that donors may need to understand the politics and sociology of senior civil servants. He suggested that networks of senior civil servants may be more influential than formal hierarchical arrangements. Lienert also highlighted the need to address the incentives of senior civil servants and argued that little attention had been given to the power within the executive.

Partial versus general equilibrium analysis

Manning and Scartascini pointed out that it was a mistake to analyse parts of the budget process individually rather than viewing PFM reforms as part of the wider policymaking process. Scartascini argued that a general equilibrium perspective on PFM reforms that took into account the interaction between fiscal institutions and other areas in the policymaking arena, would be most useful. Manning identified the link between civil service reform and PFM reform as being crucial to success.

The debate among the participants

More research on political economy issues

Participants argued that researchers had yet to fully recognise, understand and operationalise political economy analysis. They argued that there was no 'one size fits all' approach to political economy issues. Different tax and spending regimes existed in different countries. Therefore, researchers should examine how different approaches to reform operate in different institutional environments.

There was consensus that such research should lead to policy recommendations. Some political economy insights have not proved to be operationally useful. Instead, implications of the emphasis on more political understanding have perversely meant that projects are run as before but with less emphasis on technical inputs. World Bank analysis in this area was thought to be useful contribution. However, delegates argued that the Bank needs to widen its definition of stakeholders by including civil society organisations to a greater extent rather than focusing so heavily on the government.

Participants also emphasised that political influence on reform processes should not be thought of as incidental — decisions such as those regarding wages and salaries were the outcome of careful political strategies.

Creating demand for change

Participants thought that the apathy in public expectations needed to be examined more fully. If the problem was a lack of public information then it was unclear who could lead an initiative to increase access to information. Existing diagnostics such as Poverty and Social Impact Assessments (PSIAs) should engage with the public in order to create more demand for change.

However, the suitability or legitimacy of external agents creating greater internal demand for reform was also questioned.

Role of actors

The roles of various actors were discussed. Increasing power to parliament was considered by some to be risky, as parliaments were likely to be driven by their own incentives, which could conflict with progress in PFM reform.

The degree to which donors or other pro-reform actors could help insulate technocrats from political pressures was questioned. More research is needed on the interaction between technocrats and politicians. One suggestion was that effort needed to be focused on making political benefits clearer to politicians. For instance, reforms to budget systems actually give politicians more tools to implement political decisions rather than undermining their role.

Participants also questioned whether opportunities for reform that exist at the state-level rather than at the executive-legislative level could be exploited.

What are the implications for donors? It was unclear whether they were able to generate the demand for reforms. Some suggested donors might not have adequate country-specific knowledge to do this. Furthermore, it was questioned whether donors could be undermining reforms. Another problem facing donors was how to transfer institutional knowledge to newly arriving staff from donor agencies. Some participants believed that staff lacked support in this area from their institutions.

Technical solutions to reform

A participant suggested that 'good enough' PFM reforms should be considered for two reasons. First, as Nick Manning suggested, simple reforms seemed to work better. Second there appeared to be much that still needed to be achieved on core PFM functions. It was also suggested that practitioners might be aiming too high in their reform goals.

One theory was to create an external incentive to improve budget systems by rewarding well-functioning systems with more resources. Although donors provided budget support and technical assistance, whether the private sector could provide such incentives for change was unclear. Participants suggested that those offering finance should not also provide advice on reform.

Dependence of PFM on Civil Service Reform

Participants agreed with Manning's suggestion that public-sector wage bills were problematic for the sustainability of PFM reforms. What is challenging, especially in the context of fragile states, is the existence of a large service wage bill overall but low individual pay, which provides little incentive for civil servants to perform efficiently.

However, it was unclear what the dependence of PFM on civil service reform (CSR) means for the sequencing of reform processes. Also unclear is how a country could move out of capacity constraints and in what time frame. One way of understanding this could be to examine what civil service reforms were needed at each of the three levels of PFM reform — i.e. the number of civil servants; their pay and their performance could be related to issues of fiscal sustainability; resource allocation and resource use.

Session 4 conclusions

This session produced several observations on 'theories of change' associated with PFM reform rather than firm conclusions on how such reform processes can be motivated and sustained:

- Political economy considerations are crucial in the analysis of PFM reform. To conclude whether a reform was likely to be successful, we need to examine the incentives of key actors. In particular, more attention should be given to the incentives of civil servants, public sector pay and the power within the powerful executive branch.

- Parallel informal realities exert pressure on formal processes. Different institutional and political environments require different technical approaches to reform. However, reform approaches have to take into account the possibility that informal practices could undermine formal rules. Furthermore, these reforms have to eventually be linked in with wider civil service reform. More systematic research is needed to understand the workings of both formal and informal systems.

- However, more thought needs to be put into how this political understanding can be operationalised. So far, reform agendas have only recognised that technical solutions are insufficient yet no more work has been done on how such solutions can become more politically savvy.

- Recognition that the existing reform agendas have so far been driven mainly by the executive and by donors is needed. Other actors are only able to exert mild pressure on such reform processes.

- The interaction of actors is a dynamic process and needs to be understood in the context of time horizons and discount factors.

- Political support and sustainability were identified as necessary factors in successful PFM reform. Support for reform had to be either endogenously determined or had to change the incentives of actors. Changing public expectations was seen as one way to increase demand and support for reform.

How to succeed with PFM reform in difficult governance contexts: Implications for policy-makers and researchers

Session 5

Chair: Paul Smoke, New York University

Panellists: Anwar Al-Kamarani, Ministry of Finance, Yemen Republic

Tim Cammack, Oxford Policy Management

David Gray, DFID

Chris Scott, London School of Economics

The presentations for this session can be found in Appendix 2 or online at:
www.odi.org.uk/events/CAPE_conference_2007

Introduction

This session sought to draw out emerging conclusions from the conference and to set out policy implications for domestic reformers and the agenda for future research around PFM reform effectiveness in unfavourable environments. It explored whether lessons for reform could be learnt by comparing the experience of developing, transition and advanced countries.

Main issues and the presenter's arguments

Paul Smoke reviewed the main arguments and conclusions from preceding sessions.

From his perspective, one of the key messages emerging from the conference was demand for better and deeper analysis. Such analysis needed to go beyond establishing a technical understanding of PFM reform and instead identify and explain the role of various actors and factors that have bearing on reform processes. The ultimate objective of such an exercise would be to examine successes and failures of PFM reform across countries in order to identify any sustainable lessons, which could be, replicated other reform processes.

Building on conference discussions, Smoke presented his views on the type of issues a deeper analysis of PFM reform needed to explore:

- The balance between technical content and political awareness in approaches to reform. Do technical reforms lead or follow political buy in?
- The need to consider whether a piecemeal approach to reform is more effective than a comprehensive one. Could partial PFM reform be attempted, for example with an emphasis on reforming sector budget systems led by sector ministries? More analysis is required of the

balance between synergistic effects (i.e. those that could be derived from better sequencing of public sector reform processes such as PFM and CSR) and demonstrative effects (i.e. those that can show the benefits of reform earlier in the process and therefore build more willingness for broader reforms as a whole). A possible danger of aiming for demonstrative effects is that piecemeal reforms can remain separate from, and unintegrated with, other formal systems.

- Related to this was the need to consider whether reform processes should be targeted in areas where the political benefits of such reforms become clearer. This could help build political willingness for broader, more large-scale, reforms.

- The complexities of relationships between the central finance ministries and other central and line ministries need to be understood. Too often, reform is implemented from the perspective of ministries of finance alone. Reforms permeate through layers of bureaucratic structures and people, and a lot of reforms do not happen centrally. There may be merit in viewing reform implementation as moving horizontally from ministries of finance to sector ministries but also vertically from central to decentralised levels.

- Moreover, current thinking around implementation needs to be broadened. Are there other approaches to our current consensus on a gradual rolling out of reforms? Can reform implementation be asymmetric and based instead on existing capacities, which are uneven across government ministries?

Such a discussion suggested to Smoke that a better and fundamentally different ex-ante diagnostic tool was needed. This tool would seek to inform the reform process and produce the kind of analysis that is not currently available, such as, what is the institutional climate in a country? What is the role of donors? Which actors matter most to the reform itself? Much of this is about improving information and knowledge for countries and donors. Smoke said it was unlikely that a thorough understanding of the fiscal institutions of a country could be developed before the reform is implemented, and any improvement on our current understanding of the reform context would be helpful.

Discussions then sought to explore the implications of the conference debates for both the way we currently understand reform and how we approach it. Various perspectives, some complementary and some contradictory, were expressed.

Implications for reformers

Role of political leadership

There was some discussion on the usage of different terminology to describe political factors. It was felt that the meaning of political 'leadership', 'space', or 'commitment' had different nuanced implications for reform processes. The extent to which these mattered to PFM reform seemed to the conference participants to be dependent on two main factors: the reform trajectory and the extent to which PFM reform was dependent on several inter-related public sector reform processes.

Some participants argued that perhaps political leadership is important at the early stages of reform (i.e. to prompt basic changes), but that it becomes less necessary as reforms became more technically advanced. An alternative view was that reforms became more difficult as they proceed or that some reforms are likely to be less politically controversial than others. One suggestion was that the importance of political leadership to PFM reform could be seen in the form of a "U-shaped" curve. Initial reforms of technical basics are relatively easy in political terms, and later stage advanced reforms also less political attention. In between these stages, reforms can be more politically contentious and thus less feasible without strong political leadership and support.

Another much-discussed factor was the extent to which PFM reforms rely on civil service reforms to have any real meaning. It was largely agreed that the two need to progress in parallel for there to be real changes in PFM outcomes but the political challenges to such civil service reforms are tougher.

Currently, reformers do not typically have enough information about the complementarity of public finance and civil service reforms. Both seem to proceed independently of each other.

Although the conference progressed in framing the politics question in these two different ways, most participants felt that this was an area that needed more analysis. Such analysis could be a two-way exercise. Moreover, deeper political understanding needed to be put into practice. It was felt that reform is often too strongly product-oriented and prescriptive, with quite detailed technical specification of key deliverables which are at odds with the political economy of the country. Domestic reformers stated quite strongly that donors and consultants operating in developing environments had very little understanding of the political nature of reform processes. Even when country reformers shared their own political understanding of the feasibility of reforms, those engineering and funding the reform process often ignored such advice. Moreover, these same donors and consultants also failed to understand the cultural and social norms of the context in which they operated, which in some cases exerted more pressure on reform processes than political concerns. Consultants, on the other hand, felt that in most cases they could play a useful role in mediating the balance between donor demands, which were often politically insensitive, and what was required domestically to build political capital.

The proposal that political factors in reform merited further research was strongly questioned by some. Those with experience of leading reform processes in developing environments felt that the problem was not that donors did not know enough about the political context but in most cases failed to understand its significance. Technocrats already had the most serious grasp on political realities and were in the best position to comment on the content and political context of reform processes given that this is something they negotiate daily. Donors, it was felt, had their own political agendas to pursue and it was naïve to assume that they were in any sense ‘apolitical’ and cared more about reform outcomes than other actors. Institutional and governance assessments that have already been tried by the World Bank, for instance, were not successful. It was suggested that there are a number of relevant diagnostic tools already in existence: the key question is how one applies them.

Improving the technical sequencing and timing of reform

Delegates discussed how best to implement reforms in technical terms and expressed concern that lack of capacity within the civil service compromises reform efforts. Often, people are expected to implement reform activities on top of running existing systems. This creates friction between those who are paid government salaries and others who are on donor-funded projects. ‘Change agents’ are required in each line ministry for PFM reforms to work. It was stressed that most line ministries have limited capacity and very little awareness of what they are supposed to do in line with any changes that come about through reform. Another problem is when additional resources to sector ministries are used to create the incentive for pilot reforms — this becomes difficult to sustain once reforms are rolled out throughout government. For reform processes to be effective, incentives needed to be aligned. Where this was not so greater transparency and accountability mechanisms were needed.

Some participants also pointed to the problems created by the use of jargon and technical vocabulary. This can affect the political desire for reform. Consultants and donors who cannot converse in the same language as the politicians depend on technocrats to translate. Technocrats can ‘fudge’ such translations getting political approval for reforms in the first instance only to be met by resistance once the implications become clearer for political actors.

There is a need for greater focus on the beneficiaries of PFM. Excessive focus has been placed upon the perspectives and importance of donor agencies and government technocrats. The objective of a PFM system is to deliver services to beneficiaries or service-end users (i.e. taxpaying citizens), but their views are not necessarily well represented.

Role of donors

Some participants felt that the importance of donors in reform processes was often exaggerated. Although donors, consultants and technocrats each had a role in reform, one way in which they could act effectively is to develop a common understanding of the realities and constraints within which each actor operated.

The main reasons why donors may not be effective in reform were the lack of harmonisation between them and their lack of operational flexibility because of the way their funding was configured. Particular reference was made to the restrictive procurement procedures of some donors who could only procure relatively inexperienced international consultants, which placed additional burden on overstretched government officials. Participants said donors did not provide consultants with enough information on what was required, and that the terms of reference are often totally inappropriate. Consultants then have to negotiate between donor demands and the country's needs.

Some felt that the Latin American experience had little to offer in this context since the role of donors there was limited. In more aid-dependent environments, donors had a major role, especially in placing information in the public domain. Alternative evidence was given, such as the recent evaluations of the usefulness of budget support, which showed donors having a positive effect on reforms. It was felt that perhaps reforms benefited from being initiated by donor support, but then being dependent on domestic demand to be sustained.

Donors could be more effective by being more cautious in recommending reforms, both in terms of existing operational capacity and political feasibility. It was felt that reform implementation needed to be gradual and there was no point in implementing technically advanced reform if it was beyond existing capacity. The "platform" approach offered an opportunity to do this, since it was not a prescribed set of technical reforms but an approach with a series of small and manageable steps.

Other factors that affect reform

Other actors and processes could make reform implementation easier. The EU accession process was thought to be a good example of countries responding to demand for reform, especially in terms of public audit (e.g. Hungary, Croatia). However, the success of EU accession countries in sustaining public financial management or civil service reform is still in question. Participants also said that the conference had underestimated the role of the legislature in reform processes as they have the potential to exert considerable influence on reform outcomes. A suggestion made was that the role of parliaments could be strengthened by involving them not only in budget approval processes but using them to hold the executive to account when intended reform processes stall.

Other factors identified as having a negative influence on reform included unexpected increases in public revenues. Some participants felt that the placing of information in the public domain also meant that the information would be open to manipulation by political opposition, which could lead to politicians' resistance to increasing budget transparency.

Implications for researchers

As well as Smoke's suggestions for further analysis, these areas were suggested for further investigation:

- Clearer definition of 'difficult' environments;
- Identifying which reforms 'stick' and which 'slip';
- Incentives for different donor agencies and how these shape how they operate;
- Differences in donor agendas in bilateral and multilateral donor agencies;
- The relationships that exist within the executive and how these influence reform processes;
- Pair-wise comparisons between case studies and N-country studies would be useful. Research must look at how particular factors change over time;
- The role of democratisation and the question of what is 'good enough' PFM;
- How research can be made more operationally effective.

Discussion focused on methodological issues. It was suggested that comparisons of actors and institutions should be made both in country contexts and across time. In this way, the research community may be better able to determine what a successful model would look like. Case studies and historical research were needed to complement quantitative research, as both areas were important. Above all, these methods should be rigorous. It must be clear why case studies have been chosen (i.e. not just because the donor requests a particular country be examined). The selection criteria could be identified by key variables.

Participants called for a better availability of data: gaps and needs must be identified. It was thought that differences between Latin America and other regions should be looked at more closely (i.e. comparisons could be made on a South-South basis). For this to occur, data would need to be obtained for other regions too. However, data may not be comparable in all situations. For this reason, PEFA statistics should be understood within the governance and institutional structure of a country and be used in conjunction with administrative statistics.

When drawing research conclusions and policy recommendations, researchers must take care not to separate data from their context. Countries often differ from each other so much that that finding relevant research may be a challenge. Even selecting countries with a particular characteristic to fit into a group and making generalisations about that group may not be useful, because the countries will differ in many other ways. This implied that the research community could only attempt to assist the countries rather than provide them with a particular solution.

To improve the translation of research into policy-relevant advice, use of a common language is needed — i.e. to avoid jargon specific to one area.

The timeframe of reform programmes was identified as important because short-term and long-term programmes have different achievable policies.

Summary of main debates and conclusions

The central question debated in this year's CAPE conference was whether improvements to public finance management can progress in challenging governance environments. The conference investigated the types of PFM reforms that have taken place in countries where characteristics typically associated with 'good governance' are absent or few. To draw out lessons for successful reform, the conference considered the types of factors that motivate and sustain PFM reform, drawing on country case studies and theoretical frameworks to explain reform successes in unpromising environments.

Defining governance and 'successful' PFM reform

The conference established the need to develop a common understanding of the broader conceptual issues that frame the relationship between governance quality and PFM reform success.

- First, a better understanding is needed of the complexities that surround the definition of 'governance'. Nuances of meaning could influence how we view the dependence of PFM on good governance conditions.

- Second, a working consensus is needed on the definition and measurement of 'successful' PFM reform. Without agreement about the objectives of reform, it remains difficult to judge whether successful reform can take place in difficult governance environments.

Participants did not reach consensus on these two issues, but made important progress in refocusing the debate about PFM reform so that it considers more explicitly the implications of a country's governance characteristics.

Conference participants acknowledged the difficulty in classifying countries according to the quality of their governance environment and thus defining 'difficult' governance characteristics. The World Bank definition of governance – the manner in which the state acquires and exercises its authority to provide public goods and services to achieve societal goals – was broadly accepted. However, this framework must also consider explicitly the informal patronage-driven relationships that are typically more prominent in developing countries and which strongly influence the interaction between reform actors. Grindle's (2007) formulation of "good enough" governance was agreed to be a helpful starting point, but there are problems with aggregate governance concepts and considerable heterogeneity among countries with similar governance characteristics.

The conference considered the corresponding complexities with defining and identifying "success" in relation to PFM reforms. Most determinations of success are based on upon strong normative assumptions, which disregard country context and the existence of multiple perspectives on reform outcomes. Success may be viewed differently by different stakeholders so it is important to consider its relevance to each group and to establish whether the impact has been universally positive. Equally, there are often high costs, as well as benefits, associated with PFM reforms and the former are not systematically considered. Finally, declaring success too early poses significant risks to sustainability by creating disincentives to further reform effort. There is a need to view successful reform as 'a journey, not a destination' and to acknowledge the continuous, long-term nature of PFM reform in all countries.

Investigating the relationship between governance quality and PFM reform

Building on these emerging definitions, the relationship between governance and public financial management generated significant discussion. There was agreement about the benefits of using a heuristic framework to analyse the relationship and to consider the implications of different types of governance environment for PFM reforms. It was also agreed that such a framework must move beyond simple typologies to understand country-specific complexities and to focus on the combination of positive governance conditions that is “good enough” for a particular set of PFM reforms to succeed. This is important because trajectories of governance reform are not linear and change does not occur in a progressive sequence. Informal accountabilities do not necessarily result in more formal constitutional accountability relationships as development advances.

Participants agreed that countries have different reform trajectories and different entry points to reform, in which either strengthening of bureaucratic quality through technical PFM reforms or of the surrounding checks and balances through improved transparency and participation may be prioritised in the early stages. The experience of PFM reform in Latin America demonstrates the driving influence of individual country contexts in terms of the actors involved, their existing preferences and the way in which these variables interact. This again suggests that the sequencing and trajectory of reform is highly country-specific and that success requires a close and prior understanding of the governance context.

The empirical evidence presented at the conference on whether good governance is necessary for PFM reform to succeed was not definitive. Evidence from the World Bank showed that PFM operations tend to perform relatively satisfactorily regardless of the governance starting point. This contrasts with Administrative and Civil Service Reforms, which are much less successful in countries with a lower standard of governance based on the same measurement framework. However, analysis of the HIPC tracking indicators for PFM improvements paints a more uncertain picture of PFM reform progress and work presented at the conference comparing PFM progress across time by using PEFA and HIPC data also shows mixed results.

The role of politics in motivating and sustaining PFM reforms

Despite the apparent consensus on country specificity, some opinions did emerge from the conference on the consistent factors that drive reform in ‘difficult’ governance environments. Significant discussion time focussed on the importance of ’political leadership’, ‘political acquiescence’ and ‘political space’ for public financial management reform processes. Proactive political leadership was distinguished from more passive political acceptance or acquiescence, but it was agreed that the meaning of each has nuanced implications for reform processes.

Several competing arguments were advanced about the relative importance of political leadership at various stages in the reform process and in various governance contexts. There was some support for the hypothesis that political leadership is required throughout PFM reform processes. Others argued that political leadership is important in the early stages of PFM reform, or that reforms require greater political leadership in their more advanced stages, or that certain types of PFM reforms are more politically controversial than others irrespective of how they are sequenced. Another possible analysis is that the importance of political leadership to PFM reform could be depicted as a ”U-shaped” curve with initial reforms of technical basics being relatively easy in political terms and later, advanced reforms attracting less political attention. In between these stages, reforms may be more politically contentious and thus less feasible without strong political leadership and support.

A recurring theme during the conference was the need to ‘endogenise’ politics within the process of PFM reform. This has implications for both reformers and researchers. Reforms need to be ‘sold’ to political actors in order to motivate their support either by highlighting political gains in the initial stages or by making overall gains more explicit. For example, politicians need to recognise that the budget is a powerful political tool for driving better results in the medium term. The responsibility for ‘selling’ the reform rests principally with technocrats, who were identified as the main group of actors capable of negotiating around political factors in reform processes. For researchers, the challenge is to understand the interaction between actors within the executive better, including how ministries of finance interact with other line ministries and with decentralised entities.

One proposed solution to the question of how to deal with the politics issue was to make political gains and losses clearer to politicians. This has implications on whether reforms are best done piecemeal or comprehensively and also on the time dimension of this decision. We need to consider the balance between synergistic effects (i.e. those that could be derived from better sequencing of public sector reform processes such as PFM and CSR) and demonstrative effects (i.e. those that can show the benefits of reform earlier in the process and therefore build more willingness for broader reforms as a whole).

The role of "demand-side" actors in motivating and sustaining PFM reforms

Delegates concluded that more could be done to establish demand for PFM reform. Public expectations about spending allocations and public service delivery are a critical motivating force. Strategies for PFM reform should target the raising of public expectations as a means of influencing political decision-making processes so that they support positive public finance and management reforms. Demand-side actors can also offer influential support to reform-minded technocrats in achieving results through the formation of alliances. The influence of broad coalitions may be low at the early stages of reform, but it increases as more advanced reforms or controversial reforms are attempted. Other demand-side factors identified as important to PFM reforms were the presence of a strong and politically-engaged middle class and the external incentives for reform that may be generated through membership of regional networks or clubs.

The role of some actors identified in the literature as important to PFM reforms was challenged. Although the role of parliaments and civil societies in the reform process is increasing it is still relatively minor. Similarly the importance of international donors in reform processes has been exaggerated. Donors have an important role in more aid-dependent environments, especially in providing technical advice to reformers and in stimulating enhanced accountability by placing information in the public domain (e.g. improved disclosure of PEFA assessment reports). However, their effectiveness is compromised by lack of harmonisation and by limitations to their operational flexibility caused by the configuration of their funding. Thus, PFM reforms may benefit from donor initiation and early support, but depend on domestic demand to be sustained.

For demand-side actors to play the necessary stronger role, it was agreed that mechanisms for promoting transparency and accountability are crucial. For example, increased transparency, both in terms of the information disclosed to demand-side actors and the format in which is it presented, facilitates more effective legislative scrutiny of the draft budget and enables parliamentarians and the public to interrogate the government spending proposals. In Latin America, formal transparency rules have played an important role in holding the executive more accountable.

The importance of linking PFM reform and civil service reform

There was agreement that the ultimate success of PFM reform is dependent upon making progress with corresponding civil service reform. The two types of reforms must proceed in parallel for there to be real changes in PFM outcomes, although the political challenges to such civil service reforms are often tougher. Some responsibility rests with the donor agencies that promote reforms to ensure better alignment between PFM and civil service reforms. In particular, civil service reform needs to be implemented in the correct technical fashion with advanced public management approaches avoided in weaker institutional environments.

The challenges of measuring PFM performance

There was considerable support for the positive developments in PFM measurement that have been brought about through the PEFA initiative. The consensus generated around an objective set of indicators has resulted in donor harmonisation benefits, and the consistency of data available on PFM performance over time and across countries has improved markedly as a consequence of the programme. However, PEFA assessments do not present an understanding of the local context in which PFM systems operate and the functioning of informal systems. Nor do they measure adequately the sustainability of PFM outcomes. The assessment framework focuses on intermediate formal outcomes rather than broader budget outcomes.

The conference raised issues about the normative assumptions underlying the PEFA framework. Major assumptions have been made about what constitutes “good practice” standards in the context of advanced OECD countries, but there was concern about the lack of debate over the applicability of these assumptions to countries with much weaker formal governance characteristics. A tension was identified between the important benefits of continuing the PEFA programme and leaving the framework substantially unaltered, and responding to the need for a less normatively-loaded framework that would serve to promote neutral dialogue around PFM performance and reform objectives.

The need for better analytical tools

A key conclusion from the conference was the need for better and deeper analysis of country reform context. Although broad cross-country analysis based on key characteristics of countries and reform programmes can be useful, more robust, systematic and deeper examination of a range of cases of both stronger performance and weaker performance would be of particular interest. Such analysis should go beyond establishing a technical understanding of PFM reform and attempt to understand more fully the political and institutional dynamics of reform. It should avoid analysing individual parts of the budget process but rather view the dynamic interaction of the actors involved in PFM systems and how the PFM systems interacts with the governance environment as a whole.

In order to avoid such an analysis generating yet another blueprint for reform, the case was made for a better, fundamentally different ex-ante diagnostic tool that helps researchers and others to think more reflectively and robustly about which technical PFM reforms and related political and institutional processes might work in a particular country. Such a tool should also give rise to more operational implications for designing and implementing reforms. The current emphasis on the importance of politics of PFM reform has had the perverse consequence of diluting technical inputs into reform processes. It has failed to inform practitioners of what they need to do differently in the context of politically challenging environments.

Some explicit suggestions were also made on what this analysis should include. Understanding the role of technocrats within the executive was thought to be key in the context of the politics question. This includes the need to address the incentives of senior civil servants; the power within the executive; how donors can engage with the sociology of senior civil servants better. There is a case for broadening the perspective on PFM reform beyond the common dominance by the Ministry of Finance. Reforms permeate through layers of bureaucratic structures and, in some cases, political actors, and reform implementation needs to be viewed as moving ‘horizontally’ from ministries of finance to sector ministries but also ‘vertically’ from central authorities to decentralised levels.

The emerging research agenda

The conference identified several specific topics where further research may be necessary before clear policy conclusions can emerge.

- First, we should re-examine our definition of PFM reform 'success' so that we capture a broader set of perspectives, acknowledge the continuous nature of progress towards substantive reform and avoid declaring success too early.

- Second, we should look more closely at the normative assumptions underlying existing measures of PFM performance and make more explicit acknowledgement of those assumptions in order to promote more value-neutral dialogue on PFM reform.

- Third, we should attempt to understand better the integral relationship between PFM reform and civil service reform so that approaches to them are pursued in a manner that is mutually reinforcing.

- Fourth, we should investigate more closely the cross-country experience of sequencing and prioritisation of PFM reforms in order to identify empirical lessons for country reform strategies.

- Fifth, we should identify ways of making political economy insights relevant to the operational concerns of reformers through improved diagnostic tools and the development of practical guidance about how to pursue PFM reforms based on a deeper understanding of country-specific governance characteristics.

The driving objective of this future research agenda must be to identify clear and practical policy implications for reform strategists and practitioners alike.

Appendices

Appendix 1: List of participants

Anwar Al-Kamarani	Ministry of Finance, Yemen
Gustavo Bagattini	IDS Sussex
Ruhail Baloch	Ministry of Finance, Balochistan
James Bianco	DFID
Nicola Blackford	ODI
David Booth	ODI
Jim Brumby	World Bank
Simon Burall	ODI
Martin Burke	Irish Aid
Bill Burnett	NAO
Tim Cammack	OPM
Ranjit Chakraborty	Ministry of Finance, Bangladesh
Karin Christiansen	ODI
Paolo de Renzio	Oxford University
Natalie den Breugom de Haas	MFA, Netherlands
Alison Evans	ODI
Jörg Faust	DIE
Verena Fritz	ODI/Independent
Mitsuaki Furukawa	JICA
David Goldsworthy	NAO
Camilo Gomez Osorio	Independent
David Gray	DFID
Geoff Handley	ODI
Edward Hedger	ODI
Nick Highton	ODI
Malcolm Holmes	Independent
Daniel Iga	Irish Aid
Laura Jarque	ODI
Tony Killick	ODI
Zainab Kizilbash Agha	ODI
Philipp Krause	LSE
Birthe Larsen	Danida
Andrew Lawson	Fiscus
Ian Lienert	IMF
Nick Manning	World Bank
Mario Marcel	Politeia Public Solutions
Lynne McKenzie	Southern Cross Advisers
Andres Mejia Acosta	IDS Sussex
Luc Moens	PWC
Margaret Myklebust	NORAD
Adrian Nembhard	DFID
Deba Raj Pathak	Ministry of Finance, Nepal
Steve Pierce	USAID
Sanjay Pradhan	World Bank
Carole Pretorius	Independent
Kirsten Richter	GTZ
Caroline Rickatson	CIPFA
Heidy Rombouts	BTC
Sok Saravuth	Ministry of Finance, Cambodia
Neil Satchwell-Smith	DFID
Emeline Saunier	DFID
Carlos Scartascini	IADB
Aaron Schneider	IDS Sussex
Chris Scott	LSE
Mark Silins	Independent
Duncan Sinclair	ODI
Matthew Smith	PKF
Paul Smoke	New York University
Michael Spackman	LSE
Henk-van Trigt	MFA, Netherlands
Annelies Van Bauwel	BTC
Paul Verle	BTC
Joachim Wehner	LSE
Clay Wescott	World Bank
John Wiggins	Independent
Vera Wilhelm	World Bank
Richard Williams	PKF
Tim Williamson	ODI/Independent
Ole Winckler Andersen	Danida
Mark Worledge	Atos

Appendix 2: Speaker presentations

Contents

All of the presentations can also be found online at:
www.odi.org.uk/events/CAPE_conference_2007

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

14 – 15 November 2007
Overseas Development Institute, London, UK

Irish Aid
Department of Foreign Affairs
An Roinn Gnóthaí Eachtracha

BTC CTB
EMPOWERING DEVELOPMENT

DFID

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Simon Maxwell
Director, ODI

14 – 15 November 2007
Overseas Development Institute, London, UK

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Edward Hedger
Research Fellow, ODI

14 – 15 November 2007
Overseas Development Institute, London, UK

Overseas Development Institute

CAPE Conference 2007

Tales of the Unexpected:
Public Financial Management Reform in Difficult Environments

14 - 15 November 2007

Edward Hedger, ODI

CAPE Conference 2007

- Conference rationale
- CAPE hypotheses
  - Existing knowledge
  - Possible explanations
- Questions for conference

How much does governance matter for PFM reform?

- Apparent correlation between governance quality and success of PFM reform
- Implication that successful PFM reform progress is dependent upon “good governance”
- But positive PFM reforms still apparent when the governance context seems complex and challenging
- → Is “good governance” really necessary for successful and sustained PFM reform?

What factors are important for PFM reform success?

- Actors in the reform process and their roles and interaction
  - "Supply side" of reform: political leaders, senior public officials, technical staff
  - "Demand side" of reform: legislatures, civil society, media, opposition parties, international agencies
- Technical reform processes and approaches to reform implementation
  - Timeframe, sequence, type

What don't we know about the "success" factors?

- What is the relative importance of these factors?
  - Some factors are often missing in developing and transition countries
- How do they complement, substitute or compensate each other?
- If one success factor is weak or absent can others compensate?
  - What if political leadership is missing?

Current Approaches to the Politics of Reform

- Technically-driven strategies that equate politics with ownership
  - But risk that "ownership" is negotiated ex post → reform design then political commitment
- "Politics matters" approaches to understanding better the politics of PFM reform
  - But need for operational implications and guidelines
- Emerging attempts to operationalise political analysis
  - But work in progress and confidential donor strategy tool

Towards a CAPE position: some hypotheses (1)

- Technical reform process contingent upon reform actors → reform process is important, but actors are instrumental
- Supply-side actors are more important than demand-side actors to the PFM reform process itself
  - Domestic "demand-side" actors are not always essential: they facilitate and sustain reform but do not directly give effect to it
  - Domestic "supply-side" actors are unavoidably important: they drive and sequence reform

Towards a CAPE position: some hypotheses (2)

- Roles and interaction of supply-side reform actors are influential
  - Strategic reform management and technical implementation capacity are critical
  - Active political leadership highly beneficial, but maybe not essential → political acceptance enough
- Technocrats can be instrumental in reform process → uniquely positioned to understand and negotiate politics to achieve PFM reform results
  - But need to consider motivation and incentives
- International actors have important role but cannot substitute for absence of domestic factors → cannot directly negotiate politics

How to recognise PFM reform success?

- Need to be clear about the objectives
  - Stronger budgeting and financial management processes?
  - Better public financial management outputs?
  - Improved fiscal outcomes?
- Towards improved PFM performance
  - Statutory changes → reform implementation → sustained reforms: what constitutes success?
  - How to measure that success?

Questions for the Conference

- Can PFM reform succeed in difficult governance contexts?
  - What is the relationship between good governance and PFM reform? (Session 1)
  - How do we define and measure successful PFM reform? (Session 2)
  - What factors motivate and sustain successful PFM reform in unfavourable governance contexts? (Sessions 3 & 4)
  - What are the implications for reformers and for future research? (Session 5)

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

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CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Session 1
PFM and Governance
How are they related?

14 – 15 November 2007
Overseas Development Institute, London, UK

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Sanjay Pradhan
World Bank

14 – 15 November 2007
Overseas Development Institute, London, UK

The Relationship Between Governance & Public Financial Management

Presented to:
CAPE PFM Conference 2007
Overseas Development Institute (ODI)
London, UK

Presented by:
Sanjay Pradhan
Director, PREM
The World Bank

The World Bank November 14-15, 2007

Outline

A. Governance & Public Financial Management (PFM): Framework

B. Monitoring PFM

C. Tailoring PFM Reforms to Country Context

D. Political Economy & Drivers of Reform

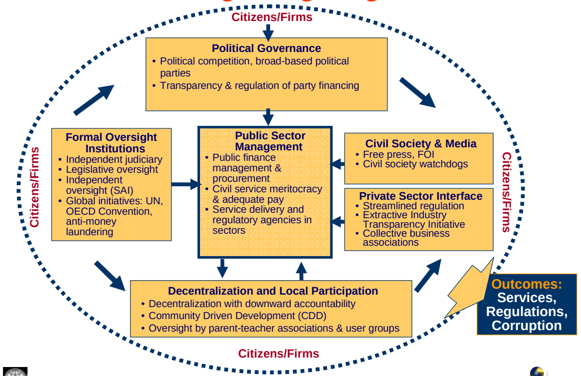
The World Bank Sanjay Pradhan Governance & PFM Page 5

Definitions

Governance	The manner in which the state acquires and exercises its authority to provide public goods & services to achieve societal goals
Public Finance Management	Institutional arrangements governing the mobilization, allocation and use of public finances to achieve aggregate fiscal discipline, strategic priorities and operational efficiency

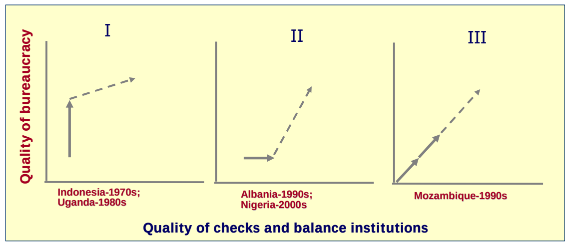
The World Bank Sanjay Pradhan Governance & PFM Page 6

Governance has many dimensions:
PFM is integral to good governance



Countries differ in trajectories & entry points

- Trajectories are driven by political forces
- Some countries have strengthened bureaucracy (e.g., PFM) before broader checks and balances; others have done the reverse
- Key issue: How to sequence reforms?



Source: Global Monitoring Report, 2006

In some countries, this will mean moving from reforms of bureaucracy to support checks and balances

Outline

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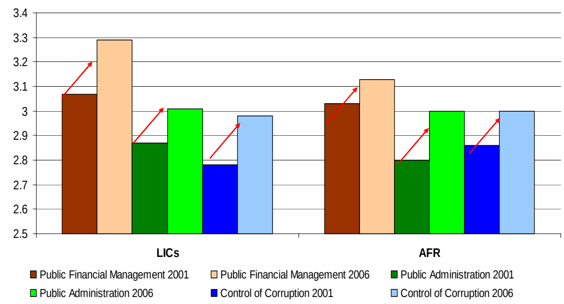
Public Sector Management Systems are Gradually Improving



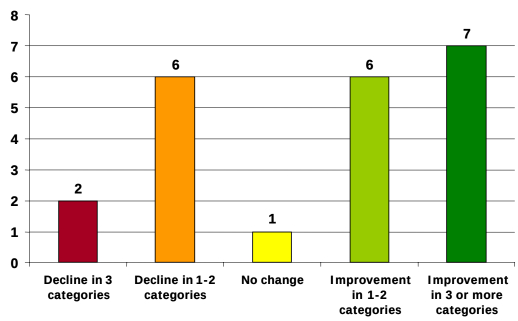
Source: Colum Garrity, World Bank, based on governance CPIA Data, 2001 and 2006. CPIA scales are from 1 to 6.

PFM operations perform satisfactorily regardless of governance starting point, but civil service operations are successful only in stronger settings

	All projects		CPIA (Q16) < 3.0		CPIA (Q16) from 3.0 to 3.5		CPIA (Q16) Greater or equal to 3.5	
	No. of projects	Projects with Satisfactory or better (%)	No. of projects	Projects with Satisfactory or better (%)	No. of projects	Projects with Satisfactory or better (%)	No. of projects	Projects with Satisfactory or better (%)
PFM	39	85%	15	87%	18	83%	6	83%
ACSR	24	58%	11	36%	9	78%	3	100%

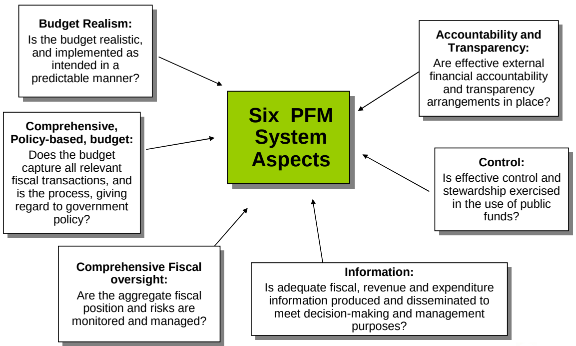
OED Evaluated PSGB-mapped projects with PFM (without Administrative & Civil Service Reform) and ACSR (without PFM) primary themes, FY00-FY05

Trends in PFM can be monitored
Net Change in HIPC Tracking Indicators, 2001-2004



PFM Progress Can Be Monitored

PEFA's Performance Measurement Framework



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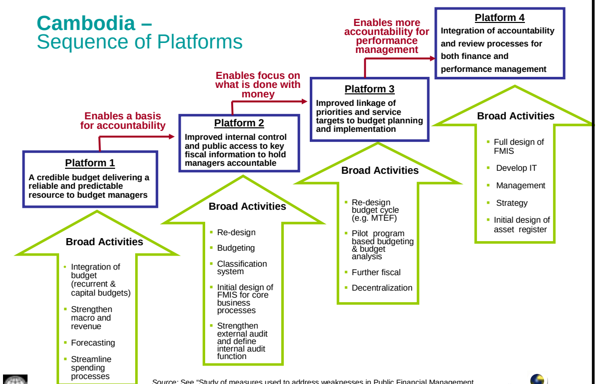
Tailoring Reforms in Different Governance Contexts

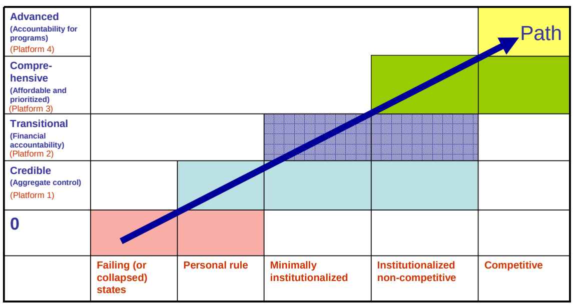
Type of States	Key Challenges
Fragile States (Guinea-Bissau, Haiti, Equatorial Guinea)	➢ Low political leadership and managerial commitment to anti-corruption reforms ➢ Absence of rules and regulations (authoritativeness) governing the budget process ➢ Poor quality fiscal information ➢ Civil Society is not engaged in the budget process ➢ Absence of internal and external oversight
Reforming States (Ghana, Armenia)	➢ Improving the accuracy of fiscal information ➢ Disregard for rules governing the budget process ➢ Limited transparency of budgetary information ➢ Ineffective internal and external audits ➢ Sustaining political commitment to reform
Capable States (Brazil, South Africa)	➢ Increase performance orientation in public spending, increase coordination and integration between central institutions ➢ Strengthening transparency, external audit and external scrutiny of public spending ➢ Strengthening accountability and enforcement

Improving PFM – A Platform Approach



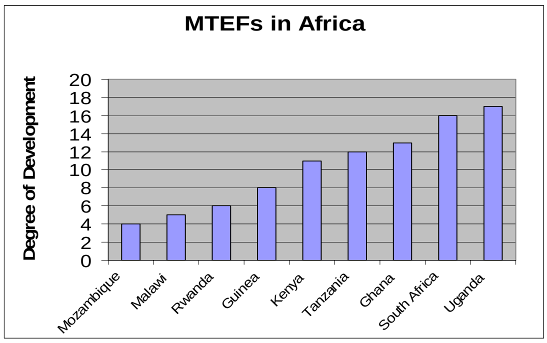
Source: See "Study of measures used to address weaknesses in Public Financial Management systems in the context of policy-based support," by Peter Brooke, at www.pefa.org

Likely PFM platforms and governance characteristics



Governance categories from Merilee Grindle "Good Enough Governance Revisited" (2007).

Level of MTEF Development



MTEFs

Highly complex technological and institutional task

Aspects of a working MTEF	Envelope creation ▪ Macroeconomic and public sector envelopes developed Determination and articulation of high level policy priorities ▪ Policies and objectives constrained by resources, involves reallocation between sectors Departments bidding in compliance with amounts agreed ▪ Implementation of policies proposed by sector, can involve reallocation between ministries, and within ministries Iterated consideration of bids ▪ Recasting of departmental and sectoral bids to take account of emerging preferences and any changes in macro conditions Finalized credible budgets ▪ Reconciled policy, implementation and means
Implies these PFM system needs	A credible macro framework An ability to set priorities Acceptance of the central co-ordination role Gate-keeping discipline, including management of budget bids and baseline control Enforcement and control in budget execution to make bids credible

MTEF Conclusions & Lessons

- MTEFs in Africa have largely failed in their promise to deliver improved PEM in a number of countries where operational MTEFs do not closely resemble their textbook cousins
- In the two countries where it seems that the MTEF had some impact – South Africa and Uganda – the MTEF process started from very different "initial conditions" in terms of PEM capacity. In both cases they also enjoyed strong political support
- MTEF reforms have not paid sufficient attention to initial PEM conditions
- MTEF reforms have not been properly sequenced/phased
- MTEF reforms have not paid sufficient attention to political-institutional issues

Source: Philippe Le Houerou, Rob Taliercio, World Bank 2004

Outline

A. The Relationship of Governance & Public Financial Management (PFM)

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D. Political Economy & Drivers of Reform

Drivers of PFM Reforms in Different Contexts

- High-level Political & Bureaucratic Leadership (Uganda)
  - Political and bureaucratic leadership crucial in initiating reform (Museveni & Tumusiime-Mutebile)
- Technocrats in government working with demand-side actors on specific reforms:
  - Utilizing civil society & media (G-Watch and Philippines textbook)
  - Empowering local communities with information (Uganda primary education)
  - Fostering broad coalitions to overcome vested interests against reform (Philippines Procurement)
- Role of donors
  - HIPC Debt Relief and HIPC Expenditure tracking indicators
  - Budget support, scaling up and PEFA

Source: W. Dorotinsky & S. Pradhan, in Campos & Pradhan, *The Many Faces of Corruption*, World Bank 2007

Forging Coalitions for Reform
Philippines: Procurement Reform

Transparency and Accountability Network (20+ member groups)

Walang Ku-Corrupt Movement (Youth)

PAGBA & AGAP (w/in Gov't)

Procurement Watch: Drew other civil society groups into the advocacy efforts and coordinated the activities

CBCP (Church)

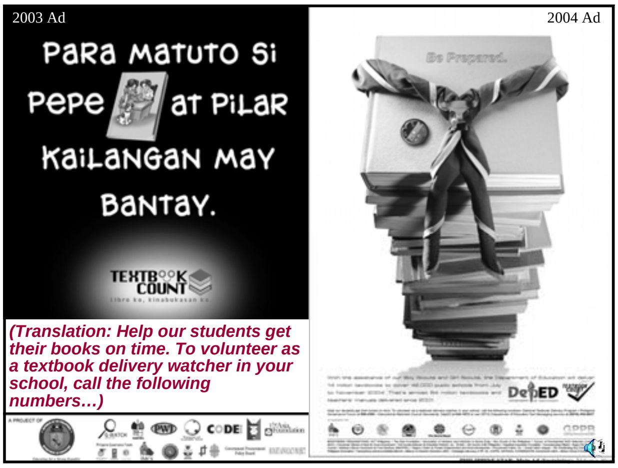
Local chambers of Commerce (Private sector)

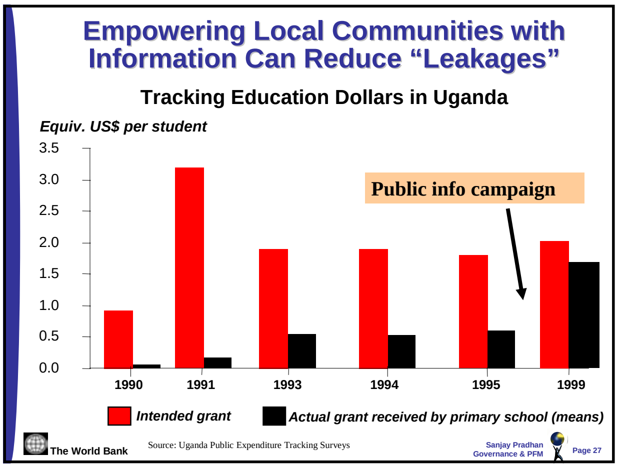
Philippine Contractors Association (private sector – main stakeholder)

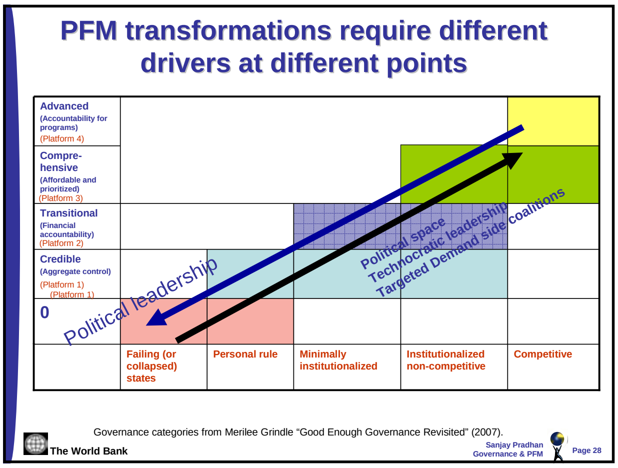
The Philippines Textbook Delivery Tracking: DOE & G-Watch Alliance

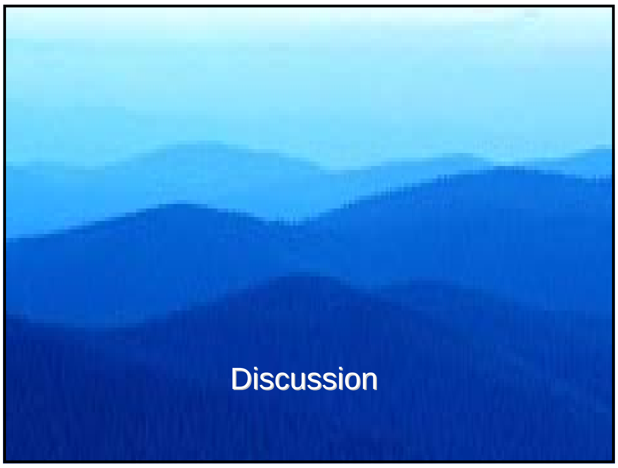
- Reform-minded technocrats in Department of Education requested G-Watch to track production and distribution of textbooks to schools
- In 2002, 40% of textbooks had disappeared
- The Partnership for Transparency Fund (PTF, partially funded by the World Bank) has supported G-Watch effort for 3 years
- In 2006, 6,000 Boy and Girl Scouts recruited to monitor delivery at school level
- Coca-Cola delivered to every community
- Successful delivery of over 95% of textbooks, saving $450,000


2005 Ad
To quench our students' thirst for knowledge,
we called on COCA-COLA to help deliver textbooks to hard-to-reach schools.


2003 Ad
2004 Ad
PaRa MaTuTo Si
Pepe at PiLaR
KaiLaNGaN May
BaNTaY.
TEXTBOOK COUNT
(Translation: Help our students get their books on time. To volunteer as a textbook delivery watcher in your school, call the following numbers…)
Be Prepared.
DepED


Empowering Local Communities with Information Can Reduce "Leakages"
Tracking Education Dollars in Uganda
Equiv. US$ per student
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Public info campaign
1990
1991
1993
1994
1995
1999
Intended grant
Actual grant received by primary school (means)
The World Bank
Source: Uganda Public Expenditure Tracking Surveys
Sanjay Pradhan
Governance & PFM
Page 27


PFM transformations require different drivers at different points
Advanced
(Accountability for programs)
(Platform 4)
Compre-hensive
(Affordable and prioritized)
(Platform 3)
Transitional
(Financial accountability)
(Platform 2)
Credible
(Aggregate control)
(Platform 1)
(Platform 1)
0
Political leadership
Political space
Technocratic leadership
Targeted Demand side coalitions
Failing (or collapsed) states
Personal rule
Minimally institutionalized
Institutionalized non-competitive
Competitive
Governance categories from Merilee Grindle "Good Enough Governance Revisited" (2007).
The World Bank
Sanjay Pradhan
Governance & PFM
Page 28


Discussion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Overseas Development Institute
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Tales of the unexpected:
PFM reform in difficult environments
14 – 15 November 2007
Overseas Development Institute, London, UK
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Session 2
What do we mean by successful PFM outcomes and performance?

14 – 15 November 2007
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Tales of the unexpected:
PFM reform in difficult environments

Paolo de Renzio
Oxford University

14 – 15 November 2007
Overseas Development Institute, London, UK

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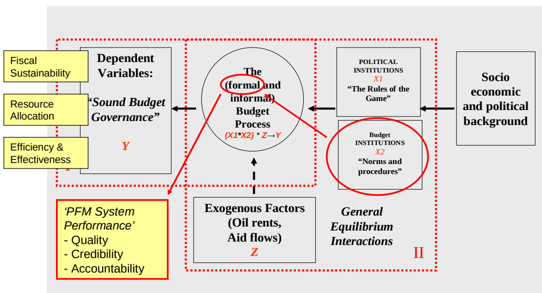
MEASURING PROGRESS IN BUDGET OUTCOMES AND REFORMS

Paolo de Renzio
University of Oxford and ODI
14 November 2007

BUDGET GOVERNANCE FRAMEWORK



Source: Mejia (2007)

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WHAT BUDGET INDICATORS?

- ***PEFA*** *and its predecessors (HIPC Assessments)*
- ***CPIA*** *(Indicator 13)*
- ***Open Budget Index*** *(transparency)*
- ***Global Integrity Index*** *(accountability)*
  - ⇨ *Different dimensions/samples/methodologies*
  - ⇨ *No time series (exc. CPIA, ICRG and part. HIPC)*
  - ⇨ *Other data in various reports, but scattered and 'uncoded'*

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HIPC-PEFA 2001-2006

	HIPC Indicator (2001, 2004, 2006)														
Country	1			2			3			4			5		
Benin	B	B	B	A	A	C	B	B	B	B	B	B	B	B	B
Burkina Faso	B	B	A	A	A	A	B	B	B	C	C	B	B	B	B
Ghana	C	B	B	B	B	A	C	C	B	B	B	B	C	B	B
Guinea	C	A	B	B	B	B	B	C	B	A	B	B	B	B	B
Guyana	A	B	A	B	A	A	B	B	B	A	A	A	C	B	B
Honduras	B	B	B	A	A	A	B	C	B	A	B	B	A	B	B
Madagascar	B	B	B	A	A	A	B	C	B	A	B	B	B	A	A
Malawi	C	C	C	A	A	A	C	C	B	B	B	B	A	B	B
Mali	B	A	A	A	B	B	B	B	A	B	B	B	B	A	A
Mozambique	B	A	A	C	C	B	B	B	A	B	B	B	B	C	C
Nicaragua	C	A	B	C	C	B	B	B	B	A	A	B	B	B	B
S. Tome & Principe	B	B	B	B	A	B	C	C	C	A	A	B	C	C	C
Tanzania	B	B	B	A	A	A	B	B	B	B	B	B	C	B	B
Uganda	B	B	B	B	B	B	B	C	B	A	B	B	A	B	B
Zambia	C	C	C	B	B	B	C	C	B	A	B	B	C	C	C
Benchmark	A			A			B			A			B		

	HIPC Indicator (2001, 2004, 2006)																	
Country	7			8			9			10			11			15		
Benin	B	A	B	A	B	C	B	B	B	B	B	C	A	A	A	C	C	C
Burkina Faso	A	A	A	B	A	A	B	B	B	A	A	B	A	A	A	C	C	C
Ghana	B	B	B	C	A	A	C	B	B	B	B	B	C	A	A	C	C	B
Guinea	C	B	B	B	C	C	C	B	C	C	C	C	A	A	A	C	B	C
Guyana	B	B	B	A	A	A	B	B	B	C	C	B	C	C	B	B	B	C
Honduras	B	B	B	A	A	B	B	B	B	C	C	C	C	C	A	C	C	B
Madagascar	C	A	B	C	B	B	B	B	B	B	B	C	A	B	B	C	C	C
Malawi	B	B	B	A	B	C	B	B	B	A	B	C	B	B	B	C	C	C
Mali	B	A	A	A	A	B	A	B	B	B	B	B	A	A	A	C	C	C
Mozambique	B	B	B	A	A	A	A	B	B	C	C	C	B	C	C	C	C	B
Nicaragua	C	C	B	B	B	A	B	B	B	C	C	B	A	B	B	C	C	C
S. Tome & Principe	C	C	C	A	B	C	C	C	C	C	C	C	B	B	C	C	C	C
Tanzania	A	A	A	A	A	A	B	B	A	B	B	B	A	A	A	C	C	B
Uganda	A	A	A	B	C	C	B	A	B	B	B	B	B	A	A	B	B	B
Zambia	C	B	B	C	C	C	B	B	B	C	C	B	A	A	A	C	B	B
Benchmark	A			A			A			B			A			B		

Source: de Renzio and Dorotinsky (forthcoming)

- *15 out of 26 countries*
- *11 out of 16 indicators*

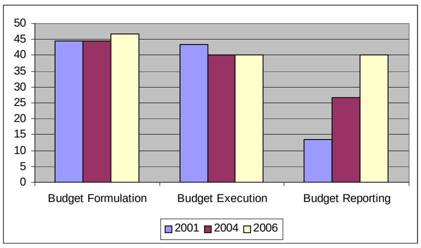
HIPC-PEFA 2001-2006

Benchmarks met by Country (2001-2006)

	HIPC	HIPC	PEFA		
	2001	2004	2005	2006	2007
Benin	6	6			3
Burkina Faso	6	7			8
Ghana	1	4		7	
Guinea	4	4		3	
Guyana	5	6			7
Honduras	5	3		5	
Madagascar	6	4		3	
Malawi	4	3		3	
Mali	7	7		6	
Mozambique	4	3	4		
Nicaragua	4	4		4	
S. Tome & Principe	2	2		0	
Tanzania	6	7		9	
Uganda	6	6	6		
Zambia	2	2	4		
Total	68	68		72	

HIPC-PEFA 2001-2006

% of Benchmarks met by Budget Phase (2001-2006)



HIPC-PEFA 2001-2006

- ***93 percent of countries were able to limit the discrepancies between budget allocations and budget outturns*** *(indicator 3), compared to 73 percent in 2001 and 47 percent in 2004;*
- ***Less than 10 percent of countries could fully reflect donor funds in their budget documents*** *(indicator 4), down from more than 50 percent in 2001;*
- ***Improvements in budget classification were sustained from 2004*** *(indicator 5), with 80 percent of countries meeting the benchmark;*
- ***There was a recent decline in the quality and integration of medium-term projections in budget processes*** *(indicator 7);*
- ***Effectiveness of internal controls*** *(indicator 9)* ***and budget coverage*** *(indicator 1)* ***remain problematic****.*

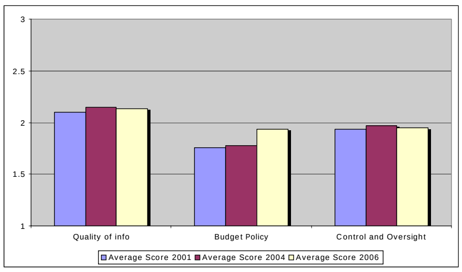
HIPC-PEFA 2001-2006

Overall progress by Country (2001-2006)

	HIPC	HIPC	PEFA		
	2001	2004	2005	2006	2007
Benin	24	24			19
Burkina Faso	24	25			26
Ghana	15	22		25	
Guinea	19	21		19	
Guyana	22	23			25
Honduras	23	20		23	
Madagascar	22	23		22	
Malawi	23	20		19	
Mali	25	26		26	
Mozambique	21	19	22		
Nicaragua	19	20		22	
S. Tome & Principe	18	18		14	
Tanzania	24	25		27	
Uganda	25	23	23		
Zambia	17	18	20		
Total	321	327		332	

HIPC-PEFA 2001-2006

Overall progress by Budget dimension (2001-2006)



HIPC-PEFA 2001-2006

Overall progress by Budget dimension (2001-2006)

Change 2001-2006	Quality of Info	Budget Policy	Control & oversight	TOTAL
>=5	-	-	Ghana	**Ghana**
3/4	Ghana	Zambia	-	**Guyana, Nicaragua, Tanzania, Zambia**
1/2	Burkina Faso, Guyana, Mali, Mozambique, Nicaragua,Tanzania	Ghana, Guinea, Guyana, Mali, Mozambique, Nicaragua	Burkina Faso, Honduras, Tanzania, Zambia	**Burkina Faso, Mali**
0	Guinea, Madagascar	Honduras, Madagascar, São Tomé and Principe, Tanzania, Uganda	Guyana, Madagascar, Nicaragua, Uganda	**Guinea, Honduras, Madagascar, Mozambique**
-1/2	Benin, Honduras, Malawi, São Tomé and Principe, Uganda, Zambia	Benin, Burkina Faso, Malawi	Benin, Guinea, Malawi, Mali, Mozambique	**Uganda**
-3/4	-	-	São Tomé and Principe	**Malawi, São Tomé and Principe**
<=-5	-	-	-	**Benin**

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HIPC-PEFA 2001-2006

CPIA Indicator 13 (Quality of Budget and Financial Management)	
Countries improving 2005-6	**Countries worsening 2005-6**
Burundi	Benin
Cambodia	Chad
Ethiopia	Comoros
Georgia	Guinea
Ghana	Kiribati
Grenada	Mali
Haiti	Samoa
Lao PDR	Sao Tome and Principe
Mauritania	Solomon Islands
Nicaragua	St Lucia
Rwanda	Sudan
Zambia	Zimbabwe

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HIPC-PEFA 2001-2006

Donor Support for PFM Reforms (2000-2005)

	2000	2001	2002	2003	2004	2005	Total
Tanzania	1.8	3.0	3.3	9.1	7.9	13.3	**38.4**
Mozambique	1.0	4.1	5.0	9.0	5.1	7.4	**31.5**
Uganda	0.3	7.3	2.7	6.2	5.7	6.3	**28.5**
Zambia	0.0	0.3	0.8	2.5	6.1	10.9	**20.6**
Benin	0.8	3.8	0.6	1.5	6.5	4.3	**17.6**
Nicaragua	0.0	0.7	0.4	3.8	3.9	5.3	**14.1**
Mali	2.6	2.5	1.8	1.6	2.3	2.5	**13.3**
Malawi	0.8	1.7	1.3	1.3	1.2	2.1	**8.5**
Ghana	0.6	1.0	2.9	1.4	1.1	1.3	**8.4**
Madagascar	0.1	0.2	0.1	0.2	0.9	5.3	**6.8**
Burkina Faso	0.6	0.5	0.7	1.3	1.9	1.8	**6.7**
Guinea	0.9	0.5	0.8	1.0	1.0	1.7	**5.9**
Honduras	0.2	0.5	0.6	0.6	0.6	1.1	**3.4**
Sao Tome & Principe	0.1	0.6	0.2	0.4	0.6	0.3	**2.2**
Guyana	0.0						**0.0**
Total	**9.8**	**26.7**	**21.3**	**39.8**	**44.9**	**63.5**	**206.1**

Source: OECD/DAC CRS database

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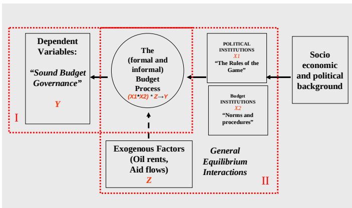
BACK TO THE FRAMEWORK…



- *Need to look at broader picture*
- *Combine x-country and case study research*
- *Need for more and better data*
- *Need for more transparency and dissemination*

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THANK YOU!

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CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Carole Pretorius
PFM Specialist

14 – 15 November 2007
Overseas Development Institute, London, UK

Good practices in PFM reform – WB study

ODI - Cape Conference
14th November 2007
Carole Pretorius

Assignment Purpose

- The main purpose of the exercise is to identify examples of <u>success </u>in strengthening different <u>aspects</u> of public financial management from developing/middle income countries.
- To share information between pfm personnel in Bank, with governments and other development partners.

Missing

- No submissions received for the following areas
  - Payroll
  - Revenue administration
  - Public access to financial information
  - Fiscal decentralisation
- *Procurement now being covered by separate exercise*

Good practices in PFM reform ?

- During initial discussions/ review of submissions realised that term “good practices” could be misleading or misinterpreted as a model to be universally applied.
- Pursuit of perfection.
- Need for local context lost.

Definition of success?

- Measurable progress in one indicator or dimension in the PEFA set of indicators
- Others - cost savings, reduction of audit queries or more timely reporting (if it results in other changes)
- Cross cutting issues e.g. management of reform or capacity development more subjective

Success is a journey, not a destination.

- In some cases – declaring success too early may be damaging and support/effort may be reduced or real “drivers” of sustained success not recognised.
- Unintended consequences e.g. central payments office may lead to greater efficiency but also to >er potential for corrupt practices.
- Sophisticated system/process may achieve some success but what is the opportunity cost.

Whose success?

- Emphasis on success of government/country NOT donor intervention
- Relevance to stakeholders @ central level and/or frontline (street level bureaucrats)
- Relevance to "customer" and/or "taxpayer".

Challenges in the verification process

- Lack of baseline data.
- Inter relationship of many aspects of pfm (**and public service reform**) often make the attribution of success to a particular aspect of pfm difficult.
- Unclear use of generic terms e.g. MTEF/IFMS widely used, but precisely what had been done often unclear.

Challenges in the verification process

- Conflict in budgetary outcomes – success in one may lead to poorer results in another
- Interpretation of conditionalities
  - Conditionality – Develop and Implement new budget execution procedures.
  - Conditionality achieved – Budget manual issued ???
- Multi million dollar investments with no **basic** costing or analysis of alternative options/ methodologies

Approach adopted

- Correspondence/Discussion with TTLs new and old + FM practitioners
- Old and new diagnostics reviewed
- Published documents/ websites etc
- Clarification with governments/ other donors/consultants
- No field research

Contradictions

- **PER 2005**
  - **"with important progress made in the realism of tax revenue projections"**.
- **CPIA - 2006**
  - **"led to increasing realism of revenue targets"**.
- **IEG 2007**
  - **"persistent overestimation of revenue"**

Case studies

- Background
- Show what has been achieved and why
- **Be honest** about what remains to be done
- Identify critical success factors
- Lessons to be shared

First "tentative"group

- This is not the final list but it is likely to include some or all of the following
  - Kenya (internal audit)
  - Chile (results based budgeting)
  - Mongolia (GFMIS)
  - South Africa (capacity development)
  - Mexico (internal audit)
  - Tanzania (IFMS)
  - Cambodia (reform management)
  - Uganda (legislative scrutiny)
  - Senegal (external audit)
  - Karnataka (external audit – follow up)
  - Sri Lanka (financial reporting)

Initial observations

- Critical success factors were almost entirely "people" related rather than technical.
- In many cases, success was achieved by adapting conventional wisdom to local circumstances.
- Small steps rather than giant leaps

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PFM reform in difficult environments

Session 3
Reflections from country reformers

14 – 15 November 2007
Overseas Development Institute, London, UK

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Tales of the unexpected:
PFM reform in difficult environments

Mario Marcel
Politeia Public Solutions

14 – 15 November 2007
Overseas Development Institute, London, UK

PUBLIC FINANCIAL MANAGEMENT REFORM IN AN EXPANSIONARY ENVIRONMENT – THE CASE OF CHILE

Mario Marcel
Consultant, Politeia Soluciones Publicas
Budget Director of Chile 2000-2006

CAPE PFM Conference 2007
Tales of the unexpected:PFM reforms in difficult environments
ODI, London, 14-15 November, 2007

COUNTRY BACKGROUND: THE ECONOMY

- Upper middle income country: per capita GDP at US$ 15,000 ppp
- Small economy in Latin American context: overall GDP US$ 140 bn, 4th in the LAC region after Brazil, Mexico and Argentina
- Strong growth over last 20 years: 6% p.a.
- Open market economy, highly competitive, low sovereign risk
- Poverty rate: 13,7%
- Highly unequal: Gini monetary income before government transfers 0.53

COUNTRY BACKGROUND: POLITICS AND GOVERNMENT

- Presidential system
- Returned to democracy in 1990, under Constitution passed by the military
- Continuity in governments: last four governments from the same coalition
- Unitary state
- Relatively small government: general government expenditure 25% GDP
- Tradition of honest, disciplined civil servants
- Reliance on public-private partnership: infrastructure PPPs, DC pillar with private management in pensions, privatized utilities
- Effective government: good record in social indicators, human development, policy effectiveness

COUNTRY BACKGROUND: PUBLIC FINANCE

- Copper revenues important source of funding (10% of fiscal revenues); tax burden 18% GDP
- Prudent fiscal management: overall surplus in 16 out of 20 years
- Hierarchical budgetary institutions
- Emphasis on stabilisation due to volatile revenues: copper stabilization fund from 1986, followed by structural surplus fiscal rule since 2001
- Public revenues, expenditure growing at 7% p.a. for 17 years
- Net public debt 2007: -5% GDP
- Surplus for 2007: 8% GDP, due to high copper prices

DRIVERS FOR PFM REFORM

- Gap between development needs and public resources: education, demographic transition, environment, gender equity
- Unsatisfactory outcome of increases in public funding: national health service, quality of education, inequality
- Expansionary environment as a threat to fiscal discipline
- Fiscal policy under socialdemocrat president 2000, scandals 2003
- Rising international standards, pressure from investors, shifting standards from population, media

WHAT MAKES GOOD PFM?

1. Macro effectiveness
2. Efficiency in allocation of resources
3. Efficiency in use of resources
4. Transparency

MACRO EFFECTIVENESS

- Structural balance fiscal rule (2000)
  - Builds on studies on fiscal policy indicators
  - The rule: annual structural surplus of 1% of the GDP (changed to 0.5% of GDP for 2008)
  - Strict monitoring, transparency, compliance to secure credibility
  - Improves on European convergency criteria on stabilization, monitoring

EFFICIENCY IN THE ALLOCATION AND USE OF PUBLIC RESOURCES: PERFORMANCE-BASED BUDGETING

- Chilean views of PBB:
  - Performance information: M&E systems
  - Adapt budget process to use PI
  - Build incentives to performance management in agencies
  - Flexibility for managers to achieve results

PBB TOOLS: FACTS AND FIGURES

TOOL	DESCRIPTION	2007
Project apparaisal (1975)	Investment projects apparaised on the basis of cost-benefit analysis	-Appraisals performed by Ministry of Planning on the basis of shadow social price system -Minimum social return required for funding -Online Databank with 300.000 entries --15.000 projects submitted every year
Performance indicators (1994)	Indicators of effectiveness, economy, efficiency, quality of service with goals in budget process	-1,600 indicators of economy, efficiency, effectiveness -Adequate size, still need to balance dimensions -Performance reported to Budget and Congress in budget process and CPRs
Program evaluation (1996)	Programs selected annually for evaluation by independent panels, conclusions ans recommendations reported to Congress	-240 evaluations performed or in progress, 2/3 of gov program spending -Growing share ofImpact and comprehensive evaluations -Ministry-Budget agreements assessed and reported to Congress in CPRs
Management Improvement Programs (MIP) (1998)	Annual bonus paid on basis of agency's progress against goals in seven key management areas, benchmark-based approach	-Supports institutional performance pay system covering 100% of employees of Central Government -Annual bonus up to 10% of salary, paid quarterly -MIP results reported to Congress in CPRs -75% of staff on maximum bonus -External ISO 9000-type certification -Devolution of financial authority to top performers
Comprehensive Performance Reports (CPR) (1996)	Annual report prepared by every agency on performance against budget, targets, institutional commitments	-200 agencies send CPRs to permanent Budget Committee of Congress -CPRs basis for President's report and review by permanent Budget Committee of Congress
Bidding Fund (BF) (2000)	Pool of funds allocated to innovative programs on basis of quality and consistency of bids from ministries	-10% of gov expenditure allocated through BF -BF suspended for last half of administration; replaced by standardized template for budget programs

EFFICIENCY IN THE ALLOCATION AND USE OF PUBLIC RESOURCES: PERFORMANCE-BASED BUDGETING

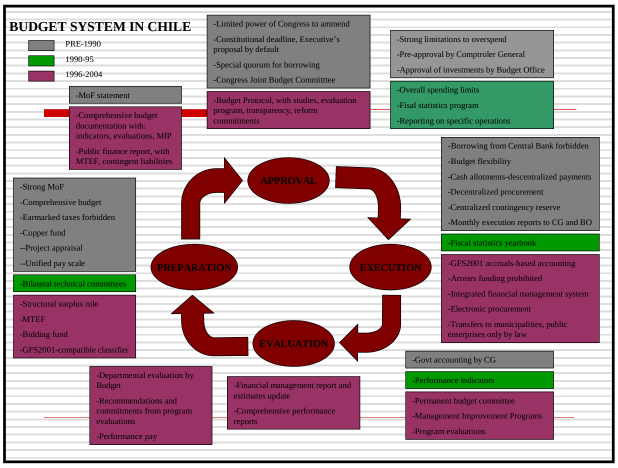
- Some features of Chilean PBB system:
  - Multi-tool
  - Common methodological framework
  - Fully operative
  - Routinized processes
  - Government-wide
  - Mostly centralized
  - Open to public scrutiny

TRANSPARENCY

- Adapting budget classifications to ad-hoc program structure
- Fiscal statistics (2003)
  - Adoption of GFS FMI 2001 standard, accruals accounting
  - Adoption of IMF-UN to functional classification
  - Coverage extended to off-budget central government
  - Publication on monthly, quarterly, annual series starting 1987, semi-annual government debt report
- Integrated Financial Management Information System-SIGFE(2000)

OTHER INITIATIVES

- Medium-term financial outlook
- Asset and Liability Management
- Public Finance Report
- Control of "secret" spending
- Performance-based pay
- Civil service reform
- Government procurement
- Internal audit



SUCESS MEASURES

- Reforms fully operational across central government (60% of government expenditure subject to some form of evaluation)
- Fiscal policy as an asset in country risk assessments
- Fiscal policy objectives reconciled with sector policies/goals
  - Orderly expansion of government expenditure at 6% p.a. since 2000
  - Expenditure reallocations: US$ 1.5 billion 2001-2005
- Use of PBB by managers, ministers, BO; change in managerial culture
- Overall effectiveness measures
- New PFM framework helped to respond to unforeseen restraints, scandals, without loss on consistency
- Positive external assessments by multilaterals (IMF Fiscal ROSC, CFAA IDB-WB, OECD)

THE B-SIDE

- Failures
  - Using indicator-based performance pay
  - Sub-institutional team-based performance pay
- Obstacles
  - Outdated external control
  - Limited ministerial involvement
- Pending challenges
  - Extend evaluation to policies, subnationals, SOEs, tax expenditures
  - Overall strategic planning

SOME KEY ISSUES

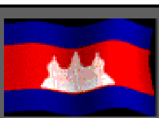
- Is growth and normality more favourable that crisis environment?
- Graduality vs. shock treatment
- Constructive vs. inquisitive approach
- The importance of social dividend
- Purpose and timeliness of legislation
- Building constituencies and bringing politicians on board
- The importance of building a virtuous circle

CAPE CONFERENCE 2007

Tales of the unexpected: PFM reform in difficult environments

Sok Saravuth
Ministry of Finance, Cambodia

14 – 15 November 2007
Overseas Development Institute, London, UK



Public Financial Management Reform Program (PFMRP)

Cambodia Experience:

Four Platforms Toward International Standards

Kingdom of Cambodia
Ministry of Economy and Finance
London, 14-15 November 2007

Outline

1. Background
2. Achievements and Challenges
3. Next Step and Conclusions

---

1. 1. Background: Problem Statement

1. Technical issues

- **Fiscal Sustainability:** Medium term sustainability depends on improved domestic resource mobilization and adequate, effective public sector expenditure in economic services to finance the poverty reduction and growth agenda
- **Prioritization of Resource Allocation:** Weakness in both the budget formulation and execution process undermine locative efficiency
- **Efficient and Effective Use of Resources for Service Delivery:** Weakness in treasury operations, cash management, expenditure management, and monitoring and reporting, making the public expenditure and financial management system a source of fiduciary risk

---

1. 2. Background: Previous Efforts

2. Reform Efforts and Assistances

- Some separated and uncoordinated reform efforts have been undertaken since 1995
- Some individual technical assistances have been provided since 1995
- Technical Cooperation Assistance Program (TCAP) was the first comprehensive and integrated program with better coordination
- No common understanding of problem, unclear objective and strategic plan, short term focus
- Low ownership and low effective/efficient of the reform efforts and assistances

1. 3. Background: Platform approach

PFMRP

International standards of PFM system by 2015

Stage 1(2005-2007)	Stage 2 (2008-2010)	Stage 3 (2011-2013)	Stage 4 (2014-2015)

Platform4: Effective Performance Accountability

Platform3: Affordable and Prioritized Policy Agenda

Platform2: Effective Financial Accountability

Platform1: Credible Budget

2. 1. Platform 1 Objectives

A More Credible Budget

Revenue Policy & Forecasting:

- Strengthen Macro-Fiscal Framework & Forecasting
- Improved Revenue Administration & Collection

Budget Formulation:

- Budget process
- Comprehensiveness & Integration of Budget
- Debt Management
- Post Budget Supplementary

Budget Execution:

- Streamline Process
- Use Banking System
- Cash Management
- TSA/Bank Accounts Consolidation
- Arrears Reduction
- Procurement

2. 2. Platform 1 Achievements

Budget Credibility

key objectives to achieving platform 1 | Preparation for later platforms

Revenue Administration and Collection Has Improved Significantly	Budget Formulation Has Improved Significantly	Budget Execution Has Improved Significantly	Substantial Preparation On Fundamental Areas for Later Platform Has Been Made	Minimum Requirement For Capacity/ Institutional Development & Motivational Measure Has Been Achieved

2. 2. Platform 1 Achievements (cont.)

Revenue Administration & Policy

Revenue Administration and Collection Has Improved Significantly

- Revenue achieved 114.7% in 2005 and 105.4% in 2006.
- Tax revenue increased by 20.4% in 2005 and 20.2% in 2006.
- Non-tax revenue increased by 6.6% in 2005 and 9.3% in 2006.
- Collection through bank: 46%
- Laws/regulations have been strengthened

- Revenue forecasting has been improved and further improvement on macro-fiscal and revenue forecasting model is under construction.
- Trainings/workshops have been conducted
- Revenue policy framework has been drafted and is under consideration.

2. 2. Platform 1 Achievements (cont.)

Budget Formulation

Budget Formulation Has Improved Significantly

- Budget cycle/process: 3 stages/start from March
- BSP has been used as a vehicle for comprehensive and integrated budget
- New budget classification
- Salary budgeting process has been improved through better coordination and arrangement among LMs, CSS, CAR, and MEF

- Post budget supplementary credit has been cap within contingency fund.
- Mid-year review has been introduced since 2005
- Rev-Exp plan has been introduced in 2006
- Partial amendment of Budget law has been made and full amendment has been drafted.

2. 2. Platform 1 Achievements (cont.)

Budget Execution

Budget Execution Has Improved Significantly

- Expenditure profile

	2005	2006
1st Qtr	14%	15%
2nd Qtr	37%	40%
3rd Qtr	64%	63%
4th Qtr	95%	95%

- Expenditure by types

Salary	98%	104%
G/S	103%	108%
Capital	95%	82%

- Arrears reduction: 10% in 2005 and 38% in 2006.
- First phase streamline done
- 21 internal audit Departments
- Payment by check: 67%
- Procurement decentralization has been implemented
- Quarterly Expenditure plan has been used for disbursement

2. 3. Preparation for later platforms

Later Platform Preparation

Substantial Preparation On Fundamental Areas for Later Platform Has Been Made	• New COA and Budget classification has been implemented • Initial design of FMIS has been started • Internal audit has been introduced • Expenditure tracking has been piloted • Partial amendment of Budget Law has been made	• Program budgeting has been piloted • Full amendment of Budget Law has been drafted and is under consultation • Fiscal decentralization study and options have been conducted/proposed • Initial design of state asset register has been started • Minimum ICT capacity has been achieved

2. 4. Capacity development and Motivational Measures (CD&MM)

CD&MM

Minimum Requirement For Capacity/ Institutional Development & Motivational Measures Have Been Achieved	• Some institutional changes have been made within MEF • Motivational measures have been undertaken (PMG/MBPI) • Some training courses, workshops, and study tours have been conducted • Initial step of functional review and establishment control have been undertaken	• Short/long term training strategies have been developed • New recruitment has been made for CED, TD, NTRD, and NT • Minimum ICT capacity has been achieved (computer equipments, networks, database, and some basic computer training)

2. 5. Challenges

- Sequential and interrelated works:
  - Macro-fiscal model and time series data availability and reliability
  - Comprehensive/integrated budget and institutional regulation/unpredictable nature of finances
  - Technical change and institutional/human resource management changes (program budgeting/FMIS)
  - Fiscal decentralization and D&D

2. 5. Challenges (cont.)

- Complexity and time consuming:
  - Accrual accounting in the new COA
  - Functional classification in the new budget classification
  - Program budgeting
  - FMIS needs new business process and capacity
  - Institutional/Motivational measures need overall civil service reform policy

3.1. Next Step
From Platform /Stage 1 to platform/Stage 2

16 Objectives	63 Activities
- 5 objectives of platform 1 to be continue monitoring in stage 2	- 15 activities to be implemented in order to ensure the sustainability of budget credibility installed during platform/stage 1
- 8 objectives of platform 2 to be implemented in stage 2	- 39 activities to be implemented in order to improve and strengthen financial accountability
- 3 objectives for later platforms to be implemented in stage 2	- 9 activities to be implemented in order to prepare for later platforms

3.2. Next Step
From Budget Credibility to Financial Accountability

Platform 2 Goal	Objectives
Effective Financial Accountability	1: Improved lines of accountability 2. Further improve the implementation of new budget classification and new chart of account 3. Introduction of Financial Management Information System 4. Improved reporting and transparency 5. Improved auditing/inspection and response to/use of audit/inspection findings 6. Improved instruments for encouraging responsible financial management and enforcing accountability 7. Develop and implement fiscal decentralization policy 8. Implementation of the second phase of capacity development plan

3.3.Next Step

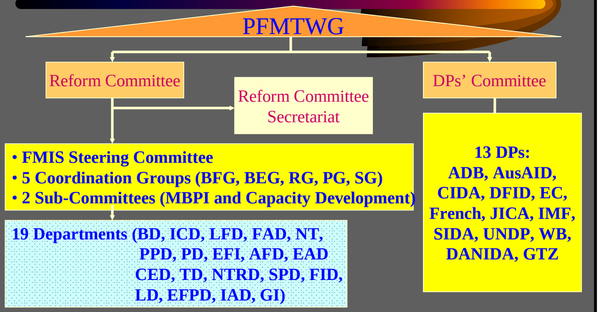
Works to be prepared for later platforms in Stage 2

Goals for later platform	Objectives
Program Budgeting, Fiscal decentralization, and long term Capacity Development	1. Improve and expand the pilot implementation of Program Budgeting 2. Develop and implement fiscal decentralization 3. Review and further develop the overarching capacity development plan

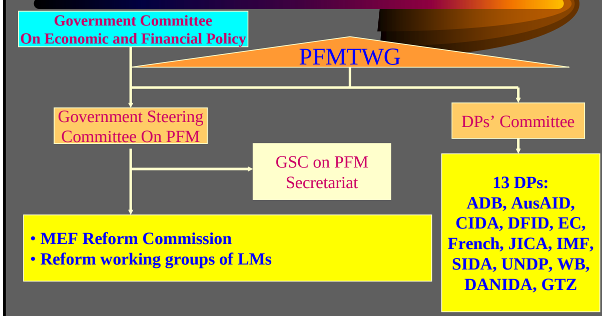
3.4. Performance Indicators for Stage 2 (PIs)

7 indicators from platform 1: (to continue measuring against the 5 objectives from platform 1 to ensure budget credibility)	(1) Revenue out-turn close to target, (2) no accumulation of new arrears, (3) expenditure profile, (4) Reduction of bank accounts to be closed, (5) composition of expenditure, (6) better tax yield to GDP, (7) single budget process.
10 additional indicators from PEFA: (to measure against the 8 objectives of platform 2 to ensure financial accountability)	(1) clear rules for both responsibility and empowerment of all budget managers, (2) Core FMIS in place, (3) implement an alignment of COA and budget classification, (4) Taxpayer obligations and liabilities transparency, (5) Transparency in reporting to parliament and to public, (6) clear and transparent fiscal relationships between central and locally based public bodies, (7) clear sanctions in place, (8) clear rewards in terms of trust; freedoms and flexibility, (9) Strong post audit arrangements in place, (10) Minimum capacities established in key line ministries with regards to skill set required for exercising of effective accountability.

3. 5. Implementation Arrangements for Stage 1



3. 6. Implementation Arrangements for Stage 2



3.7. Conclusions

- PFMRP is the first most comprehensive reform program with clear objectives and strategic plan
- PFMRP is the first SWAp with effective/efficient coordination and implementation arrangements
- PFMRP has achieved significant results and gained more and more supports
- PFMRP is proving and promising in building Cambodia PFM system towards an international standard through a platform/stage approach
- PFMRP success depended on sustainable commitment, leadership, ownership, capacity development, and motivational measures

Thank You

CAPE CONFERENCE 2007

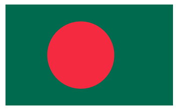
Tales of the unexpected:
PFM reform in difficult environments

Ranjit Chakraborty
Ministry of Finance, Bangladesh

14 – 15 November 2007
Overseas Development Institute, London, UK

2007 CAPE Conference
Overseas Development Institute

Tales of the Unexpected:
PFM reform in difficult environments
Experiences from Bangladesh



Ranjit Kumar Chakraborty
Joint Secretary to the Government of Bangladesh
Project Director, Financial Management Reform Programme (FMRP)

Agenda

- The “guiding principles” behind PFM reform in Bangladesh;
- Background, timeline and sequence;
- The Financial Management Reform Programme;
- Achievements in Bangladesh;
- Constraints and Challenges;
- Future PFM Reforms

The Background to PFM Reforms in Bangladesh

- Two guiding principles of PFM reform in Bangladesh are:
  - It is a “home-grown” initiative, led by Finance Division with a strong champion for change;
  - “Evolution not revolution”;

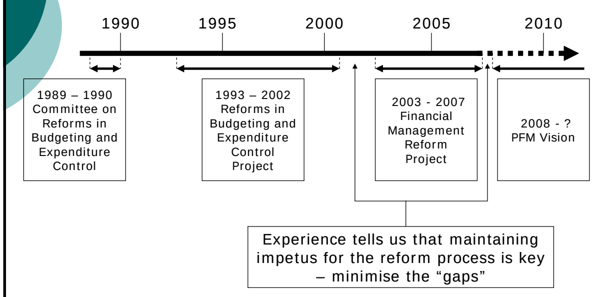
The Background to PFM Reforms in Bangladesh

PFM Reforms have been ongoing since the “Committee on Reforms in Budgeting and Expenditure Control” was formed in 1989 …

The Background to PFM Reforms in Bangladesh

… and a follow-on project will be launched when the Financial Management Reform Programme ends in June 2008

Background and Timeline of PFM Reforms in Bangladesh



Sequence of reform

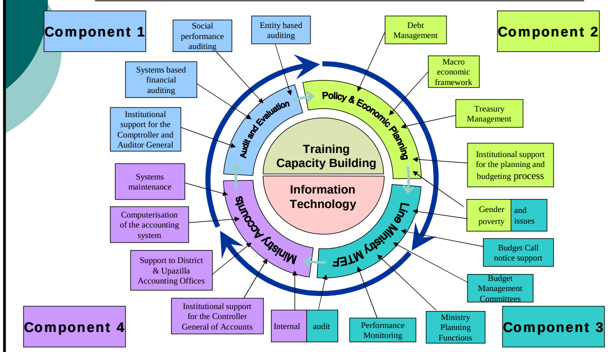
- The 1st phase of reforms focused on <u>technical improvements,</u> including:
  - Consolidation of financial data;
  - Streamlined budget administration;
  - Effectiveness of external audit;

Sequence of reform

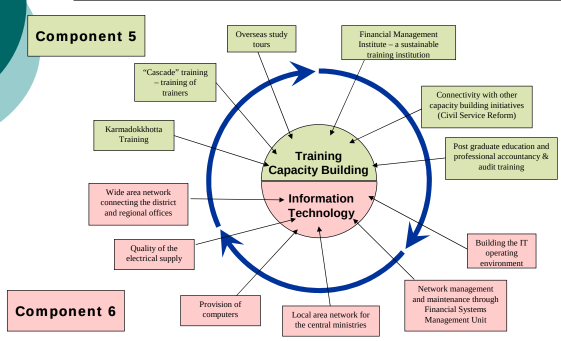
The 2nd phase focused on <u>improvements to resource management,</u> brought about largely by the MTEF:

- Macro modelling, debt management;
- Strengthening the linkage between policy planning and budgeting;
- Devolution of responsibility for planning and budgeting to the line ministries;
- Increased focus on monitoring and evaluation;

Operational Components of the Financial Management Reform Programme



Cross Cutting Components of the Financial Management Reform Programme



Achievements in Bangladesh

- **Computerisation of budget and accounting processes alongside a new classification system;**
- *<u>Impact</u>:*
  - *Improvements to the consolidation and presentation of financial information;*

Achievements in Bangladesh

- **Establishing a macro-fiscal modeling and Resource and Debt Management capability;**
- *Impact:*
  - *Provides more robust data for fiscal planning leading to fiscal stability;*
  - *Enables strategy creation and debt policy;*

Achievements in Bangladesh

- **Systems based auditing and improved level of professional qualification;**
- *Impact:*
  - *The ability to audit a ministry as an "entity" aligns the audit approach with budgetary responsibility;*
  - *The ability to undertake performance and social audits;*

Achievements in Bangladesh

- **Implementation of an MTEF approach to budgetary control;**
- *Impact:*
  - *Builds linkages between the policy planning and budget setting functions;*
  - *A tool to "operationalise" the poverty reduction strategy at the line Ministry level;*
  - *Builds effective monitoring and evaluation, including the capacity to report more effectively on Gender and Poverty expenditure;*

Achievements in Bangladesh

- **Establishing one of Bangladesh's biggest Wide Area Networks;**
- *Impact:*
  - *Allows the exploitation of modern technology;*
  - *Faster, more accurate and more comprehensive data collection;*
  - *Electronic data links to the banking system;*

Achievements in Bangladesh

- **Enhanced regulatory control through the dissemination of a Public Expenditure Manual, Internal Control Manual and Procurement Act & Regulations**
- *Impact:*
  - *Better operational financial management control;*

Achievements in Bangladesh

- **Setting up a Financial Management Academy to provide training:**
- *Impact:*
  - *A focal point for professional education and ongoing financial management training, (conceptual and operational) – an essential component of ensuring sustainability;*

Constraints over Reform

- A regulatory framework which in many areas goes back decades;
- A base of largely manual accounting systems;
- Large numbers of staff to train;
- High transaction volumes;
- Poor infrastructure, especially in rural areas;

Constraints over Reform

- The Controller General of Accounts' Department:
  - Employs over 6,000 people;
  - Processes approximately 3 million transactions a month;
  - Operates out of more than 500 locations;

Key challenges in implementing reform in Bangladesh

- *The Human Resource implications:*
  - *High levels of staff transfer erode the impact of the capacity building – significant levels of training are necessary just to stand still;*
  - *There is still not full buy-in from some institutions whose processes are affected by changes to the planning, budgeting and evaluations systems brought about by MTEFs;*
  - *Restructuring of Bangladesh Civil Service;*

Key challenges in implementing reform in Bangladesh

- *The roll-out of the computerised accounting systems, particularly to the rural treasury offices:*
  - *The continuity and quality of the electrical supply;*
  - *Appointing staff with the requisite technical skills;*
  - *Carrying out system maintenance, managing upgrades etc;*
  - *Establishing robust reciprocal systems in the banks which interact correctly;*

The Future Direction of PFM Reform

GoB PFM Vision and Goals:

- *Maintain fiscal discipline, macroeconomic stability and pro-poor growth;*
- *Promote the efficient use of public resources in accordance with the government priorities,*
- *Encourage better budget execution and enhanced transparency and accountability;*
- *Strengthen democratic accountability in budget planning and formulation and strengthen independent, external scrutiny;*

Thank You for Your Attention

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Tales of the unexpected:
PFM reform in difficult environments

14 – 15 November 2007
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Irish Aid
Department of Foreign Affairs
An Roinn Gnóthaí Eachtracha

BTC CTB
EMPOWERING DEVELOPMENT

DFID Department for International Development

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Tales of the unexpected:
PFM reform in difficult environments

Session 4
What are the key explanatory factors underlying successful PFM reform?

14 – 15 November 2007
Overseas Development Institute, London, UK

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Tales of the unexpected:
PFM reform in difficult environments

Nick Manning
World Bank

14 – 15 November 2007
Overseas Development Institute, London, UK

Good budgetary institutions and a good Civil Service: Two sides of the same coin?

Nick Manning
The World Bank
November 2007

Definitions: What do we mean by…

- **Civil Service**
  1. Capacity – Ministries and Departments
  2. Fiscal weight – public domain
- **Budgetary Institutions**
  1. Aggregate Fiscal Discipline
  2. Allocative tasks
  3. Implementation/service delivery

Public Sector Employees: Capacity v. Fiscal Weight

Domains				Employees Contingent Fiscal Liability: In Principle	Employees Contingent Fiscal Liability: In Practice
Public Sector	General Government	Central Government	Ministries and departments in CG	High	High
			Schools, hospitals, etc. largely funded and controlled by central government but not owned by CG		
		State Governments			
		Local Governments			
		Social Security Funds			
	Other Public Sector				
Private Sector in the Public Domain				Modest	High

Points of Entry

Some PFM reforms…

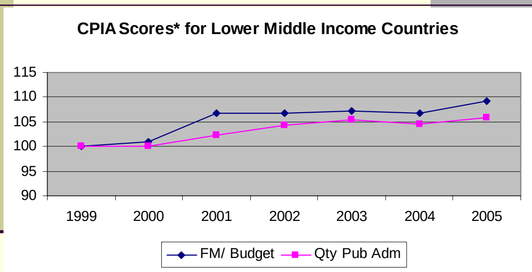
- are easier than most CS reforms
- must precede some CS reforms
- can be undertaken in isolation

But…

PFM reforms have to be matched by complementary CS reforms, otherwise PFM reforms are pointless!!

- Budget Preparation: Wage bill determines allocation
- Budget Execution: No top-down (traditional) discipline or (NPM) quasi-contracts

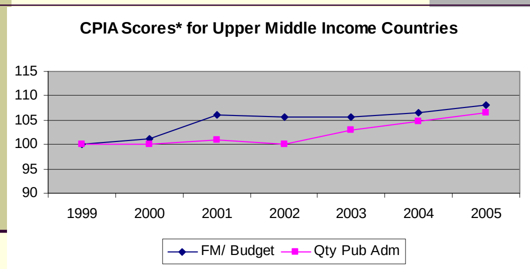
PFM improvements "pull" CS reform in Lower Middle Income countries



Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

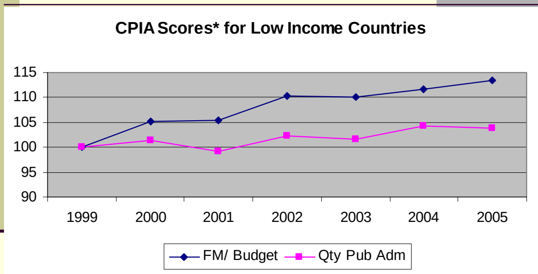
…and in the Upper Middle Income countries



Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

But PFM goes it alone in Low Income countries



Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

Narrow approach to PFM improvements

"Get a bunch of technocrats to run the Ministry of Finance"

- Not a crazy idea
- Common in some specific situations (post-conflict)
- WB support. Low income or post-conflict countries: Paraguay, Pakistan, Laos, Tanzania, Sierra Leone, Kenya, Lebanon
- But…there's a whiff of desperation
- Just a point of entry

Capacity in the MoF is hostage to larger Forces

(i) Macro-fiscal forecasting of revenues and expenditures – the Legislature is critically involved – **Brazil**

(ii) Budget execution and expenditure efficiency - the quality of management and service delivery units is the constraint – **Honduras**

(iii) Accounting and FM information – requiring significant cooperation from often reluctant agencies – **Peru**

There are some success stories in following through…

A more measured approach tries to ensure work on CS accompanying work done on PFM

- Budget execution and expenditure efficiency - When can performance contracts be made to work? **Chile**
- Accounting and financial management information. Why did an IFMIS work in **Guatemala**?

The Moral of the Story

- PFM can lead, but CS must follow
- It is often the CS issues that are the brake on progress
- The challenges are:
  - To get it right technically
  - To increase pressure for both

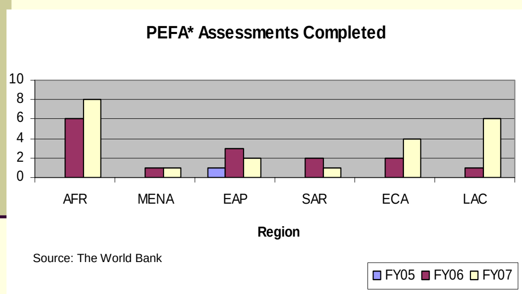
Getting it right technically on the CS

- The direction of CS reform in weaker environments is the reverse of that followed elsewhere
- Quasi-contracts very interesting in Brazil and Chile
- Hierarchical control somewhat more useful in Guyana

Generating demand for reforms

- Breaking out of the equilibrium
- Managed disappointment
- Institutionalized expectations

PEFA – a good start

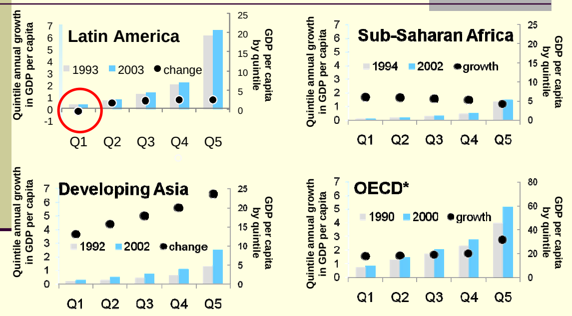


*Public Expenditure Financial Accountability Tool

But we need public engagement

- This means some degree of confidence in government – about something other than pork and patronage
- Latin America shows the challenges

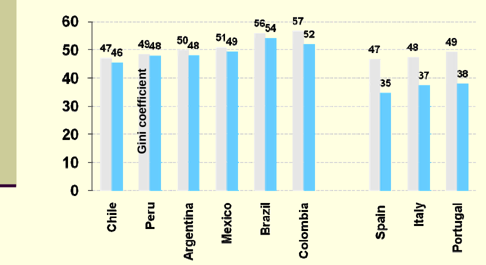
Some of the poor in Latin America have little reason to trust economic policy



Source: OECD Development Centre, 2007. Based on IMF , *Globalization and Inequality*, 2007. OECD* includes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Netherlands, Norway, Singapore, Spain, Sweden, UK, US., from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

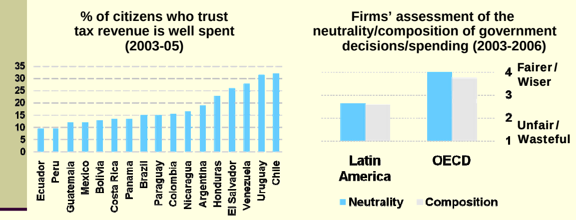
Many of the middle class have little reason to trust tax policy…

Inequality before and after taxes and transfers



Source: OECD Development Centre, 2007. Based on data by Goñi, López, and Servén (2006), from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

…and many have little confidence in the government's fiscal wisdom



Source: OECD Development Centre, 2007. Based on Latinobarómetro (2003, 2005) and World Bank Institute, Governance Indicators Database. Based on World Economic Forum, Global Competitiveness Report, 2003-2006, from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

Conclusion

- As institutional plumbers, we need to keep our skills up to date – let's get it right technically
- But we also need to work more imaginatively to manage public expectations upwards

CAPE CONFERENCE 2007

Tales of the unexpected: PFM reform in difficult environments

Ian Lienert
IMF

14 – 15 November 2007
Overseas Development Institute, London, UK

Influences on PFM Reforms other than that of executive branch of government

Ian Lienert
Fiscal Affairs Department
International Monetary Fund

CAPE conference, ODI, London
November 15, 2007

Outline of this presentation

- Potential influences on PFM reforms from non-executive branch actors
- Areas of PFM reforms susceptible to non-Government influence.
- Who influences PFM reforms in OECD countries?
- Who influences PFM reforms in developing countries?

Potential influences on PFM reforms from non-executive actors

- Parliaments
- External audit offices
- "Independent" agencies
- Civil society groups, NGOs
- Media
- Donors

Parliament's potential for influence depends (in part) on separation of powers

One extreme: Westminster system: Where the government is selected from Members of Parliament and Cabinet Ministers continue as parliamentarians:

- The Executive effectively controls the Legislature.

Other extreme: Presidential system: Where the Legislature and the Executive are independent of each other.

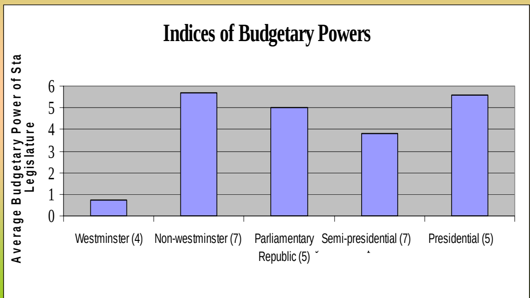
- The Legislature of USA is in the driver's seat for determining the shape and size of annual budgets, as well as PFM reforms (for which it adopts laws).
- Other presidential countries: less budgetary power

Political considerations—electoral system, party cohesion, etc.—are important

Is it a coincidence that USA has adopted many major laws relating to budgetary processes, whereas in other countries, budget-related laws are fewer?

Budgetary Powers of Parliaments vary considerably

Source: Author, based in IMF WP/05/115



Three main PFM areas of parliamentary influence

- **Budget approval.** Parliament is more likely to strengthen its own powers where it has greatest clout, notably during budget adoption:
  (1) amendment powers of draft budget
  (2) structure, type, and duration of appropriations
  (3) time allowed for parliamentary discussion
  (4) support to parliament for budget analysis
- **Budget reporting.** Parliament, which is sometimes "out of the loop", may require fuller reporting of:
  (1) in-year budget developments and fuller annual reports
  (2) more comprehensive information to accompany draft budget (medium-term fiscal strategy; debt strategy; rationale for fiscal measures; fiscal risks..)
- **External audit follow-up**
  (1) Parliament forces Executive to act on external audit report.
  (2) Parliamentary resources are strengthened to do this.

Areas of PFM systems where external audit office exerts influence

- **Budget execution.** External auditor recommends improvements in internal control, internal audit, treasury payment or IT systems.
- **Budget reporting.** External auditor may recommend improvements in quality and timeliness of government (annual) accounts.
- **The 3 Es.** If value-for-money audits, the executive needs to act on auditors' recommendations to improve efficiency.

Influence of Other Actors *(civil society, NGOs, media)* is largely indirect

"Non-governmental groups are now investigating how budget work can help achieve their goals. In recent years, a wide range of groups in dozens of countries have begun to engage in budget work, including:

- *Writing general reviews of government budgets;*
- *Advancing budget literacy in their countries through budget trainings and other educational efforts;*
- *Seeking to make budget systems more transparent and participatory;*
- *Conducting budget analyses, often with a particular concern with policies affecting the poor."*

Source: "Guide for Applied Budget Work", International Budget Project

Who influences PFM reforms in advanced countries?

Executive may initiate reforms to improve its operations and credibility:

- **Macro stability:** concern to attain macro-fiscal targets, debt objectives, and reasonable stability in tax rates.
- **Internal organization and responsibilities for PFM**: change: (a) the roles of spending ministries and the "ministry of finance" (MOF); (b) responsibilities within the MOF; (c) reporting by budget managers to the political executive. Such reforms aim at **improving budget management and accountability.**
- **Internal control:** more (or less) autonomy for agencies; depends on extent of delegation of authority.
- **Performance**: of government agencies, who must achieve specified outputs/outcomes (performance indicators).
- **Transparency:** including provision of fuller and more-useful budgetary information

Who influences PFM reforms in advanced countries (continued)?

Parliament may initiate reforms to strengthen budget powers:

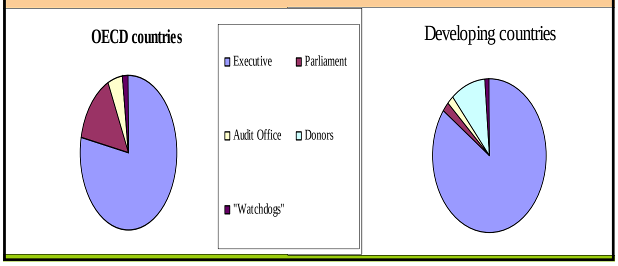
- **Require more time** to consider the draft budget proposals.
- **Restrict flexibility of executive:** (a) no "hidden" spending without parliamentary approval; (b) appropriation limits as lower limits (e.g., USA); (c) earmarking of expenditures in budget "programs".
- **Impose stronger accountability on Executive:** (a) require enhanced clarity of fiscal policy intentions and justification of budget outcomes; (b) increase hearings before parliamentary committees; (c) more serious follow-up and monitoring of external audit reports; (d) demand gains in budget performance and clarity/usefulness of P/indicators.
- **Transparency:** require fuller information on budget, including for annual budget (fiscal risks), medium-term budget objectives, and long-term scenarios.
- **Internal organization of Parliament:** (a) to strengthen parliamentary committees (budget and sectoral); (b) to create a Congressional (parliamentary) Budget Office.

Reforms in Budget Systems Laws Selected OECD countries

PFM areas covered in the new law(s)	France	Germany	New Zealand	Sweden	United Kingdom	United States
1. Improve macroeconomic stability in general (reduce fiscal deficit)		1967-69	As from 1986	Early 1990s		As from 1985
1a. Qualitative fiscal rules			In 1990s	mid-1990s	(but not by law)	
1b. Quantitative fiscal rules		Golden rule				1985-89* 1991-02
2. Enhance fiscal transparency	2001		1994		1998	
3. Introduce a medium-term budget framework		1967-69	1994	1996		
4. Introduce performance-oriented budgeting	2001		Late 1980s		2001	1993
5. Introduce more flexibility in budget appropriations	2001	Late 1990s	Late 1980s	1996		
6. Introduce accrual accounting or possibility of accrual accounting	2001		1989		2001	
7. Reduce off-budget activity	2001					
8. Weaken the authority/powers of the executive in budget processes	2001					1974, 1990

Who influences PFM reforms in developing countries?

Are the key differences as depicted below?



Developing Countries: Role of Parliaments in PFM system

Parliaments in developing countries often lack:

- Involvement in budget priority setting.
- A transparently presented budget.
- Ability to change draft budget proposed by the government.
- Analytical capacity, for examining the ex ante budget and ex post outcomes (which may differ substantially from approved budget).
- Follow-up on external audit reports (Public Accounts Committees, if they exist, are often not effective).

Developing Countries: External audit offices

- Independence may be compromised e.g., with appointment (often) or dismissal (infrequent) by executive.
- Executive branch "controls" e.g., content of published audit reports.
- Lack of capacity: both infrastructure and human resources.
- Inadequate budget for audit office; not all budgeted funds released.
- Lack of cooperation with civil society/media.
- Statutory deadlines missed (in part because government does not provide timely final accounts, thereby resulting in an audit that it too late to influence new budget).
- Executive: little incentive to follow-up auditors' recommendations.

Developing countries' "Independent" agencies

- *Anti Corruption Agencies* have been created in many countries.
- In francophone countries, *Inspection Générale des Finances (or de l'Etat),* firmly under the executive and less independent than in France.
- Inspectorates in anglophone countries not well developed.
- These organizations are mainly "guardians or enforcers of existing rules" rather than initiators of changes in the PFM rules.
- Nonetheless, in some cases, changes, or at least reviews, of existing rules have resulted, e.g., Nigeria's civil service rules, Financial Regulations, and Procurement procedures

Developing Countries: Role of civil society groups, NGOs, Media

- Can be instrumental for increasing awareness of budget policies and their consequences.
- Suggestions/recommendations can be ignored by strong governments.
- Links with budget decision-makers not strong.
- More public dialogue implies more indirect influence. Politicians listen to voices!
- But: "we-serve-the-president" mentality persists.

Who then influences government budgets in developing countries?

- Conclude: Parliaments, civil society groups, NGOs, the media, and "independent" official organizations have not had much influence on reforming PFM systems........although their role is gradually increasing.
- Propose: Donors have a strong influence on PFM systems and budgetary policies:

"The foundations of budgetary policies represent the view of a small group of transnational professionals based in key government ministries and donor agencies, which occlude the possibilities for deepening democratic oversight of policies of national development" (Gould and Ojanen)

- Is this an overstatement? What are the channels of donor influence?

Developing Countries: Multilateral institutions' conditionality

- IMF – Structural benchmarks, structural performance criteria, and government declarations of proposed PFM action, as contained in IMF programs.
- World Bank – loans/grants include conditionalities, including in PFM.
- Development banks – also include conditionality in PFM.
- Examples range from a few isolated "key" measures (e.g., present new PFM law to Parliament) to a whole program of PFM reforms (e.g., see annex to 2002 IMF staff report for Laos)
- Impact: depends on: (1) whether conditionality is met; (2) effective implementation (mixed record), and (3) whether authorities would have taken PFM measures even without the multilaterals' programs.

Bilateral Donors

- Government to government support – usually contains less conditionality than multilaterals.
- Participate in donor coordination groups that dialogue with government on budget priorities/policies.

But:

1. Bilaterals must report to home-country legislatures on accomplishments in recipient countries (and may not adhere to Paris Declaration principles for harmonizing aid).
2. As donors pool resources, increasingly via budget support operations, "policy reform matrices" – conditionality – is becoming more common (e.g., in Burkina Faso, where non-BWI donors exert more influence in PFM system than multilaterals).

Donors' Technical Assistance (TA) Activities

- IMF – Resident or peripatetic TA to implement specific parts of a PFM reform program and strengthen capacity.
- World Bank and Development Banks – consultants.
- Bilaterals – Resident experts (e.g., France), donor financing of experts (foreign and/or local), salary top-ups for selected staff involved in PFM reforms.

Impact:

- Mixed results from TA, especially for *permanently* improving capacity (see e.g., http://www.ieo-imf.org)
- Best results when strong local "ownership", skills are transferred (both technical and management), and good donor coordination with authorities.

Conclusions

- Government policy-makers dominate budget-making and PFM reforms in all countries, except those where the Legislature is strongly separate from the Executive.
- Executive-dominance for PFM reforms is pronounced in developing countries, especially in Africa (in part a reflection of colonial inheritance + adoption of strong presidential regimes).
- Parliaments and external audit offices have potential to increase their influence on PFM reforms, but this will be a long process (democracy is young).
- Civil society groups' influence on PFM system is low, but very slowly increasing.
- Donors exercise considerable influence on governments in developing countries, through financial assistance, TA, and direct dialogue.

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Overseas Development Institute

CAPE CONFERENCE 2007

Tales of the unexpected:
PFM reform in difficult environments

Carlos Scartascini
IADB

14 – 15 November 2007
Overseas Development Institute, London, UK

Fiscal Reforms in Latin America.
A "New" Political Economy Perspective.

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CAPE PFM Conference 2007
"Tales of the Unexpected. PFM Reforms in Difficult Environments"
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Opinions expressed in this presentation do not necessarily reflect the view of Bank management or member countries.

Outline

1. Fiscal Reforms in Latin America: Budget Institutions
2. Reforms in practice
3. Some lessons learned
4. A "new" framework

Fiscal Reforms in Latin America

- What has happened in terms of fiscal reforms in Latin America?
  - Basically, a lot.
  - As described in *The State of State Reform in Latin America* (Lora (ed), 2007), a “silent revolution” of “second generation” reforms has swept the region.
  - Regarding fiscal reforms, the tax structure has changed, most countries have increased their level of decentralization, and they have introduced more restrictive **budget institutions**.
  - This presentation will present the evidence on the latter.

The Role of Budget Institutions

- ***Budget Institutions*** are the set of rules, procedures and practices according to which budgets are drafted, approved and implemented (Alesina and Perotti, 1996).
- Budget institutions impose restrictions on the actions of the budget process participants, and define the rules of engagement.
- These rules may take various forms, such as numerical rules, procedural rules, and transparency rules.

The Role of Budget Institutions

- **Numerical rules**
  - *Laws and/or regulations which establish ex ante constraints on deficits, debt, and/or expenditures.*
  - Numerical limits, MTFF, debt constraints, etc.
- **Procedural rules**
  - *Norms and regulations that indicate the prerogatives of the actors involved in the budget process.*
  - Prerogatives of the legislature, of the line ministries, of the Ministry of Finance, etc.
- **Transparency rules**
  - *Norms and regulations that establish the conditions under which budgets are prepared and presented to society.*
  - Comprehensiveness of budget documents, extra-budgetary funds, etc.

Source: Filc and Scartascini (2005, 2006)

The Role of Budget Institutions

- Caveat: understanding fiscal reforms by looking only at the evolution of budget institutions has some problems:
  - Based on formal rules, rather than actual practices.
  - Linked to fiscal sustainability.
- However, it provides a framework to understand their origin and classify them, based on an established literature.

Do Budget Institutions affect fiscal performance?

- International experience suggests that the impact of Budget Institutions is robust, and economically important
  - **US**: States with more stringent balanced budget rules have better fiscal outcomes (lower deficits, lower debt, adjust more quickly to adverse shocks) (Eichengreen (1992), Bohn and Inman (1995), Alt and Lowry (1994), Poterba (1994), Bayoumi and Eichengreen (1996))
  - **EU**: More hierarchical Budget Institutions reduce deficits and debt, without affecting capacity to stabilize output. Von Hagen (1992) and von Hagen and Harden (1995), Hallerberg and others (2001)
  - **LAC**: More restrictive, hierarchical and transparent budget institutions are associated with smaller deficits (Alesina et al 1996, Filc and Scartascini 2005, 2006).

Reforms to Budget Institutions

- Studying the role of budget and fiscal institutions has provided invaluable insights for understanding fiscal results for Latin America.
- In part based in that research, during the last two decades, most countries in Latin America have been actively engaged in the process of reforming their budget institutions.

Reforms to Budget Institutions

- Reform efforts have come in different waves
  - Early 1990s, main feature was adoption of integrated financial administration systems, which have increased transparency, as well as the flow of information available to the budget authorities
  - Since 2000, one of the main features has been the adoption of numerical fiscal rules, often within the context of broader fiscal responsibility laws (7 countries adopted FRL's in this period)
  - More recently, increased emphasis on performance budgeting (shifting the focus from fiscal sustainability to efficiency of public expenditures)

Reforms since 1990

Table 5.1 Summary of fiscal reforms in Latin America

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Argentina			N, F		U,E[1]					R(N,C,T),SP,*r(c)*,S,E,F[2]		*r(n)*,S			R(N,S,C)	
Bolivia				S							U					
Brazil									N		R(N,S,T),P					
Colombia		*f*[3]			F[4]	C					N	S		R(N,P,T)		
Chile											R[5](N,C)			*e*[6], T		
Costa Rica												U,A				
Ecuador						U		E[7]	N	C			R(N,P,C,T)		T	*r(n)*
El Salvador				U			A									
Guatemala											P,N,U					
Honduras														P,U		
Mexico									C				C[8],P,T			
Nicaragua													S,F[9],A			P
Panama									U				R(N),S,T		*r(n)*	P,U
Paraguay			*e*[10]								U			P		P[11]
Perú					U						R(N,P,C,T)		*r(n)*,C,T			
Dominican Rep									F[12]						T	
Uruguay							U,E[13]									
Venezuela									C,U		P			R(N)[14]		
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005

Notes:

N: Numerical rules; C: Contra-cyclical Fund; P: Multiyear framework; R: Fiscal Responsibility Law: Subnational Govts; U: Single account; E: Increase in Executive power; F: Increase in power of Finance Ministry; T: Transparency, and; A: Principles of transparency.

Italic lower case means that the previously established reforms were reversed or the restrictions weakened.

R(X,Y) means that the Fiscal Responsibility Law included restrictions to X and Y.

Source: Filc and Scartascini (2006)

Numerical Rules

Country	Low restrictions	Medium restrictions	High restrictions	Main reform
Argentina	—	—	→	Fiscal Responsibility Law
Bolivia	▬			
Brasil	—	→		Fiscal Responsibility Law
Colombia		—	→	Fiscal Responsibility Law
Chile		—	→	Structural Balance Rule
Costa Rica	▬			
Ecuador	—	—	→	Fiscal Responsibility Law
El Salvador	▬			
Guatemala	▬			
Honduras	—	→		Multi-annual framework
Méjico	—	—	→	
Nicaragua	▬			
Panamá	—	→		Fiscal Responsibility Law
Paraguay	▬			
Perú	—	—	→	Fiscal Responsibility Law
Rep. Dominicana	▬			
Surinam	▬			
Uruguay		▬		
Venezuela	—	—	→	Fiscal Responsibility Law

Source: Filc and Scartascini (2006)

Procedural Rules

Country	Low hierarchy	Medium hierarchy	High hierarchy
Argentina	—	→	
Bolivia	▬		
Brasil			▬
Colombia		▬	
Chile			▬
Costa Rica		—	→
Ecuador		—	→
El Salvador			▬
Guatemala	▬		
Honduras			▬
Méjico		—	→
Nicaragua		▬	
Panamá		▬	
Paraguay	▬		
Perú		▬	
Rep. Dominicana		▬	
Surinam	▬		
Uruguay		▬	
Venezuela			▬

Source: Filc and Scartascini (2006)

Transparency Rules

Country	Low transparency	Medium transparency	High transparency
Argentina		+	
Bolivia		+	
Brasil			+
Colombia		+	
Chile		+	
Costa Rica		+	
Ecuador		+	
El Salvador			+
Guatemala		+	
Honduras		+	
Méjico			+
Nicaragua	+		
Panamá			+
Paraguay			+
Perú		+	
Rep. Dominicana			+
Surinam		+	
Uruguay			+
Venezuela			+

Source: Filc and Scartascini (2006)

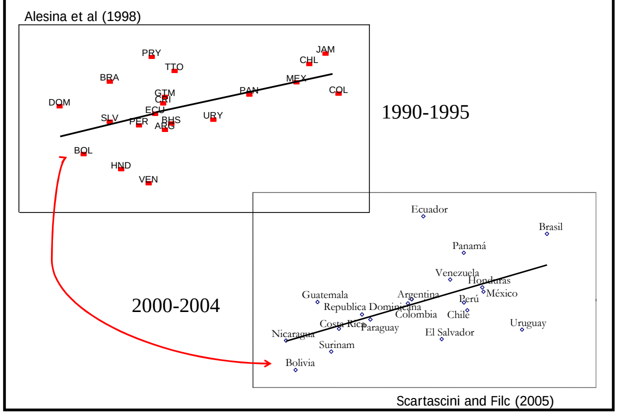
How do we explain reforms?

- The literature has focused on economic reforms in general and fiscal reform in particular. Some of the determinants of reform are:
  - Economic crises (Hirschman 1965, Haggard and Kaufman 1992, 1995, Weyland 1996, 2002)
  - Availability of policy ideas (Skocpol and Weir 1985, Hall 1989, etc)
  - Bureaucracies (Skocpol and Weir 1985)
  - Regime type (Olson 1982, 2000, Haggard and Kaufman 1995)
  - Veto players (Tsebelis 2002)
  - Power of the executive (Mainwaring 1999)
  - Polarization (Haggard and Kaufmann (1992, 1995)
  - Degree of electoral competition (Geddes 1994, Corrales 2002, Hallerberg 2004, Wibbels 2005)
  - Identity of initiators of reform (Tommasi and Velasco 1996, Cukierman and Tommasi 1994)

Could we really explain reforms?

- This literature has helped to understand certain stylized facts of the process of reform.
  - For example, following the financial crises of the mid to late '90s, those countries with stronger executives tended to pass stricter numerical rules. The introduction of these rules accompanied the consensus in the literature regarding their relevance.
- Still, we have to construct on its findings in order to explain better:

1. Why certain reforms have not prospered.



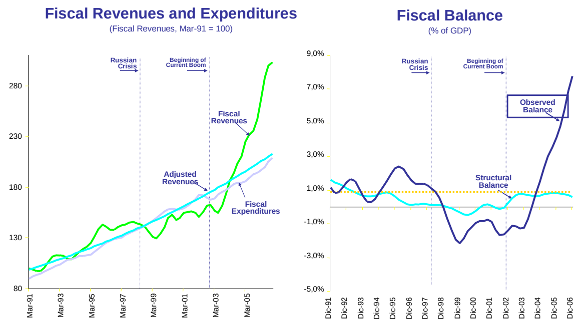
Do we really explain reforms?

2. The success (or lack of success) of the reforms.
   - For example, Argentina, Brazil, Chile, and Peru introduced numerical restrictions in order to improve their fiscal results.
   - While Argentina, Brazil, and Peru did it using Fiscal Responsibility Laws, Chile introduced a Structural Balance Rule.

Some Results of the Reforms

- Regarding their results, one of the main objectives of the reforms was to reach fiscal sustainability (and reduce volatility).
- Chile has had the most success using the less stringent type of norm (*political commitment*).

Chile: Structural Fiscal Balance*

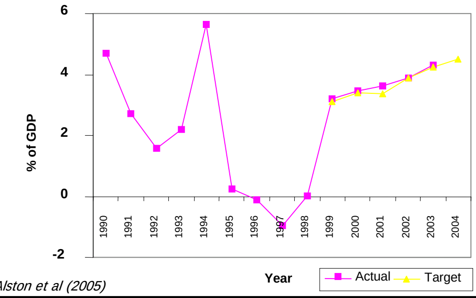


*Talvi, Ernesto (2007), "*If Latin America Were Chile: A Note on Structural Fiscal Balances*".

Some Results of the Reforms

- Brazil: it may be too early for definitive conclusions, but so far results have been encouraging.
- Its experience is quite different to Ecuador's (a country with similar characteristics of political institutions).

Brazil: primary deficit and targets



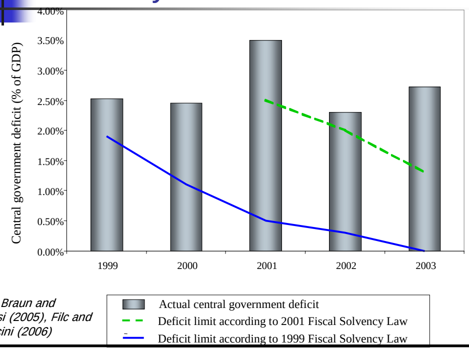
Source: Alston et al (2005)

Some Results of the Reforms

- In Argentina it took several years (and reforms) to finally comply with the (several times revised) law.
- Current good performance could be deceiving…

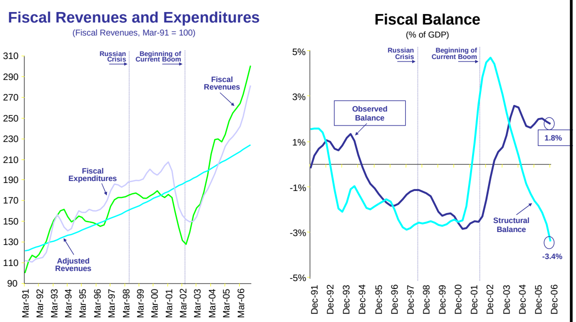
  …as well as past low performance
- The approved budget law could mean little at the end of the year in terms of actual appropriations (*superpowers*).

Argentina: Deficits and the Fiscal Solvency Law



Source: Braun and Tommasi (2005), Filc and Scartascini (2006)

Argentina: Structural Fiscal Balance*



* Izquierdo, Ottonello, Talvi (2007), " *If Latin America Were Chile: A Comment on Structural Fiscal Balances and Public Debt*" .

Some Results of the Reforms

- In Peru, the numerical rules component of FRL's has only recently been complied (partially) with.
  - Peru has complied with the deficits rule the last couple of years, it has diminished the electoral business cycle, but has yet to comply with the rule that limits the real increase of expenditures.
  - Other aspects of the law (e.g. multi-annual macro program, increased transparency and budget cycle) have positively changed the dynamic of the budget discussions.

Electoral Budget Cycle in Peru

Source: Valderrama et al (2006)

Other Reforms

- Other rules and regulations have had partial success in Latin America. For example,
  - Restrictions on increases in spending by the legislatures are usually circumvented.
    - Changes in the estimations (e.g., sudden increases in government revenue agencies while budget discussions take place in Congress)
    - Reallocation of expenditures from rigid accounts (e.g., from repayment of debt to current expenditures)
  - Budget laws are not complied with during execution and final allocations differ greatly from the law approved by Congress.
    - Impact of financial administration systems?

Source: Filc and Scartascini (2005, 2006), Scartascini and Stein (2005)

Changes to the Budget During the Year and Actual Execution

• The budget law is modified during the year and final appropriations differ greatly from the original and modified law. Changes and execution are highly variable across Ministries and years.

	2001	2002	2003	2004	2005	2006
			Education Ministry			
Mod/Appr	184%	191%	126%	163%	204%	148%
Acc/Appr	126%	97%	73%	96%	136%	59%
			Health Ministry			
Mod/Appr	124%	124%	120%	154%	180%	121%
Acc/Appr	**87%**	91%	83%	**109%**	127%	58%
			Labor Ministry			
Mod/Appr	132%	112%	128%	106%	116%	109%
Acc/Appr	117%	63%	**111%**	93%	**92%**	58%

Source: updated from Scartascini and Stein (2005). Data from ILACO-Bolivia.

Some lessons learned

- The experience with fiscal reforms in Latin America generates a number of important lessons.

1. Measuring reforms is very complicated.
   - "Institutional" reforms take place (almost) everyday as the president gain or losses bargaining power.
2. Measuring success is even trickier.
   - Argentina's example of failure and success.
3. Not all the countries that are relatively successful have the most sophisticated financial systems.
   - Some developed countries would not qualify very high under certain criteria (and the donor community?).
4. Certain outcomes can be reached even using the most rudimentary systems.
   - Balaguer's Dominican Republic.

A New Framework

- Therefore, we should:

1. Understand the incentives of actors from a general equilibrium perspective
   - Most of the previous attempts have been characterized by looking at reforms from a partial equilibrium framework
2. Take into account that the budget process is part of the core of the general policymaking process.
   - Fiscal policy and institutions have a major role in the policymaking process (funding for any policy has to go through the budget)
   - Reforms to fiscal institutions can have feedback to the more general policy game.
   - For example, what happens with the equilibrium in the policymaking process if the Executive gains (looses) power (or discretion) in the fiscal game? (Scartascini et al 2005)

A New Framework

3. Understand reforms (or lack thereof) as the outcome of the bargaining among many actors.
   - Each actor behaves according to their own incentives and preferences given the rules that bind their interaction.
   - (Sustainable) Changes happen when actors try to alter a status quo they find unbearable or try to adapt to an exogenous change in the status quo.
   - External changes are not sustainable if they do not change incentives, the number of actors that intervene in the policymaking process, their discount factors, or the arenas in which they interact.

Source: Braun and Scartascini (forthcoming)

A New Framework

4. When studying reforms it is important to understand what is that reforms (or lack of reforms) are showing about the polity.

Reforms, policymaking process, and drivers of reforms

		Reform	No reform
Nature of the shock	"Real" shock (economic)	Adaptability	Rigidity
	"False" shock (political)	Volatility	Stability

Source: Braun and Scartascini (forthcoming)

A New Framework

5. Then, when studying reforms the key is not to see **if** they did happen or not but **why** was that they did or didn't.
   - Clearly, in Latin America, the reforms that had the most impact were those that were either introduced "endogenously" (Chile) or modified the incentives of those in power (Brazil).
   - If they didn't modify incentives, then they had no impact.
   - In some cases, they could have long term results as the polities evolve within the new institutional framework (but they are not bulletproof) (Peru?, Colombia?)

Source: Braun and Scartascini (forthcoming)

A New Framework

6. Therefore, the key to understand the processes is to have an in-depth knowledge of the countries before attempting reforms.
   - We have used this general equilibrium framework to understand the policymaking process (IDB 2005, Stein et al 2007), and the budget process (Scartascini et al, forthcoming).
   - We hope we will be similarly successful to explain fiscal institutional reform (Braun et al, forthcoming).

Fiscal Reforms in Latin America.
A "New" Political Economy Perspective.

Thank you

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