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Aspects of the New Public Finance

by

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This article considers the context of the emerging developing country public finance and identifies two particular driving forces behind its increased complexity: the policy space between public and private within countries, and the policy space between countries and institutions in the international arena. The article highlights that international co-operation happens not as much across national borders as at a national level influenced by international agreements. Hence the building of common approaches to partnerships, prioritisation and budgeting is important for the efficient mobilisation of resources. The article also stresses the need for more direct co-operation between countries, particularly in a regional developing context; the role of ministries of finance and budget offices in ensuring the growth of such co-operation; and the need to streamline budget institutions to ensure their effectiveness.

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1. Introduction

Public finance, as an analytical discipline and as the practical arena of public policy design and implementation, has undergone two far-reaching reforms over the past two decades. The first is the exploration of the "policy space" between markets and government action: the evolution of public-private partnerships and the pursuit of public policy purposes through the regulation and mobilisation of private sector activity and co-operation with civil society organisations. The second is the growing role of international co-operation in public affairs: action to address global public goods and increasing attention to the dynamics and effectiveness of international collaboration in both policy and public service delivery.

These dimensions of public policy add considerable complexity to the discipline of public finance and to the practice of public policy making and implementation. The tidy division of the world into public and private sectors, and domestic and foreign affairs, has given way to much more complex institutional arrangements and hence a more elaborate intellectual apparatus. At the same time, the "new public economics" is beginning to give some order to what formerly appeared to be fragmented and disorderly: the diversity of divisions between public and private activity, and the great clutter of overlapping international agreements and institutions.

There is no sharp divide between the old and the new; globalisation and increasing interconnectedness of countries has been a long historical trajectory, and the interface between the public and private sectors has been a kaleidoscope in motion for as long as public affairs have been the subject of literate comment. However, the last few decades have seen great seismic shifts in both the discourse and the practice of public finance, and some commentators have seen fit to identify a "new public economics 1" and a "new public economics 2" in recent times: the first concerned with the public-private interface, the second with the international dimensions.*

The complexity of these shifts raises difficulties for public policy, because both public-private partnerships and international co-operation carry high transaction costs. For developing countries, and particularly for small low-income countries, managing the complexity is a huge challenge. The great

* See I. Kaul and P. Conceição (eds.) (2005), *The New Public Finance*, Oxford University Press, Oxford. This article draws strongly on the overview chapter in this volume.

benefit of traditional government arrangements is that they are simple, lines of authority are clear, rules and procedures are documented and familiar, and the annual budget process provides a transparent and unambiguous assignment of resources to public purposes. Resources are raised through taxes, which have the great advantage to the fiscal authorities of being mandatory.

Co-operative or contractual arrangements with the private sector, and international collaboration in pursuit of common purposes, are fraught with negotiation difficulties, problems of trust, possible conflicts of interest, risk, uncertainty, asymmetric power and interminable frustration. It is easy enough to formulate rhetorical praise for the partnership idea; getting the agreements past the legal advisors, the financial analysts and the project steering committees is entirely another matter. Nevertheless, the complexity is with us, and we have to find a way through the barriers of misunderstanding and the legal and financial technicalities.

This situation creates rather a daunting agenda for the Collaborative Africa Budget Reform Initiative (CABRI) for the next year or two. But it is also a wonderfully exciting opportunity, because there is so much to gain from getting these things right; there are immense benefits from improvements in the public-private sector interface and in the quality and focus of international partnerships.

Constructing the right agenda for research and co-operation over the next few years means thinking hard about what the most pressing and most promising areas of collaboration might be. CABRI's resources are limited, so it is important to make careful choices.

2. The new public finance

2.1. An intermediary state

Let me share a few ideas from the "new public finance" literature that might be useful. The first is the idea of an **intermediary** state. This is a concept developed in some detail by Inge Kaul of the UNDP Office of Development Studies as a way of thinking about how governments in a globalised world have to reach compromises and negotiate an appropriate balance between the demands of the outside world and their own domestic political and policy objectives. States that fail to negotiate workable compromises risk being marginalised in the global development race, and in extreme cases end up as "rogue" or "failed" states. Thus, it is one of the tasks of modern governments to intermediate between national and global interests, but it is not efficient to think of every small country finding its own particular set of compromises with the rest of the world. Consequently, there are multilateral institutions that perform the intermediary role on a global or regional scale, in effect providing a forum for achieving collective solutions and developing "templates" for international partnership: in trade matters, in managing global environmental issues, in dealing with international crime and money laundering, and in regulating financial affairs.

CABRI has an intermediary role to play, and it may be worth spending some time exploring what this means. First, there is no need to reinvent standards of good practice in budget design and implementation, but there is a clear need to adapt from international practice simplified and standardised approaches that are suitable for countries with very limited resources, various degrees of aid dependence and, perhaps, the particular kinds of relationships between the national fiscal authorities and local or community development programmes that are characteristic of African economies. In all of this work, it is important to respect national sovereignty – country circumstances vary and sovereign governments will make their own choices – but there is a great deal of useful work that can be done collaboratively to assist governments in exploring options and finding a shared understanding, especially in those areas of public policy and financial management in which the external world has particular interests.

These interests of the rest of the world are very wide-ranging, and often uncomfortably intrusive. This is not just a First World-Third World thing: national sovereignty is subject to constraints, even in the richest and most powerful countries. Sovereignty is qualified by the rest of the world's interest in how property rights are protected, in how one country's tax laws impact on investments or trade relations, in how crime and fraud are combated, in how the environment is protected, and in how human rights are protected. Take the currently topical example of the concern, worldwide, about the prevalence and possible mutation of the bird flu virus. Because birds migrate across boundaries, a country's interests cannot simply be secured by strict border controls and municipal health inspections; every country has an interest in what every other country does to control the internal transmission of bird flu. The "new public economics" reminds us that many public goods are in fact "global" public goods that require global co-operation and partnerships.

What has this got to do with budget reform? Shared interests need to be addressed through shared resource arrangements. Of course, the rest of the world can negotiate individual aid or budget assistance or joint financing arrangements with every individual country, but progress is likely to be faster and more efficient if collective vehicles are found. So it may be helpful to give further thought to the intermediary role that CABRI can play, helping shape more streamlined arrangements for dealing with the external world's interest in financial management and resourcing both of development and of the global or regional public goods that need to be collectively addressed.

2.2. Subsidiarity

There is a second concept in the "new public finance" literature that is helpful in managing the complexity of things: the idea of **subsidiarity**. This is rather a ponderous word, but it captures the simple idea that globalisation is more about co-operation behind, rather than beyond, national borders. This gives recognition to the fact that international institutions do not have sovereign powers and international collective action is difficult and costly. Thus, many kinds of international co-operation happen, in effect, behind national boundaries – that is, they do not rely on multilateral institutions and global action, but take place within the context of national programmes and partnerships. This is a simple but very powerful insight.

It is not necessary – in fact, it is often impractical – to create an international pool of funds and directly spend or control programmes through multilateral institutions, in order to deal with global public goods or shared interests. In recent years, there have been new international funds and programmes created for particular purposes, but comparatively few permanent multilateral institutions have been created. Most action happens at the national level, influenced but not dictated by international agreements. It is precisely because this is where most of the action is that it is so very important for initiatives like CABRI to make progress in building a common understanding and consistent approaches to budgeting, planning, prioritisation and partnerships, so that resources can be efficiently mobilised although neither pooled nor collectively managed.

Although there is a preference for national-level interventions, because institutions and decision processes are largely defined by national boundaries, we need to explore options for more direct collaboration as well. Many African countries are very small, so there are economies of scale in joint initiatives. Major infrastructure projects (transport, water supply, power generation) have natural network properties that cut across national boundaries. In areas such as higher education, production and supply of school books, tertiary referral hospitals, customs and trade administration, specialist agricultural support and industrial standards and certification, even tourism promotion, there are substantial economies of scale and benefits of concentration of resources. CABRI might usefully give further consideration to how the planning, budgeting and management of joint infrastructure projects, and collaboration in improving the quality of public services, could be taken forward; these are perhaps matters for dedicated task teams to consider.

An interesting sub-component of this topic is the scope for contractual service delivery agreements between governments, or "trade" in public services. Many American states have cross-border agreements on access to and charges for higher education opportunities, for example. There are many areas of public service delivery where the normal principles of specialisation, comparative advantage and potential economies of scale argue for co-operative government-to-government agreements, and these can also involve private sector service providers. It does not make sense for every country to have its own mint, or to try to achieve a comprehensive portfolio of higher education and research programmes. However, unless work is done on the terms and conditions of agreements between countries, and the appropriate financing or pricing arrangements, these kinds of co-operation will not happen.

Economic regulation is another area of considerable complexity, in which there is much to gain from cross-border co-operation. The last 20 years have seen phenomenal growth internationally in the number and variety of arm's-length regulatory agencies, through which governments seek to provide expert and independent oversight of financial markets, industrial competition, public utilities, telecom suppliers, environmental protection, consumer protection, food safety and public health. It is not just that there would be economies of scale and technical advantages from collaboration in building regulatory capacity; there is also the huge benefit for the development of the market economy that comes with standardisation and greater certainty in the regulatory environment.

This is a useful reminder that the central economic challenge facing African economies is to achieve more rapid economic growth, investment, broader participation and employment creation. Complex and elaborate public services that carry high investment requirements or requirements for significant increases in revenue are unlikely to be affordable. Budget offices have a huge responsibility to concentrate resources on those programmes and initiatives that have the greatest impact on both economic development and poverty reduction. Of course, it does not help if the plans and analyses and programme designs for development and poverty reduction are so complex that nobody in the spending agencies actually knows what they are supposed to be doing. We need to build sound and simple monitoring and evaluation systems and continuously look for ways of achieving greater impact with the limited resources at our disposal, in association with spending departments and service delivery agencies.

International partnerships can help, and there is a great deal of work to do in simplifying and streamlining the allocation of international donor funds and ensuring that foreign technical assistance is more efficiently used. Partnerships with the private sector can help: both contractual arrangements for private sector service delivery and partnerships with local and international non-governmental organisations. Again, there is a great deal of work to be done in getting the design of these arrangements right and in building relationships of trust and effective co-operation.

In managing these and other kinds of partnership, and more generally in modernising our budget systems and financial management, it is important that we continuously guard against unnecessary complexity. Complex loan structures and guarantees can be designed for infrastructure investments, but then you need to make sure that you have lawyers and financial analysts on your side who are just as good as those hired by the banks. Multiple performance targets and objectives and outputs can be written up for a multitude of programmes and agencies, but you are much more likely to keep track of progress if you are monitoring a handful of reliable performance indicators. Modern accounting systems can be purchased as off-the-shelf computer packages, but traditional cash management systems are more likely to give you effective expenditure control.

3. Conclusion

The modern world offers many opportunities for public finance innovation and for new kinds of partnership with the private sector and across national boundaries. There are enormous benefits from getting these reforms right. However, getting them right means keeping them simple, so that as reforms proceed we have more control, we know more about what is going on, and we have a better understanding of how the national budget complements international initiatives and contributes to growth of the market economy.