Asian Regional Seminar on Public Financial Management

PFM Reforms: The lessons learnt – promises and tears

Session 1: PFM Reform Strategies
Supply-driven versus “Basics First” Reforms

Mr. Holger Van Eden
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Supply-driven versus “Basics First” Reforms

Is there a Choice between the Overloaded vs. the Uninspiring Agenda?

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Outline of Presentation

• PFM Reform on the Rise
• Evidence of Success and Failure
• Main Strategies
• Why Things go wrong?
  – The Usual Suspects
  – Other Change Management Issues
• Solutions
  – Elements of Success
  – History Repeats: The “Hidden” Hand and PDIA
Interest in PFM Reform has increased enormously in the past twenty years

• PFM received its most recent impetus from the “New Public Management” reforms in New Zealand, Australia, and the UK in the 1980s.

• Reforms were largely successful in these countries, it seemed. Aim was to transform input-oriented, control and compliance focused bureaucracies into flexible, responsive, efficient service delivery units focused on outputs and outcomes.

• Reforms were copied in Europe, US and Advanced Asian countries. Some countries did better than others.

• From mid-nineties, emerging market and developing countries tried to copy advanced country PFM reforms

• Surge in technical assistance, often supported by international financial institutions
Some Evidence of the Growth of TA……

- Between 1990 and 2005 the number of WB projects with a significant Public Sector Reform component quadrupled.
- OECD data show that donor funding for PFM reform rose from US$ 85 million in 1995 to US$ 931 million in 2007
- IMF PFM TA almost tripled from 2006 to 2014
What Type of Reforms are we talking about

• Medium-term budget/expenditure frameworks
• Program/performance budgeting
• Deconcentration/Decentralization
• Development of agencies/outsourcing of services
• Government-wide IFMIS
• Accrual accounting
• Fiscal risk management
• Fiscal rules and fiscal responsibility laws
• Independent fiscal agencies

>>> Also called second-generation reforms
Evidence of Success

• MTBF: Countries with (some form of) MTBF have increased from fewer than 20 in 1990 to more than 130 in 2008.

• Performance Information: since 2007, 80% percent of OECD countries produce performance information in their budget, and in 2011 about 2/3 indicate that they have a performance budgeting framework.

• Fiscal Reporting: countries reporting at least a financial balance sheet to the IMF has increased from 21 in 2004 to 41 in 2011.

• Accrual Accounting: 26 countries have moved to full accruals and this will reach –reportedly –63 within the next 5 years

• Fiscal Rules: Countries with fiscal rules have risen from 5 in 1990 to 82 in 2013.

• Fiscal Councils: the number of countries with Fiscal Councils grew from about 6 in 1990 to around 27 in 2013.
But Improvements have been less in Developing Countries

<table>
<thead>
<tr>
<th>Region</th>
<th>% Increase/Decrease</th>
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<tbody>
<tr>
<td>Latin America and Caribbean (LCR)</td>
<td>1.5%</td>
</tr>
<tr>
<td>South Asia (SAR)</td>
<td>-9.8%</td>
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<tr>
<td>East Asia and Pacific (EAP)</td>
<td>5.4%</td>
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<tr>
<td>Africa (AFR)</td>
<td>5.1%</td>
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<tr>
<td>Middle East and Northern Africa (MNA)</td>
<td>-1.9%</td>
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<tr>
<td>Europe and Central Asia (ECA)</td>
<td>25.5%</td>
</tr>
<tr>
<td>Total</td>
<td>2.9%</td>
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</tbody>
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Advanced Reforms not immediately suited for Developing Countries

• Need for supporting “basic reforms”
  – Credible and comprehensive budgets
  – Smooth and controlled budget execution
  – Accurate and timely fiscal reporting
  – Effective external audit and oversight
  – Concentration of PFM functionality (Treasury, Debt, Budget, IA)

• To be done first? The purists say yes!

• Not everything can be done at once: sequencing
  Strategy is necessary in any case
Different Reform Strategies were developed during the 2000s:

- “Basics first” (or even one thing at a time) – provides capacity
- “Weakest link”/PEFA driven reform – seems logical, but may not be
- “Buy the Ferrari” – provides motivation
- Law driven reforms – provides authority
- IT driven reforms – provides a framework
- Everything at once – because issues are related
- Supply/donor-driven – because donors have a blueprint and its free money

One of the more sophisticated strategies:

- The platform approach – focuses on synergies and real outcomes, and is realistic about capacity
- Tailor-made, sequenced reforms which combine basic and advanced reforms, are path dependent, and realistic about capacity

>>No strategy has been fully successful; success often superficial
Basics First usually not enough

- Not always focused on issues at hand
- Provides little motivation/buy in from political level, donors or counterparts
- Does not always address related reforms
- Does not provide a roadmap of where to go
- Underestimates the pace at which reform can take place
Supply/donor-driven agenda

- Overestimates capacity; burden for ongoing budget process
- Focused on formal rather than de facto reforms
- Not focused enough on issues at hand (blueprint driven)
- Long list of to do’s = overloaded agenda
- Sequencing = everyone a slice of the pie
- Political will/ownership lacking
- Pace usually overambitious
Issues lie deeper than sequencing

• Reforms implemented without clear reflection on what problems they would solve
• Blueprints do not work: do not take into account context, culture and political economy
• Incentives overlooked: power and money interest block real change
• Leadership and acknowledgement of importance more important than thought
• Finance ministries cannot push reforms by themselves, nor can line ministries
• Diagnostic tools are useful in noting system weaknesses but do not provide reform strategy
• Recognition of importance of wider private sector capacity
• Skepticism on achievements of “New Public Management” in OECD
Who are the Bad Guys?

• **Consultants:** Want quick “results” without accepting context; do not provide honest feedback to either countries or IFIs
• **IFI’s:** Stuck to their blueprints? Do not want to get hands dirty. Need to spend money.
• **Countries themselves:** Are either too ambitious, or just want to go through the motions; do not want to invest enough of their own people.
• **Civil servants:** Do not really want change. See reform as a danger for their interests

>>> All of the above?

>>> Or misunderstanding of change processes in institutional development
What do we know about successful change!

• Country case material

Positive:

– Sweden: fiscal/budget management reforms in the early nineties
– China: treasury single account/cash management reforms
– Brazil: fiscal management/decentralization
– Korea: public investment management
– Malaysia: performance management

Negative: many examples

– Performance Budgeting in OECD
– MTEF in many African countries
– IFMIS in many Latin American countries

>>>Successful reforms often preceded by powerful economic, or institutional crisis!
What do we know about successful change!

Elements of successful reforms

- Real problems are addressed
- Strategy is aligned with context, culture and political economy
- Leadership, authority and ownership are essential
- Incentives and motivation of participants are managed well
- Capacity and capability are aligned with Agenda (and part of the reform)
- Pace and magnitude of reform is realistic
- Process change has to go hand in hand with institutional change (this applies especially to Ministries of Finance)
- Reform agenda allows learning and change
- Bureaucrats need to feel stress not to Fail (not to Succeed)
- Planning, sequencing and prioritization are important (but different paths can be taken)
- **Last but not least**: use the power of transparency and accountability
What have we learned about change since the 1960s: the “Hiding” Hand Principle and PDIA

In the 1960s economist Albert Hirschman found:

• People only undertake reforms if they underestimate the difficulty initially
• Successful change is usually: 30% imitation, 70% invention
• Only if forced to struggle to succeed the force of “creativity” is unleashed
• Conclusion: Reform is always a hard slog

Fifty years later Harvard Economist Matt Andrews calls this:

>>>Problem Driven Iterative Adaptation: Reforms require identifying problems, and taking first experimental steps to get quick wins. Then learning, building support and capacity are a long journey. Take steps in a problem driven iterative process that promotes adaptation.

>>>Not a tidy process; can be perceived negatively.
Thank You!

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