Reforming Fiscal Institutions: The Elusive Art of the Budget Advisor

by
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This article assesses the role and responsibilities of the budget advisor in developing countries and what factors make for success and failure. Since efficient budget institutions are important, the role of the budget advisor may include providing advice on institutional issues as well as on technical questions and the budget reform process itself.

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Many developing countries – and some emerging market and high-income countries – engaged in reforming their budget and public financial management (PFM) systems use foreign advisors, with experience of budget systems in other countries, to assist them. Such assignments are extremely challenging, especially in the case of long-term resident advisors, and have a variable success rate. This article assesses the role and responsibilities of the budget advisor – which may include providing advice on institutional issues such as the legal framework for budgeting or the organisational structure of the finance ministry, or advice on specific technical issues such as expenditure and revenue projections and analysis, budget formulation and budget execution, internal control, accounting and reporting, and audit – and what factors make for success and failure in carrying out these tasks.

The term “elusive” in the title is chosen deliberately to reflect the dual meaning of this word. Elusive connotes difficulty – of acquiring the abilities, skills and experience that are essential components of the good advisor’s armoury – but it also suggests the notion of risk or hazard that the advice given may prove faulty, misleading or even damaging if put into practice. I also use the word “art” since the advisor’s role requires the exercise of judgment, diplomacy and political acumen in addition to well-honed technical skills.

1. Why efficient budget institutions are important

In recent years, issues related to enhancing the quality of budgetary institutions and PFM have increasingly taken centre stage in the dialogue between international financial institutions, such as the World Bank and the IMF, and their member countries about the surveillance of fiscal and budgetary policies and economic development issues. This in turn has created a large and growing market for budget advisors. One reason for this development is the tendency for many donors to give their aid in the form of general budget support rather than for individual projects such as hospitals or dams. Although current estimates suggest that less than 40% of developing countries receive aid through budget support, the trend is clearly upward. The Paris Declaration on Aid Effectiveness (2005) established this as a desirable feature of aid practice. As a quid pro quo, donors need to be assured by the national authorities that the budget systems through which they transmit their aid are sound and reliable. Similarly, the recent progress by the international community to grant debt relief to heavily indebted poor countries is predicated on the assumption that these countries will use the resources to promote effective poverty-reducing expenditures. Such objectives can only be realised by having in place credible PFM reform programmes that are owned, led and efficiently managed by the authorities concerned.

More generally, well-functioning budget institutions and systems are vital for making informed policy decisions – and for the ability to implement these policies – regardless of the sources of financing. Effective budget management is crucial for being able to pursue government programmes intended to reduce poverty (in countries where this is an issue),
enhance education standards, improve health care, and achieve other key policy goals. Second, well-designed institutions and systems can improve the efficiency and value for money of delivering public services and can achieve substantial savings for the budget. For example, the United Kingdom National Audit Office has assessed that the government's new system (called the Gateway-OGC model) for managing its real estate and infrastructure assets and investment projects is conservatively yielding benefits in terms of “costs avoided over the life of the projects” of around GBP 1 billion (about USD 1.8 billion at present exchange rates) after five-to-six years of operation.

2. The exacting skill requirements of the budget advisor

I endorse the view expressed by many about the need to strengthen the bridge between academia and the practical business of advising finance ministries on measures needed to strengthen their budget systems and processes. Encouragingly, the academic literature is growing in this field. The seminal work of North and, more recently, North, Wallis and Weingast, can be applied to the budget just as it has been to other political institutions. Many scholars including Alesina, Barro, La Porta, Perotti, Persson, Pollitt, Poterba, Roubini, Sachs, Schiavo-Campo, Schick, Shleifer, Tabellini and von Hagen have investigated the area of government and budgetary institutions. The recent work of Collier, Easterly and Elster, among others, on low-income countries also uses statistical tools to try to draw conclusions about institutional design. However, there is a gap in the literature between such studies and the operational work of budget practitioners in the field.

More work is needed to build the bridge between these two camps. The evolving scope and status of the literature are partly due to the fact that the investigation of budgetary institutions is not a pure academic discipline since it straddles several fields such as economics, public finance, accountancy, law, auditing, banking, political science, and even anthropology. Another complexity is that budget systems themselves are not universal; various models have been identified such as the Anglophone model, the “Westminster” model, the Nordic model, the Francophone model, the Lusophone (Portuguese) model, and so on. Each of these models has very different characteristics, legal bases, and administrative systems and processes. The perfect advisor would need to have competence in – or at least some knowledge of – all these fields, be familiar with both the conceptual and the operational literature, and be able to blend and balance his or her advice according to the political, cultural and administrative traditions and requirements of the country concerned.

Ideally, the advisor would also have direct hands-on experience of working in the budget office, accounting department, or treasury of a ministry of finance. To be effective, he or she needs to have a senior counterpart in the finance ministry – usually the secretary-general, state secretary or the minister in person – who has the ear of the prime minister or president and is a champion of reform. The advisor needs to have effective communication skills, since the PFM terminology is complex and subject to misinterpretation. For example, the terms “output” and “outcome” are sometimes used interchangeably and thus incorrectly. “Control” and “audit”, while quite distinct concepts in the English language, have a similar or identical meaning in many Central and Eastern European countries. The advisor also requires the interpersonal skills of a diplomat: cajoling and encouraging his/her counterparts where appropriate; pushing forward and backing off when needed; seizing opportunities and building coalitions; identifying leaders and reform champions; digging under the skin of systems and procedures, both formal and
informal (in Douglass North’s sense); and avoiding the familiar graveyard of the poor advisor – the “one size fits all” solution – an approach that is too often based on what works well in the advisor’s own country, but may be unrealistic and inappropriate for the client,\(^1\) while avoiding the contrary danger of "becoming a native" and turning a blind eye to local systems and procedures that are out of line with international practice.

The advisor is sometimes required to assume tasks that involve him/her directly in the management and direction of the reform project itself, with responsibility for the operations of the staff and resources of the project, as part of the line management of the ministry. This involvement may both change his/her role significantly, and compromise his/her position as an impartial advisor.

A frequently encountered failing of "PFM experts" is their inability to see beyond the budgetary institutions and systems in order to identify the underlying problems that need to be addressed. More often than not, these problems – which may very well be common to a number of countries – can be solved in a variety of ways. Many advisors, however, are convinced that "standard" solutions such as a public expenditure review, a medium-term expenditure framework, a general ledger system, or an integrated financial management information system are essential components of a reform programme, regardless of circumstances and conditions, in order to come to grips with issues such as overspending, inaccurate accounts, accumulation of arrears, unrecorded liabilities, or low efficiency of public services. The experience of OECD countries, however, suggests that there are numerous ways of addressing these generic problems.

Similarly – while general principles of good practice in PFM have been established in many areas and should act as the anchor for the good advisor – institutional arrangements that in general are regarded as efficient in most countries are not necessarily appropriate in all countries. For instance, the concept of an integrated finance ministry that takes responsibility for all issues relating to the public finances, budgetary management, and revenue policy and administration is normally regarded as good practice. However, several advanced countries including Australia, Canada and the United States depart from this model by having separate ministries responsible for the budget. France has recently followed suit by creating a ministry for the budget out of the former ministry of economy and finance, and assigning it responsibilities for social security and the civil service. Such arrangements can work successfully provided there is a high degree of co-ordination between officials working on finance and budget issues.

Another complicating factor is the existence in many countries of substantial extrabudgetary activities and funds (EBFs) in areas such as health, unemployment benefits, social security and natural resource funds, and that represent, across both developed and developing countries, over 40% of central government expenditures. A frequently proposed principle of “good practice” is that the budget be comprehensive and the number of EBFs minimised. However, especially in advanced countries with developed systems of financial management, EBFs can be tolerated, and even encouraged, as a mechanism for promoting accountability and microeconomic efficiency in the use of public funds, provided the appropriate governance and financial management arrangements are put in place.

The absence of universal, off-the-peg solutions to such issues reflects the diverse focus and characteristics of fiscal institutions and PFM systems. As a result, the commonly used expressions “best practice” and “good practice” in describing a particular set of arrangements or practices in country X can be misleading when applied to countries Y
and Z. All countries are ultimately unique in an historic, cultural, legal and economic sense, and the budget advisor must be extremely cautious in transporting an idea or model regarding institutional arrangements from one country to another. Of course, there may be exceptions to this basic rule of thumb. For example, there are certain groups of countries or regions that are more homogeneous both as regards problems and solutions. The countries comprising the former Yugoslavia, for instance, had – and to some extent still have – a budget system that is both idiosyncratic and unique to the region (e.g. the payment systems, or ZOPs, which in recent years have been phased out, broken up or merged with a reinforced treasury system). Another exception to the rule is the successful introduction of basic automated financial management information systems in post-conflict countries such as Afghanistan, Kosovo and Timor Leste.

A related issue is the narrow focus of many experts, who often like to present themselves as general advisors on a wide spectrum of topics. Not surprisingly, accountants tend to conclude that what a country needs is an improved accounting system, incorporating the latest set of international standards and an accrual methodology. Experts with a background in debt management argue that the most important issue is to establish a debt management office with all the features of advanced systems. And financial controllers argue that installing an effective system of commitment control or internal audit is crucial. Thus, it is difficult to arrive at a consensus on the nature of a country’s central problem. This issue is to some extent addressed by using general analytical tools such as the public expenditure and financial accountability (PEFA) diagnostic instrument2 and the IMF fiscal transparency reports on the observance of standards and codes (ROSC). However, the fundamental problem remains. The knowledge and experience of a PFM advisor tend to affect the advisor’s judgment and the advice that he or she provides.

In short, the requirements for a good budget advisor are wide ranging and challenging to meet. Moreover, the benefits of the advisor’s position are frequently uncertain and unpredictable. The payoffs from good advice are often slow to realise; unfulfilled objectives, frustration and unexpected challenges clutter the path ahead. Changes in political leadership can lead to the abandonment of promising initiatives and the launching of new ideas and projects. Governments may be reluctant to refuse offers of “free” assistance from the donor community: in such cases, advisors may be taken on without any prospect that their advice will be listened to, far less implemented. Many resources have been wasted in this way. For instance, despite its good intentions, the European Union’s so-called “twinning” programme started in the late 1990s and involved supplying technical assistance advisors from government departments in existing EU member states to the candidate countries (the cost being borne by the EU budget under the “Phare” programme). The twinning programme seems to have had a limited impact on building capacity in some of the recipient countries, partly because of low ownership by the governments concerned and partly because the advisors selected by the donor countries were of mixed quality and generally had little experience of advisory work in a foreign environment and culture.

In addition, developing countries are increasingly looking to their peers for advice on reform methods for their financial management systems. Slovenia, for example, has become a net provider of technical assistance to the countries of Southeast Europe (and elsewhere) on issues such as the reform of treasury, cash management and debt management systems. Brazil and Chile are taking on a similar role in Latin America, as are Korea and Singapore in Asia, and countries such as South Africa, Tanzania and Uganda in
Africa. This trend is to be encouraged, of course, but it may affect the role of the resident advisor, especially if that person is insufficiently familiar with the particularities of the region in which he or she is operating.

3. The complex nature of the budget reform process

PFM reform tends to be a complex, slow and time-consuming process. This makes the advisor’s task difficult and potentially frustrating since, measured against the slowly shifting sands of progress, any contribution that he or she can be expected to make must surely seem insignificant. The reform process is continuous and endless, from the “tally sticks” used to record the budget in 17th century England, to the modern techniques of fiscal rules, fiscal risk analysis, expenditure ceilings, control totals, top-down budgeting, performance and programme budgets, accrual accounting, and expenditure review. Some ideas prove to be good and take root, some prove to be ineffective or based on false assumptions and expectations (e.g. PPBS, planning programming budgeting system), and some arise and fade but come back again (e.g. the current trend in many OECD countries for periodic “zero-based” reviews of expenditure efficiency).

The progression of PFM reform is an unpredictable and not necessarily linear process. In the United States, for example, the creation of a unified accounting, budgeting and auditing system was originally proposed by the Taft Commission in 1910 but took 40 years to complete. In the United Kingdom, initial experiments in multi-annual budgeting were made in the 1930s, or even earlier, but only came to fruition in the 1960s and 1970s with, first, the Plowden Report of 1961 and the subsequent development of the Public Expenditure Survey Committee (PESC), programme analysis and review (PAR) – a forerunner of today’s programme budgeting and expenditure review – and the Thatcher government’s medium-term fiscal strategy. In several African countries, and in some of the former Soviet Union, reform has proceeded by a series of fits and starts, at first surging forward and then stagnating, or in some cases even regressing for a period.

There are two main reasons for this situation. First is the importance of political leadership; where this exists, momentum for reform is created and can proceed rapidly. In many developing countries, however, the lack of sufficiently strong institutions, and the existence of powerful elites that use the budget process to extract economic rents, can prevent reforms from taking place. Such reforms rarely take place in a vacuum – indeed, it is undesirable that they should. Frequently, they are part of a wider programme of government reforms that include institutions such as the civil service and the judiciary. If properly managed, such institutional changes can add strength to the PFM reforms or, indeed, may be a prerequisite before any such reforms can be initiated. In Africa, for example, countries such as Ghana, Mali, Mozambique and Uganda have shown capacity for large reforms of budget management and have given incentives to civil servants for better performance. By contrast, in some countries, a finance ministry may be “controlled” by several political parties in a coalition government, with one deputy minister being responsible for, say, macroeconomic forecasting, fiscal policy and the budget, another for the treasury, and yet another for debt management. This fragmentation of the ministry can create a paralysis in terms of reform which is hard to override, even by a powerful finance minister.

The second critical issue in many developing and middle-income countries is the low capacity of the finance ministry and related fiscal institutions. There are poor and post-
conflict countries where the entire budget department, or the treasury, of the ministry of finance comprises no more than a handful of staff, most of whom are poorly qualified and suffer from low morale. Without adequate political leadership, it is not surprising in such circumstances that reform efforts stagnate. In some countries, essential PFM tasks, such as preparing the accounts and fiscal reports, are carried out directly by foreign advisors acting essentially in staff positions. However, this action does nothing to raise local capacity; when the advisors leave, the country has not advanced, and the systems and procedures put in place by the advisors often fall into disuse. Unfortunately, this remains the situation in many poor countries in Africa, Asia, and elsewhere. Even middle-income countries are not immune to the problem.

This situation raises a related issue, namely that reform of budgetary institutions and systems is frequently a dynamic and opportunistic process, driven by internal political developments such as the emergence of a new leader with a powerful idea or a zest for reform, or sometimes driven by external factors. Examples are plentiful of countries where PFM reform has been successful wholly or partly because of a wider tapestry of circumstances and happenstance. In Chile and South Africa, for example, reforms were linked to fundamental political change and the requirements of a new constitution. In the former Soviet Union, reforms were the result of the break-out from the communist system (though old habits still die hard in many of these countries) combined with the political and financial incentives facing the countries that were eligible to join the European Union. The EU imposed very specific demands in relation to modernising systems of control, audit and procurement if the countries were to qualify for massive amounts of pre-accession aid equivalent to several percentage points of GDP. In New Zealand, reforms in the 1980s were driven by an external fiscal crisis and by a desire to re-engineer the state to deliver public services more efficiently, a pattern that has also emerged to a varying degree over the last 20 years in countries such as Canada, Sweden, the United Kingdom and the United States (the “reinventing government” programme of the early 1990s). In France, the remarkable set of fiscal reforms launched in the budget law (Loi organique relative aux lois de finances) of 2001 was originated by demands from some parliamentarians for greater involvement in the budget process and for greater accountability from civil servants and programme managers.

4. Sequencing PFM reforms

The problem of achieving an appropriate sequencing of PFM reforms is a task that is improperly understood and imperfectly applied in practice in many countries. The important lesson that we repeatedly learn from the past – that reform is an inherently slow, unpredictable and non-linear process – tends to be overlooked. In too many countries, PFM reform programmes are overloaded with hundreds or even thousands of measures. In many cases, the donors and their advisors are to blame. Donors understand that packaging all reform proposals into a “public finance reform” grant or loan is more likely to gain approval from the management board, which gives the donor leverage in the country concerned. However, these packages too often prove unmanageable and ineffective, raise unrealistic expectations about what can be achieved, and fall into disarray with only a small fraction of the measures having been implemented. Other approaches have been tried (e.g. the “hurdle” approach in Thailand) that attempt to create an incentive for spending agencies to improve financial management in return for greater flexibility in managing their resources. However, such approaches have met with mixed success.
Donors and countries are hopefully learning from the bad experiences of the past, and techniques have recently been developed, such as the “platform” approach to PFM reform, that attempt to structure a medium-term reform programme into a series of blocks or platforms, each one requiring completion before the next stage in the reform is embarked upon. A few countries, such as Cambodia, are experimenting with such techniques which show promise if properly managed and not overloaded with too many initiatives and inflated expectations. Budget advisors need to demonstrate knowledge and experience of the benefits and limitations of such approaches.

Nevertheless, the issue remains that countries in general can manage only one substantial reform at a time. Denmark, for example, is introducing accrual budgeting and has put all other reforms on hold. The introduction of performance-oriented management in Sweden in the early 1990s crowded out all other public sector reforms. Egypt initially focused its recent reforms on modernising the budget classification before turning attention to establishing a treasury single account and updating the legal framework for budgeting. Moreover, the time frame for such reforms needs to be realistic and take into account unexpected developments. For example, in the United Kingdom, the implementation of accrual (or “resource”) accounting and budgeting took more than eight years to complete (1994-2002); the cost of new IT systems and the need to retrain accountants and financial managers were severely underestimated; and the final accounts of several government departments continued to be qualified by the auditors for several years after the reform was completed.

In their eagerness to promote and support change, advisors too often become overambitious. Although the concept of a structured reform programme should be the goal, it is not always possible to achieve in reality. Reforming government institutions involves a lot of patience, trial and error, and “wandering in the dark”. It also requires deliberate selectivity in the choice of topics on which to focus the reform effort. The structured reform agenda – with platforms, sequenced steps, and co-ordination and participation of the authorities, donors and other stakeholders – may to some extent give a false impression of order in a fundamentally chaotic process.

5. Conclusion

The role of the budget advisor is a complex and challenging one. Developing countries have become much more discerning and demanding in their requirements for technical assistance. More and more they rely on their neighbours and peers to fulfil this role. At the same time, competition among providers of assistance has increased. Against this background, an effective advisor needs to have not only outstanding technical skills and broad international experience but also patience, persistence, resilience, balanced judgment, and diplomatic skills.

Notes

1. One is reminded of the Greek legend of King Procrustes, who had a special bed on which he put his guests after having made them drunk: if too tall, he would have part of their legs sawed off; and if too short, he would have their bodies stretched on the rack. Neither option was conducive to the health of the unfortunate guests.

2. The PEFA programme was launched in 2002 and is managed by the World Bank, the IMF, the European Commission and several bilateral donors (see www.pefa.org). The goals of the programme are to ensure more effective co-ordination between national authorities and donors in reforming
PFM systems, and to reduce the number of overlapping and duplicate technical assistance missions and other interventions. A PEFA assessment framework has been developed that enables a country to evaluate the efficiency and effectiveness of its PFM systems according to a standard methodology of 31 indicators. This framework has already been rolled out to more than 60 countries around the world. Having a solid and coherent diagnostic assessment of the strengths and weaknesses of their PFM system is fundamental to countries that want to launch a strategy and action plan for PFM reform. However, the programme suffers from several limitations including the complexity and difficulty of calibrating indicators, and the variable quality of the PEFA assessment reports. The high-level nature of the indicators also implies that the assessments do not analyse the performance of, say, a treasury or public procurement system in sufficient depth to allow strengths and weaknesses in specific PFM areas to be identified and corrective remedies proposed.