

Public financial management: Selected reading

The Author

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Acknowledgements

This selection was produced for the 2007 Centre for Aid and Public Expenditure conference 'Tales of the unexpected: Public financial management reform in difficult environments'. It gives an introduction to some of the public financial management literature and is not intended to be exhaustive. Thanks go to Zainab Kizilbash Agha, Edward Hedger and David Booth for their comments and editing.

Introduction

Improving the management of public resources is crucial to the development of effective states. However, despite sustained efforts, recent diagnostic studies show that progress on public financial management (PFM) reform has been uneven (IMF, 2007; Dorotinsky and Floyd, 2004). Measures used to track the performance of countries receiving debt relief under the HIPC initiative have shown that budget execution and accountability remain weak (Dorotinsky and Floyd, 2004). The literature has started to explain these concerns by emphasising that PFM reforms likely to be unsuccessful if they do not address the problems of weak institutional and governance conditions (e.g. DFID, 2007; Wehner et al., 2007; Schick, 1998; Mejía Acosta and de Renzio, forthcoming). This literature acknowledges a correlation between countries with a high quality of governance and those that have successfully reformed their PFM systems.

However, it is disputed whether the relationship between PFM reform and the 'good governance' or even the 'good enough governance' agenda can be viewed as a simple, linearly positive one. Governance is a complex concept, difficult to define and measure exactly (Grindle, 2007). Many of the recommendations made about 'good governance' appear to be important factors for successful budget reform. Some authors identify for example accountability and transparency to be critical for reform success (Diamond, 2006; Campos and Pradhan, 1999). It has also been suggested that PFM reform should be synchronised with wider civil service reforms, because the latter are able to complement budget reforms (Stevens, 2005; Diamond, 2006). Others have cautioned against introducing reforms such as medium term expenditure frameworks (MTEFs), when basic governance conditions are lacking (Stevens, 2005). However, anecdotal evidence from case studies suggests that good governance does not necessarily promote development and that development can occur when governance is fairly weak, if other favourable conditions are present (Goldsmith, 2007). Such contradictions point to the need to understand better the complex relationship between PFM reform and 'good governance' and seek clarity over the direction of causality. They also make clear the need to investigate the importance of other factors that may support successful reform of PFM systems in the absence of a favourable governance environment.

Much of the literature has emphasised the importance of creating a reform that is well sequenced and suitably paced. Often, developing or transition countries do not possess the basic budget infrastructure to make progress on certain fundamental aspects of reform (Diamond, 2006; Schick, 1998). Several case studies conclude that small changes over a range of areas may be a more effective way to reform PFM systems than investment in rapid large-scale reforms (Campos and Syquia, 2006; Lawson and Rakner, 2005). One approach that has been developed to deal with the problem of sequencing reforms is Brooke's 'platform approach', which assesses the country's budget and financial capacity and ensures that the reform moves at a pace suited to the particular country context (Brooke, 2005). However, it has been argued that even adopting the budget basics approach does not guarantee reform success, because other factors, such as the incentives to reform and the leadership and acceptance of political and managerial reform, are necessary for successful reforms (Andrews, 2006).

The technical configuration of reforms that will lead to successful PFM outcomes requires an understanding of the roles played by different actors in the reform process. Case studies can be informative in identifying which actors are central to facilitating successful reform

processes. For example, a case study of procurement reform in the Philippines shows that a strong coalition of pro-reformers within the government is essential. Evaluations of case studies also find the support of civil society to be an important tool in the budget reform process, even in environments where governance is weak (Robinson, 2006; de Renzio and Krafchik, 2007). Furthermore, several case studies have shown that the political climate can be a strong determinant of the demand for reform (Campos and Syquia, 2006; Schwartz, 1994).

The lack of progress with apparently feasible technical reforms has also led increasing recognition that reforming budgetary systems has important political dimensions too. Both the institutional and the political context must be considered (DFID, 2007; Wehner et al., 2007). Budget decisions and policy implementation are typically a reflection of the underlying power relations, which are in turn shaped by both political and institutional factors (DFID, 2007). The literature has found empirical evidence that both electoral systems and budget institutions affect fiscal outcomes. However, Dietsche (2003) highlights that due to the contingent nature of policy choices, a generic model advocating specific governance factors is unlikely to be satisfactory for policy reform. Moreover Mejía Acosta and de Renzio (forthcoming) suggest that the causal mechanisms and political dynamics behind good governance must be analysed to provide a more comprehensive understanding of the budget process. Several donors have responded to these concerns by designing approaches that enable them to investigate the country-specific political and institutional context. Examples of these are the World Bank's Expected Stakeholder Utility Model, DfID's Drivers of Change approach and Sida's power analyses.

The following annotated bibliography provides a summary of some of the literature that seeks to investigate what factors may be important in the successful reform of PFM systems and that questions the role of governance in the reform process. This sample of the literature suggests that there remain problems in assessing the relationship between PFM reform and governance. However, encouraging attempts are being made to improve the measurement of PFM systems and to gain a deeper understanding of political economy factors, the technical sequencing of reform, the organisational and institutional setting, and other country-specific factors.

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Selected Readings

Alesina, A., Hausmann, R., Hommes, R. and Stein, E. (1996) "Budget Institutions and Fiscal Performance in Latin America"

This paper contributes to the growing empirical political economy literature, which looks for variables that affect budget outcomes. It has been hard to explain the large variations in fiscal positions using only economic variables or variables relating to conflict as explanatory factors. However, this study suggests that the nature of budget procedures and budgetary institutions has a large effect on fiscal outcomes. In particular the authors show that procedures which include legislative constraints on the deficit and more transparent and 'hierarchical' institutions are associated with lower primary deficits in Latin America in the eighties and early nineties. Hierarchical procedures are defined as those that limit the power of the legislature in expanding the budgetary balance and give one individual in the government more power to limit the decisions of the spending ministers. In contrast, collegial procedures distribute the power more evenly within the budget process.

The authors provide a theoretical discussion explaining why the presence of laws limiting the size of the deficit, hierarchical voting procedures and budget transparency should promote fiscal discipline. Spending ministers create a 'tragedy of the commons', where each one has an incentive to over-spend on their department, as resources come from a common pool of tax revenues. The Treasury Minister is needed to promote fiscal discipline as spending ministers do not internalise the budget constraint. Laws which establish fiscal constraints can help promote fiscal discipline, but monitoring problems and incentives for creative accounting imply that these laws may be counterproductive. Hierarchical institutions, which limit the role of the legislature, can also promote fiscal discipline by placing more power within the budget procedure in the hands of the executive. However, this implies that the budget tends to be tilted towards the preferences of the majority of voters. However, a lack of transparency can relax fiscal discipline even under the most hierarchical institutions as politicians have incentives to follow loose fiscal policies when the electorate is not able to perfectly observe fiscal variables.

Regression results show that budget procedures affect fiscal outcomes in the sample. The authors use a sample that includes annual data between 1980 and 1992 of 20 Latin American and Caribbean countries. They create an index of budgetary institutions based on questionnaires given to countries and checked with written legislation. Then a score is given in the range 0-10 where 10 is most hierarchical-transparent and 0 is most collegial-non transparent. Fiscal discipline is the dependent variable and is measured by the average primary deficit. More hierarchical-transparent institutions lead to lower deficits. Disaggregating this index, the authors also find that legislative and macroeconomic constraints appear effective and more executive power relative to legislative power leads to more fiscal discipline.

The authors recognise that there are limitations to their study. The authors assume that institutions are exogenous. They base this assumption on the fact that it is costly and complex to change institutions. The authors claim that despite very unsatisfactory fiscal outcomes possibly inducing institutional reforms, fiscal institutions are likely to be stable over the medium to long run. However, they concede that other factors, such as socio-cultural-political

variables, could explain both fiscal outcomes and institutions. Indeed it would be an important advance in this line of research to investigate the dynamics of institutional change. Furthermore using an aggregate index does not shed much light on what factors within the budget institutions may be behind the effect and the interactions and complementarities of the separate features. These effects may also differ for countries with differing political regimes. It could be informative to study whether budget reforms in the region have had the expected effects on fiscal outcomes.

Publisher: *National Bureau of Economic Research (NBER) Working Paper*
Key Themes: Budgetary procedures and institutions, fiscal outcomes

Andrews, M. (2006) “Beyond ‘Best Practice’ and ‘Basics First’ in adopting performance Budgeting Reform”

This paper questions the established wisdom in approaching public financial management reform by focussing on budget basics first. The ‘basics first’ theory argues that the basics (e.g. strong budget controls, reliable financial accounting and reporting etc.) facilitate regulation, control and effective management. Hence they must be implemented before an attempt is made to move towards performance-based budget systems. The author uses seven case studies to analyse the experiences of a move to performance based budgeting. He concludes that getting budget basics right does not guarantee successful reform. Instead reform practices must move beyond the idea that the sequencing of reform is of overarching importance to its success. Instead it should first consider the complex and interactive system of factors that lead to development of basic budget functions. Then the appropriate reform environment can be determined.

Andrews finds that there appears to be little econometric evidence that targeting budget basics first guarantees the success of public financial management reforms. The author argues that econometrical issues imply that the impact of the case studies in the literature is not adequately evaluated. The lack of counterfactuals and controlled experiments implies that care must be taken to disentangle the impact of the reform from other sources. Other factors can influence reform progress and the endogeneity of budget basics (i.e. budget basics and performance based reform could both be driven by another factor) mean that a successful performance based reform cannot necessarily be attributed to ‘getting the basics right first’.

Furthermore, it is argued that the way in which the basics are implemented greatly affects their impact on reform progress. Even proponents of the ‘basics first’ theory agree that when basics are poorly implemented, they can have a negative effect on budget basics. For example when the implementation of the basics is unrealistic, it can constrain managers so excessively that they will find ways to circumvent the controls.

The author argues that the case studies show that the presence of budget basics can be positively or negatively associated with reform progress. Weak budget basics, such as weak formal laws and poor financial reporting, can undermine reform progress. However, there is also some evidence that an excessive focus on improving budget basics can impede reform progress. Tanzania and Thailand are two examples of this. In Tanzania attempts were made to identify, measure and integrate performance indicators into the budget process and the Medium Term Expenditure Framework. A focus on line item budgeting and cash controls had a seemingly negative effect on reform progress, despite providing budget stability. In this case it

was hard to change the mindset of managers from one of excessive focus on fiscal discipline to one required for successful implementation of budgetary reforms. The author postulates that Dixon's analysis of Thailand's experience with public financial management reforms shows that the basics first approach reinforced the negative characteristics of the control-oriented budget model in Thailand. Strong budget basics sustained a type of managerial and organisational culture that was not conducive to public financial management reform.

The author emphasises that we must consider the impact of factors other than budget basics on reform progress. He identifies these as: the leadership and acceptance of institutionalised political and managerial reform, the incentives to reform, the appropriateness of the design of the reform, the effective use of time, personnel and social capacity and the quality of information systems. The effects of the technical sequencing of reform interact with the factors identified to influence reform outcomes. For example in Ghana, where political leadership was strong, reform progress was 'extraordinary' despite weak budget basics. However, later when electoral change led to a decline in political appetite for reform, progress slowed. In Andrews' opinion both the public finance and governance literature has yet to consolidate lessons learnt from the reform experiences of various countries and identify factors which facilitate reform. As yet, we are unsure of what actually drives reform: a favourable environment, design of the reform process or how the reform is actually implemented.

Publisher: *Public Administration and Development* 26, 147-161

Key Themes: Sequencing of budget reform

Brooke, P. (2003) "Study of Measures Used to Address Weaknesses in Public Financial Management systems in the Context of Policy Based Support: Final Report"

Often donors have financed public financial management (PFM) reforms, which have later proven to be too ambitious. This paper provides an opinion on how best to sequence PFM reform. The author proposes that PFM reform is best viewed as a series of step changes defined in terms of what each change enables: better resource planning, resource use control or accountability. He argues that this approach to PFM, better known as the 'platform approach', would lead to improved development outcomes. Moreover, it could be the basis for longer-term development while giving a realistic degree of fiduciary assurance to development partners in the short term.

This study was primarily intended to contribute to better donor harmonisation in the area of PFM and to help donors establish a basis for the use of more policy based aid instruments. Naturally, then the platform approach seeks to overcome weaknesses in donor interventions in this area. These weaknesses are identified as: the fragmented and partial response to financial management, inconsistency of approaches based on individual measures rather than being programmatic, demanding too much from limited government capacity and the inability of governments to address the fiduciary concerns of donors.

The author suggests a possible framework for applying the platform approach and illustrates the sorts of measures that might be appropriate to achieving an initial platform. Donors can use many different sorts of measures and application of these measures will depend on many different factors. The author identifies a series of criteria for the selection of short-term measures. These include how realistic, sustainable and self-contained the measures are; the degree to which they flow naturally from the type of system that already exists; whether they

are part of a coherent package; whether they will minimise resource leakage, improve transparency and lead to further development of resource management systems. An analysis of current practice showed that the main problem has been the lack of realism in donor requirements. More synergy between measures is needed. Furthermore, the way issues were discussed with governments and how measures were implemented deserved more attention.

The platform approach seeks to avoid these problems by assessing the country's budget and financial management capacity using ascending platforms. The initial platform can be set in the context of subsequent reform platforms once the initial platform has been achieved. In the first phase, the approach should concentrate on establishing the integrity of very basic data and control systems. It should avoid technical complexity and rely primarily on measures that require political support rather than capacities that do not yet exist. This provides a foundation for the second platform, which seeks to improve internal control and hold management accountable. The next platform links service priorities to budget planning and implementation, while the final platform holds agencies accountable for performance. The author argues that monitoring the progress of the approach, does not demand a replacement of existing diagnostic instruments, rather a development of their use.

Within the report the author identifies factors which influence the progress of the platform approach, including clarity of objectives at the onset of the reform process; making country systems the focus point of reforms and need for strong government leadership. Given the audience of the report however, the author concentrates mostly on how donors can be more effective in the process. He advocates that there should be an initial focus on the dialogue process between government and donors. This can increase the level of trust between governments and donors and help to clarify each stakeholder's role in the process, thus leading to a momentum for holistic reform. The dialogue process also facilitates strong government leadership of the reform programme. The author feels that it is up to each donor individually to assess whether achieving the initial platform should be a condition for entry onto an aid programme, because it is up to donors to make their own judgements about acceptable degrees of risk

Publisher: Prepared for *Public Expenditure and Financial Accountability Programme* (PEFA)
Key Themes: Management approach to PFM reform

Campos, J. E. and Pradhan, S. (1999) "Budgetary Institutions and the levels of expenditure outcomes in Australia and New Zealand"

This paper attempts to develop a methodology to evaluate the quality of public expenditure management systems. The authors create a framework, which categorises expenditure outcomes according to the three objectives that public expenditure management systems must achieve: aggregate fiscal discipline, strategic prioritisation of expenditures and technical efficiency in the use of budgetary resources. The main contribution of the paper is presenting an evaluation framework, which addresses these objectives in an integrated manner. In addition the framework considers the role institutional quality plays in influencing the achievement of these objectives. Previous similar attempts have been limited because they have not looked at the interactions and trade-offs that these objectives create and have only considered the implications of institutional arrangements on the problem of fiscal discipline. Crucially, however, institutional arrangements will only be binding if transparency and

accountability mechanisms are in place. It is these mechanisms that impose costs on politicians for violating rules and consequently make their commitment to rules credible.

The authors hold that achieving aggregate fiscal discipline is made difficult by the ‘tragedy of the commons’, i.e. each claimant demands a level of spending on its desired project greater than the socially optimal level, because the costs of projects is dispersed but the benefits accrue mainly to the claimant. Rules that promote aggregate fiscal discipline and overcome the ‘tragedy of commons’ problem are: the existence of a medium-term expenditure framework based upon a consistent macroeconomic programme; the relative dominance of central ministries in budget processes and formal constraints on spending and deficits. However, these rules become binding only if accountability and transparency mechanisms are in place. Examples of such mechanisms are publication and dissemination of results to the public and comprehensive integration of expenditures within the budget. Financial markets, which are open, can also act as a mechanism that makes fiscal discipline important as investors often perceive large fiscal deficits to signal macroeconomic problems.

Strategic prioritisation of expenditures is made difficult by not only the ‘tragedy of the commons’, but other institutional problems, i.e. those of transaction costs in gathering information about citizens’ preferences and informational symmetries between central ministries and line agencies. These problems can be overcome by building a consensus on how resources should be spent. An expenditure planning process and comprehensiveness of the budget are essential in this respect. In addition information is needed on preferences of different claimants, which can be extracted from feedback mechanisms and broad consultations. To exploit the problem of informational symmetries, institutions must allow flexibility for line agencies to make inter-sectoral allocations. Transparency and accountability mechanisms are also necessary to make these measures effective. In this respect ex-post evaluations and hard budget constraints that create incentives to prioritise could be useful.

Technical efficiency on the other hand can be impeded by the principal agent problem in the government hierarchy. Line ministries need a degree of managerial autonomy over their budget allocations to be able to achieve better operational efficiency. They also need to encourage competency through predictable resource flow. One example of tackling this problem is by introducing a system of forward estimates of costs, which are medium-term forecasts of the minimum cost of existing policies and programmes. These are then automatically rolled into budgetary allocations if policies do not change. Merit-based pay schemes and promotion provide incentives for competent work. Clearly publication of financial accounts and audits and oversight by parliament and civil society is needed to ensure the accountability that binds line ministries to these rules.

Based on these ideas, the authors construct a measurable index to assess the quality of a public expenditure system. First they construct an index for each institutional arrangement and if applicable, for the corresponding transparency and accountability mechanism. Index values based on expert opinion are given to each institutional arrangement and accountability/transparency mechanism. However, transparency and accountability mechanisms are given a higher weight as in the authors opinion it is these mechanism that bind governments to institutional arrangements. Weights are assigned on the basis of the analysis of the problems associated with each objective. From this they can construct a slack coefficient to represent each of the three basic objectives. They find the slack coefficients

support qualitative and quantitative findings of the experiences of institutional reform in Australia and New Zealand.

Australia and New Zealand have taken different approaches in their reform process. The New Zealand reforms focused on technical efficiency and aggregate fiscal discipline, while Australia focussed on strategic priorities and aggregate fiscal parameters with less emphasis on introducing accountability mechanisms that increased technical efficiency. However, they do share some common features. Crucially both sought to alter the underlying incentives that govern the allocation and use of resources. Both reforms focussed on transparency mechanisms and made a binding commitment to aggregate fiscal discipline, reinforced by disciplinary mechanisms of the media and the openness of financial markets. The author makes the point that because transaction costs are involved in reform, countries may fare better by concentrating their resources in areas with the highest net benefit rather than trying to adopt the best features of the two systems. However, more recent developments show the convergence of the two reforms, implying that when the areas that are associated with relatively low transaction costs have been reformed, countries proceed to tackle the remaining areas.

The comparative analysis of the New Zealand and Australia reforms highlight the importance of interactions and potential trade offs among the three levels of expenditure outcomes. However, it is still not possible to say which reforms will or will not work in different contexts, in particular those of developing countries. The problem of replicability is very complex. It requires an in depth analysis of more fundamental underpinnings (e.g. administrative capacity, justice system or the relationship between the executive and the legislature) and their mapping onto specific institutional arrangements. Further research is needed to examine the transaction costs involved in the trade offs between the levels of expenditure outcomes.

Publisher: *Asian Development Bank (ADB)*

Key Themes: PFM reform, institutional arrangements, trade offs between expenditure outcomes

Campos, J. E. and Syquia, J. L. (2006) “Managing the Politics of Reform: Overhauling the Legal Infrastructure of Public Procurement in the Philippines”

This paper provides an example of a public effort to reform an aspect of the public sector in a challenging political environment. It is a case study of reforming the legal infrastructure of the procurement process in the Philippines. It identifies factors that were crucial to that reform process. These include: the formation of group of reform-minded government officials, support of legislators who knew what strategies would work, in-depth technical studies and the implementation of a well thought out communication strategy. However, the lessons that emerge from this study can be more generally applied to governance reform and tackling corruption. The success of this reform effort shows that focussing efforts on specific areas, opportunity can be created to have an impact on broader reform processes.

The first crucial step in initiating the reform process was the building of an effective reform coalition. Because the procurement system provided lucrative rents for politicians and bureaucrats, opposition was fierce. Therefore only with sufficient and sustained support could a reform be successful. Four potential impediments had to be overcome to pass a procurement code. First the executive branch had to be unified in the effort. A strong consensus from

government agencies was needed to persuade the bill's sponsors that the bill's provisions could hold under scrutiny. Second civil society groups had to be mobilised to get the legislature to act. Only if the potential sponsors in the legislature could gain an electoral advantage via vocal civil society groups and the media, would they be interested in sponsoring the bill. The executive branch and civil society had to work together to ensure opposing legislators could not use sources of disagreement to water down or kill the bill. Finally influential legislators were needed, who were willing to invest significant political capital in the hope of even larger gains.

The experiences in this case study point to several important initial factors in pushing the bill forward. This included both the building of technical capacity for the reform to be implemented and a political context which made the fight against corruption politically beneficial. The case study also highlights the importance of galvanising civil society. It was this that caused the various actors to support the bill. When President Estrada left office, the political climate changed and there was less concern with reducing corruption. The strategy to involve civil society was successful in bringing back the impetus to deal with corruption. It involved approaching key civil society groups and using the media to raise the profile of corruption in government procurement. The technical working group had formed Procurement Watch Inc. (PWI) to monitor and train during the implementation phase. Members of PWI used their connections with anticorruption NGOs to enable discussions, which evoked their interest. They also used their connections to get the church, the private sector and local government officials involved. PWI also provided informative workshops to gain the interest of student leaders who mobilised students to make an attention drawing appearance at a Committee Hearing.

The authors also highlight the importance of the media campaign, which has traditionally been underestimated. The media campaign amplified the voices of various supporting groups and created a sense of harmony among them that exerted pressure on the decision makers. The four components of this successful campaign were: the targeted use of AM radio, invitations for legislators to TV shows, strategic articles in newspapers and an advertising campaign that created a brand name for the reform. This heightened sense of awareness among the population led to increased legislative support of the reform.

The experience in the Philippines provides some general lessons for donor agencies that wish to support reforms. First a strong core group of dedicated individuals from both within the government and civil society is needed to counter the inherent advantage of vested interests dynamically. How this group responds to challenges and developments, however, will vary from case to case and country to country. Donors must find ways of supporting this core group, strengthening external alliances and supporting a strategic media campaign. Finally the case study shows that patience and continued support is needed. Passing the new law was a long and arduous process and implementation is likely to take even longer.

Publisher: *World Bank Working Paper*

Key Themes: Governance reforms, the politics of reform, the role of civil society in the reform process

Chang (2002) "Breaking the Mould: an institutionalist political economy alternative to the neo-liberal theory of the market and the state"

This paper critiques the neo-liberal theory of the state, especially on its inadequate analyses of the role of institutions and politics and discusses an alternative approach. The author argues that the problem with neo-liberal theory lies in its conceptualisation of how markets, the state and institutions interact. Chang feels that the assumptions neo-liberal theory makes regarding the relationships between these concepts causes a number of theoretical and practical problems. In order to address these limitations, he suggests that the 'mould' of neo-liberalism needs to be 'broken' and an alternative framework developed. He refers to this alternative framework as institutional political economy (IPE). In this paper, he outlines the main features of the IPE but recognises that this approach is not yet fully developed.

Chang describes neo-liberalism as an 'unholy alliance' between the analytical tools provided by neo-classical economics and the political and philosophical traditions of Austrian-libertarian thinking. Neo-liberalism conceptualises the state as being run by self-interested politicians and bureaucrats, which causes rent-seeking and corruption. It therefore sees the imperfect nature of the state causing government failures which carry greater costs than market failures. The author argues that this approach is severely limited for four reasons:

1. Defining state intervention and free markets is problematic. State intervention in one society may not be regarded as state intervention in another, because the legitimacy of rights and obligations differ between societies (e.g. the issue of child labour or slavery). The definition of 'free markets' is based on the structure of rights and obligations, which are in fact politically determined.
2. Defining market failure is not straightforward either, as different branches of economics have different expectations of how an ideal market should behave (e.g. Schumpeter vs. Neoclassical theory). The market is in fact just one institution of what is referred to as the market economy or 'capitalism' by the author. Focussing on the market alone ignores non-market, non-state institutions which are integral elements of market economies.
3. The author also questions the assumption of the 'primacy of markets', i.e. analytical starting points that assume that markets are natural and have always been there. Chang argues that the emergence of markets has been deliberately created by states. Assuming institutional primacy of markets is especially problematic in the design of development policies for countries that have not yet developed market systems.
4. Chang severely criticises neo-liberal attempts to 'de politicise' the economy by restricting the role of the state. In his view, markets themselves are political constructs and therefore the neo-liberal view is 'at best self contradictory and at worst dishonest'. However, he does not deny that a certain degree of de-politicisation of the resource allocation process may be necessary unless it is perceived to be 'objective', in which case it can threaten the political legitimacy of the economic system itself.

Both the political economy and institutional approach of Chang's IPE go further than that of neo-liberal theory. The political economy approach of IPE goes further than that of neo-liberal theory, because it applies political economy logic not just to the state but also to the analysis of markets. It also emphasises the role institutions play in influencing human actions including those internal and external to states.

To understand how markets work, a large range of both formal and informal institutions must be considered, not just those of property rights and legal infrastructure that neo-liberals focus on. Some of these have gone so far in being taken for granted that they are 'invisible'. All

markets are based on institutions, which regulate who the market participants are, what the rights and obligations of those participants are, which objects can be legitimately exchanged and the process of exchange itself. IPE also argues that politics is an integral part of the construction, operation and change of markets. Thus the IPE framework incorporates a more comprehensive institutional and political specification of markets.

IPE also recognises the multi-faceted nature of human motivations questioning the assumptions made in neo-liberal theory that the only true motivation for human behaviour is pre-determined and self-seeking. IPE does not take these motivations as given, but like old institutional economics, acknowledges that these motivations are shaped by institutions. IPE postulates a *two-way* causality between institutions and individual motivations. It argues that human behaviour can be changed not only by changing institutions that define incentives for individuals, but also through ideological and institutional changes that influence individual motivations themselves.

Publisher: *Cambridge Journal of Economics* 2002 (26) 539-559

Key Themes: Theories of the market and the state, institutions, political economy

De Renzio, P. and Krafchik, W. (2007) “Lessons from the Field: The Impact of Civil Society Budget Analysis and Advocacy in Six Countries”

The authors synthesise the evidence on civil society budget groups to determine their impact on accountability, transparency and public spending. They also examine factors that can explain these impacts. The authors conclude that budget work is an important tool that can be used by any organisation to increase transparency and engagement. Increased budget literacy and pressure from budget groups has led to small and substantial changes in budget policy too. Furthermore where there is long-term commitment, structural change may result. The insight provided by this paper is that the environment within which the budget group operates is important, but it does not predetermine the impact of the budget work. The key to success is for budget groups to adapt their approach to their environment. Consequently understanding the (changing) environment in which they operate is of great importance.

The authors examine how both factors internal to the organisation of budget groups and the external environment within which they operate affect the budget groups' relationships with other actors. External factors include: the political, legal and institutional environment, literacy in society and the role of donors. Internal factors include: capacities, leadership and goals of the budget group. Other actors include: donors, executive, legislature and the media. Intermediate outcomes of budget accountability and budget policies are a result of these relationships. The authors concentrate on the impact of budget groups on these intermediate outcomes, but appreciate that the long-term outcomes of democracy, poverty reduction and equality are the motivation behind budget work.

The authors' research draws on six case studies (Brazil, Croatia, India, Mexico, South Africa and Uganda) where the civil society groups have had similar long-term aims of efficient use of public resources and social justice. All the organisations have been engaged in such budget advocacy work for at least five years. The case studies include not only a range of organisations but also countries with different levels of income and ones which are at different democratic stages. Because the case studies demonstrate the work of budget groups in different political and institutional contexts, it is possible to examine the impact of such

factors. It appears that the country's governance does not imply that budget work will or will not succeed. The legal and institutional context also plays a role in the effectiveness of budget work. For example budget groups can take advantage of decentralisation and focus on local level budgets. The division of power between parliament and the executive will also determine how effective it is to gain parliament as an ally.

The authors provide recommendations for donors who wish to support the work of budget groups. Donors need to ensure that their role of supporting government programmes and their involvement in budget support complements rather than conflicts with the financing of civil society groups working on budgetary issues. I.e. they must strengthen the local inputs rather than being the dominating voice in the dialogue with the government. The authors recommend that financing civil society organisations is done with long term core financing. The criteria adopted for financing must consider the following: credible monitoring and evaluation system for the budget, the linking of actors and networks and the objectivity of the group.

Civil society groups can take certain steps to structure their activities to have the maximum impact. The authors recommend they ensure the existence of a wider civil society that possesses both the interest and the capabilities to use the results from budget work for wider social change; otherwise budget work will have little impact. This implies that a starting point is to improve literacy and budget awareness. It is also important to recognise that particular types of budget work are best done by certain organisations, but that all organisations can successfully participate in budget work.

Publisher: Washington DC: *International Budget Project*
Key Themes: Civil society groups, budget work

DFID (2005) "A Platform Approach to Improving Public Financial Management"

This briefing paper focuses in particular on the technical sequencing of PFM reform. It looks at how donors can implement good practice principles in facilitating a PFM reform, which is both country-led and designed to fit the country context. It echoes what much of the recent literature emphasises: Understanding the political and institutional context is crucial to building momentum and identifying the opportunities for reform. However, the platform approach is relatively recent, so despite being implemented in a range of countries, no conclusions can be made about the long-term impact of improving PFM performance.

Recent research into PFM reform has shown that donor interventions have been uncoordinated, have over-emphasised the technical nature of reform and have paid insufficient attention to which reforms may complement or build upon each other. The platform approach addresses these concerns by implementing a package of measures over a manageable timeframe, where increasing levels of PFM outcomes are achieved. This approach thus avoids a focus on short-term measures and provides a more comprehensive strategy, which forms the basis for a sound PFM system. It also enables stronger government leadership of the reform programme. This allows the government to base the pace of reform on what can realistically be achieved, both technically and politically. The approach is also conducive to donor harmonisation and improvement of donor-government relationships. Donors must ensure that the government approves of and understands both the technical nature and the concepts behind the reform process. The first level of the platform approach is the attainment of a credible budget and reliable budget reporting. Second internal controls that hold line

managers accountable must be satisfactory. The third platform looks at priority areas and service targets, while the final step enables more accountability for performance-based management and financial management.

The paper examines the use of the platform approach in Cambodia, while cautioning that the result of this approach can differ for different countries. Cambodia has used an amended form of the PEFA PFM indicator set as a framework to measure reform. To motivate implementation it has sought to “vertically integrate” performance indicators between the overall vision of reform and personal accountabilities. It has done this by using merit-based pay initiatives as incentives for those accountable for the performance results. Harmonising donor involvement before implementing the approach was a key challenge. Cambodia is now attempting to reach the first platform.

However, the paper highlights that this approach may not guarantee a successful reform. One risk is that if the initial platform is set too ambitiously, it can undermine credibility and discourage a building up of momentum, because initially nothing will appear to have been achieved. Despite this the chances of success are improved because this approach recognises the need to address not only technical issues, but also motivational and institutional ones. Donors can also take certain steps to maximise the chances of success with this approach. Donors must seek to build trust with the government and establish a framework that both parties agree on. Donors should also facilitate a process whereby the government can lead the reform. Moreover it is crucial that both donors and governments are patient and realistic about timeframes and keep non-essentials to a minimum.

Publisher: *Department for International Development (DFID)*

Key themes: Technical sequencing of PFM reform

DFID (2007) “Understanding the politics of the budget: What drives change in the budget process?”

Donor agencies have increasingly begun to recognise the insufficiency of purely technical approaches to reform in producing desired results. This paper presents DFID’s view on the importance of understanding the political dimension of public financial management reform processes. Based on detailed analytical studies of budget systems in Ghana, Malawi and Mozambique, this paper explains why understanding the political context in which reforms take place is important, how political factors affect the budget system and the implications of this for the design of reforms. The paper emphasises that a better political understanding of the budget can help to improve aid effectiveness and understand the gaps between the formal processes and informal practices. It suggests that donors should engage with the politics behind the budget to support the reform process, in particular by strengthening domestic accountability mechanisms. While DFID sees political will as important to reform it does not see its absence as the only cause of reform failures. Dysfunctions in PFM systems and low technical capacity can equally cause PFM reforms to fail.

The paper analyses in some depth how political factors affect the budget system. It finds that budget decisions and policy implementation are determined by underlying power relations and political dynamics. It is also necessary to consider the incentives faced by the political actors and to recognise that these are shaped by the political systems themselves (e.g. degree of accountability, political competition etc.). Understanding budget systems in this way makes

it clear that resistance to change by vested interests must be tackled first; otherwise reform is likely to lead to failure. This is because the incentives of the main stakeholders can undermine formal institutions at each stage of the budget process which is why there is often a divergence between the formal rules and informal processes at several different stages of the budget process. The country studies show that these differences undermine the democracy of the budget process and create opportunities for rent seeking, clientelism and patronage.

Understanding this is particularly important for donor agencies, not least because of the growing interest in the use of programme aid modalities, such as budget support, which are delivered through government budgeting systems. Therefore both sound PFM systems and the accountability mechanisms that support them are needed to ensure that aid resources are used effectively. Political economy considerations also help to gauge both the feasibility of reform and whether the government is committed to it.

The study highlights that two things are important for the reform process: Understanding formal and informal institutions and better sequencing of the reform process. Analysing to what extent informal practices deviate from formal processes is important because supporting a reform that seeks to change formal processes is futile if these will only be undermined by informal practices. Second prioritisation of the reform process is crucial. DFID draws on the both the PFM literature on technical sequencing of reform and the work on ‘good enough governance’ to suggest that reform processes should seek to get the technical ‘basics right’ and promote ‘good enough governance reforms’ which are ‘political feasible and realistically sequenced’. The studies, on which this note is based, further highlight the importance of understanding the interdependencies existing between different aspects of the budget process. These studies showed that PFM reform could only be successful when combined with other broader public sector reforms. It is also important to appreciate the need for country specific solutions rather than advocating any particular ‘best fit’ strategy to all countries. The need to sustain reform is also considered important as achievement can be reversed.

DfID’s analytical framework show how different actors contribute via formal and informal institutions to the budget process. From this DFID draw some important policy implications. First donors need to understand reform processes better, including their own impact on reform processes. It is preferable for donors to do this in a harmonised way, as this can add value to multilateral budget support. In addition they should seek to use measures to understand the fiduciary risks of budget support. The paper suggests that PEFA assessments should be complemented by assessments of political and institutional environments that affect PFM systems. Second donors must engage with domestic accountability institutions in ways that strengthens internal demand for accountability. Strengthening the demand for accountability is likely to improve the impetus for reform. They must focus not only on the role of the executive, but support parliamentary strengthening, audit institutions and the role of civil society in improving accountability.

Publisher: *Department for International Development (DFID)*

Key Themes: Budget reform, political economy of the budget, donor recommendations

Diamond, J. (2006) “Budget System Reform in Emerging Economies - The Challenges and the Reform Agenda”

This study considers the challenges and issues associated with the introduction of performance or results-based budgeting reforms. These require a fundamental shift from methods that rely on centralised budgeting to decentralised management models. The author finds that significantly robust accountability and transparency mechanisms are needed for such reforms to succeed. Therefore the author argues that a move to results-based budgeting may not be feasible for all countries given their current governance and financial state. He goes on to highlight the substantial financial resources and political efforts involved in the introduction of such reforms.

The author identifies three fundamental characteristics of results-based budgeting systems. First managers have increased flexibility in managing resources. Second managers have higher predictability in resource availability. Third an incentive system is introduced to pressurise managers to increase their performance of attaining explicit government policy objectives. Therefore accountability relationships within the government have fundamentally changed.

This relationship imposes discipline through output rather than input measurement. However, the introduction of these reforms requires a considerable effort, as it is difficult and costly. Emerging economy officials have generally recognised that this reform must translate broad policy objectives into quantifiable projects and activities. To capture the full cost of these activities over time, many countries have taken on medium term budget frameworks. These frameworks are useful in improving planning, prioritisation of programmes and maintaining overall resource discipline. However, as the author highlights, developing and sustaining such a framework can be problematic. In addition it is difficult and costly for emerging economies to consistently provide information on performance. Even measuring and defining outputs, let alone outcomes, is not a simple task.

The author argues that OECD country experiences demonstrate that certain changes must be in place to facilitate the implementation of results-based budgeting. Basic safeguards are required to ensure that the PFM system can cope with the demands of the new system. Often complementary reforms in other institutions, such as legal institutions, are required. Substantial political and financial investments must be made to achieve success. However, the author highlights several aspects of PFM systems in emerging economies that present weaknesses which compromise the implementation of these reforms. It is crucial to establish effective internal controls before giving managers wider responsibility. Strong internal auditing is also essential and often there is a need to use information technology to produce timely management reports. Cost accounting expertise is needed to ascertain the full cost of programmes and relate this to performance. The author argues in some depth that the reform requires a shift from a cash-based government accounting system towards an accrual accounting system, which can be complicated and demand considerable resources. The costs of introducing full accrual accounting in the contexts of these countries far outweigh the benefits. The author also warns that the roles of contracting in government agencies and devolved management units can be problematic for countries with limited administrative resources.

Experiences from emerging economies show that few have been able to make progress on all the required aspects of reform. This indicates the presence of implementation problems. The author suggests this is due to the lack of basic budget management infrastructure. In particular the skills required for implementation are often in short supply. These constraints

imply that if the capacity is present to develop adequate management capabilities, a slow and well-sequenced reform is crucial.

Publisher: Washington, D.C: *International Monetary Fund*

Key Themes: Performance-based budgeting, difficulties of budget reform

Dietsche, E. (2003) “The Political Economy of Policy Decisions: Why good technical reform designs don’t always work”

Academics cannot reach a consensus on what determines reform success, because it is hard to trace reform success to particular recommendations of reform strategies or policies. Consequently different approaches and recommendations for reform agendas have been debated. The appropriateness of economic liberalisation reforms has been questioned, but more recently much of the literature that emphasises the need to build the “right” institutions has also been criticised. The importance of institutions is accepted, but as North (2001) points out, less is known about how to get the “right” institutions. Comparative institutional analysis of OECD countries suggests that this task is much more complex than a simple technical reform exercise. It is also likely to depend on many country specific factors, which has shifted the literature to search for a broad, but comprehensive framework that sheds light upon which factors may affect the capacity of governments to reform effectively. This article provides an overview of the recent debate on the political economy of policy-making and development. The author concludes that researchers and policymakers must move away from designing generic policy reforms based on static models.

Economic analyses of politics assume that individuals are “self maximising”. Much of this literature aims to prove that the strategic actions of rational individuals can lead to socially undesirable outcomes. The theory of collective action suggests that individuals need the state to overcome the free-rider problem associated with public goods provisions. Public choice theory emphasises that the state can have a negative influence due to self-interested politicians. Consequently market solutions are regarded as superior to state intervention. These ideas inspired the Washington Consensus. However, the institutional framework remains exogenous and underrated. The inconsistency in this strand of literature is that if there were such a thing as a consensus for the “right” policy reform programme, developing countries would not stick to bad policies. In response Rodrik (1996) suggested that policymakers need to consider under what political conditions the reform agenda can be sustained.

Institutional economics assumes that economic and political activities take place in an institutional framework, which determines how economic and political actors pursue their interests. The state is important because it promotes legitimacy and the enforcement process. North’s work highlights the importance of the state in overcoming transaction costs that would hinder productive economic exchange. In more recent work he emphasises path dependency and informal institutions. Much of the policy concern in institutional economics has focussed on determining which institutional settings are most likely to bring efficient economic and social outcomes. However, Khan (2002) argues that it is a mistake to focus on which institutions are “right”, because this view cannot be substantiated by the evidence. The association between governance indicators and development outcomes must not be assumed to be a causal one. The East Asian countries provide a clear example of this. Khan emphasises that promoting institutional reform is not sufficient to enforce growth-enhancing institutional

change, as the dynamics of the political environment must also be considered. In particular practitioners should consider how to promote growth-promoting political coalitions.

Structural political economy is based on the theory of rent-seeking. It reflects the view that structural characteristics of countries can largely explain the comparative differences in the distribution of power and development outcomes. Some argue that structural features such as natural resources abundance or ethnic diversity have led to more intense distributional conflicts. This literature does not see the interest of political actors as central, but implies that the influential political actors are those that have benefited from the structural characteristics of the country and so the resulting outcomes are those that favour their positions. However, this literature has been criticised by DiJohn (2002), who argues that rather than assuming a priori that the state is predatory, more fundamental issues should be considered, such as state capacity, distribution of assets and the nature of political legitimacy. In contrast, Khan (2000) argues that the net effect of rent-seeking can be positive as well as negative, depending on the social value of rents created. This value differs between countries, depending on their political conditions, institutional framework and technological trajectories. Thus policies should seek to change institutions and politics to support developmental rents.

Economic analysis of politics, institutional economics and structural economics all promote clear models with distinctive explanatory variables that explain development outcomes. However, their disadvantage lies in the fact that so far they have been static and ahistorical. Their critics doubt whether reform agendas based on these paradigms will ever generate positive empirical results in a majority of countries. In contrast comparative political economy looks at the economy in a dynamics sense. It emphasises that differences in policy choices are contingent upon historical trajectories of institutional change and reform. It seeks to explain the observed variation in political institutions and policy processes across countries using complex game theoretical models of actors' interests and powers. However, its disadvantages lie in the fact that it does not predict policy outcomes. It merely explains differences in policy choices and so is less useful for forming a country specific reform agenda. Comparative political economists argue that it is not possible to construct a generic model for policy reform, because of the contingent nature of policy choices. Countries are successful due to specific institutional advantages. This provides an explanation why technical reform approaches are only able to achieve a limited amount of empirical success.

However, Ahrens (2002) attempts to overcome the inability of comparative political economy to predict policy outcomes or provide reform advice. He offers a conceptual framework that can be analysed in a comparative way to examine obstacles to policy and institutional reform. It is based on the idea that policy tools and institutional arrangement must be re-designed to craft governance structures that enhance market structures, while fitting into the local conditions. A new research agenda should seek to combine the dynamic and contingent nature of comparative political economy research with considerations of why developing economies have not moved to higher trajectories of development.

Publisher: *Oxford Policy Institute*

Key Themes: Political economy models, reform

Dixon G. (2005) "Thailand's quest for results focused budgeting"

This paper analyses Thailand's attempts to reform its budget process. In doing so it yields lessons for other countries, which, like Thailand, have a centralised fiscal system. The author, having been involved in the early stages of the second round of Thai budget reforms, uses his own experience and reports of subsequent World Bank and AusAID missions as sources for this study. However, he indicates that other parallel research validates his findings. The findings indicate that a centralized budget system is incompatible with results based budgeting. Moreover, the study highlights that reform requires political will and is not merely a managerial problem.

Initial attempts in the 1990s to introduce programme based budgeting in Thailand failed. Thailand had a highly centralized budgetary system. The powerful Bureau of Budgeting (BOB) controlled the spending of each agency. Although this system led to effective fiscal control, spending decisions were not made with reference to service delivery. Pressure for PFM reform stemmed from the uncertainty surrounding the cost-effectiveness, efficiency and targeting of public finances. Programme budgeting was introduced. Theoretically this implied that funds were allocated to agencies in programme blocks according to the policy objectives that were being met. However, this was not the case in Thailand, as the BOB have continued to use detailed line itemization as a basis for budget allocation and tracking in parallel with the new programme budgeting framework. The BOB remained reluctant to use ex-post output information to decide how agencies should spend their funds. The author provides three main reasons behind their reluctance to relinquish their control over the public purse. First the output data was hard for the BOB to verify, increasing the likelihood of corruption or waste. Second it was more difficult to track and control budget activity using data that was not easily captured by a single indicator and was thus of a less rigorous nature. Third reducing line itemization implied that funds were no longer controlled before the spending took place, but reviewed after the event.

In 1997 a second round of budget reforms were introduced. The Asian Crisis resulted in falling revenues and led to unavoidable spending cuts, which increased the need for reform. This second attempt at reform was based on the idea of "conditional devolution". Line ministries had to meet financial management standards in seven areas before the BOB reduced line itemization. These seven "hurdles" were: budget planning by the agency, output costing, financial and performance reporting, funds control, procurement management, asset management and internal audit. Conditional devolution provided an incentive for budget reform.

However, the hurdle approach encountered some problems. The author claims that the main problem was that the standards were set unrealistically high. Without technical assistance or leadership from the BOB, there were no funds to upgrade the management standards. Other problems included the interdependency of reforms on agencies outside its control. The author also highlights the importance of the attitudes of officials in the ministries as they interpreted the introduction of standards as a move by BOB to increase its influence, leading to strong opposition. Furthermore a lack of pressure due to the absence of a deadline meant that barely any progress was made towards the standards. In 2004, however, the Thaksin initiative was successful in making advances to the hurdle approach. The decisive feature of the initiative was that a deadline was set indicating much-needed political support for reform. Other changes included providing more technical support.

Thailand's experience yields two key lessons for other centralized countries wishing to move to performance based budgeting:

1. *Results based budgeting is incompatible with centralized budgeting.* The detailed line itemized budgeting constrains line agencies from controlling their budget allocation effectively. Moreover, the continuation of input controls together with output arrangements risks a budget being "over determined". Doing this is likely to result in one of these budget control instruments dominating the other. Successful introduction of performance based budgeting requires both top-down and bottom-up reform with line agencies being assisted to build their financial management skills in parallel with central agencies.
2. *Reform is a political rather than a managerial problem.* There are important political reasons why reform is difficult. The reform process implies bureaucratic stakeholders will incur many costs, including loss of power and the effort required to understand a new system. Therefore reform is not possible without a clear political direction and support. Political deadlines, rather than administrative deadlines must be set. Top bureaucrats must be held accountable for progress.

Publisher: *International Journal of Public Administration* 28(3-4): 355-370

Key Themes: Management model of budget system

Dorotinsky, B. and Floyd, R. (2004) "Public Expenditure Accountability in Africa: Progress, Lessons and Challenges"

This paper summarises some of the main findings on PFM development since the mid 1990s in Highly Indebted Poor Countries (HIPC) countries. It uses tracking criteria which identify fifteen indicators measuring aspects of the quality of budget formulation, execution and reporting as a basis for evaluating the public financial management system of HIPC countries. They find that budget formulation has improved in many HIPC countries, but budget execution and accountability remain weak. Based on this analysis authors try and identify lessons for reform in other countries. The World Bank argues that over ambitious agendas that span over a short time frame are less likely to succeed, because state capacity will be exhausted. Often countries that have adopted more innovative and coordinated approaches have fared better. The authors also highlight the importance of institutional and governance arrangements to such reform processes.

An effective budget formulation process is characterised by macroeconomic stability, good public revenue projection, comprehensiveness (for instance, it captures aid resources) adequate internal controls and accurate accounting and budget data. However, in many countries the budget process is not regarded as the primary vehicle for making policy choices, because budget information is not available or not used for policy formulation. Policy priorities remain unidentified and the budget only covers part of the government's activities. Thus transparency and accountability are severely reduced. The authors suggest some ways to transform this situation into one of effective budget formulation. One way is to make financial reporting more comprehensive. Increasing the role of sub-national governments can also help budget formulation. However, decentralization brings its own challenges, as often capacity to manage public resources is weaker at the local level. Furthermore improvements must be retained in central ministries while decentralization is underway. When reforming the budget, however, budget management capacity must be taken into account. Past experiences have

shown that when this is not done inadequate design and sequencing characterise the reform process.

The authors emphasise that an important factor in effective budget reform is the quality of participation in the process. Line agencies should be actively involved in the process. Rather than just giving technical assistance to mid-level finance officials, involving policy officials in the process can lead to better budget formulation. Senior policy officials must be educated on the economic and fiscal policy outlined in the MTEF. Moreover, budgets must be regarded as a process for reaching political consensus, rather than just as a technical exercise. This is because ministers are more inclined to adhere to the policies when they understand the constraints of those policies. Increased donor assistance, broader political and public sector reform programmes have all helped the countries that performed well on budget formulation.

However, a well formulated budget can be undermined by poor budget execution. Adequate internal controls are needed to prevent rent seeking and waste. Timely and accurate data and a computerized system that manages and monitors accounts are also required. However, a computerized system is only worth upgrading if governments are willing to manage their own affairs by monitoring spending and then taking out corrective measures when spending deviates from policy priorities. More realistic expectations of what Financial Management Information Systems can do are necessary. The authors also highlight some examples of ineffective reform process including the strengthening of autonomous agency concepts in environments where accountability is weak. Finally the paper reviews how budget reporting can be strengthened. Accurate and comprehensive accounts are essential. However, parliaments need the resources and capacity to provide oversight. From the authors point of view, independent and transparent audit institutions can also greatly improve the quality of budget reporting.

Publisher: in *Building State Capacity in Africa*, ed. by Brian Levy and Sahr Kpundeh, Washington: World Bank

Key Themes: Budget formulation, budget execution and reporting, budget reform

Goldsmith, A. (2007) “Is Governance Reform a Catalyst for Development?”

In this article Goldsmith, provides a critique of the ‘good governance’ agenda, which has come to dominate international development work in recent years. He seriously questions claims put forward by empirical studies that investing in the quality of institutions can generate “development dividends”. These studies, academically influenced by public choice theory or new institutional economics, which identify a causal relationship between governance and development suffer from a number of methodological problems. Goldsmith identifies two: the possibility that another unidentified factor could be causing both governance and development and the problem of ‘reverse causation’, i.e. that development itself could be driving improvements in governance. To overcome these methodological flaws the author uses a case study approach which he finds are more useful in clarifying and interpreting results even if they suffer from their own limitations of being narrow in scope.

Goldsmith uses anecdotal evidence from four case studies (United States and Argentina in the 19th century and Mauritius and Jamaica in the 20th century) over a thirty year period to address the possibility that the link between governance and development requires a longer analytical time frame. In each case the author looks at the extent to which specific institutional reforms

were catalysts for development and whether unreformed governance itself could also be a contributing factor to development (or at least not a limiting one). The case studies suggest that there are several unaddressed issues which need to be investigated more closely through traditional statistical methods.

The author derives four conclusions based on the analysis of these case studies:

1. *Meritocratic bureaucracies, independent judiciaries and honest elections are good in themselves, but need not lead to a perceptible acceleration in development.* The authors suggest that this is because there are time lags associated with implementing institutional reform. Those that stand to lose from the reform process are thus able to find time to stall or reverse the process.
2. *If other conditions are favourable, 'fairly objectionable' public institutions may be sufficient to ensure an upwards surge of production and income.* Clientelism can benefit development if it legitimizes and stabilizes the political systems and therefore to a positive business environment.
3. *Good governance appears to be more an effect rather than the cause of growth although over time they become important in sustaining development.* Political demand for governance is often characteristic of an educated middle-class, which is likely to be larger in an economy with higher growth. As the economy improves, businesses and interest groups tend to agree that neutral civic institutions are preferable. However, over time as the economy becomes more complex institutions appear to become a more important factor in sustaining development.
4. *Development may initially worsen the governance environment but this in turn can stimulate responses to improve governance.* Economic growth can lead to stronger rent-seeking behaviour. In turn, however, extensive corruption can prompt the rise of civil society organizations that create political momentum.

The case studies and conclusions illustrate some areas which need to be researched more extensively. The four hypotheses made by the author need to be tested more carefully across a larger number of countries. In particular more consideration needs to be given to capturing lags and non-linear relationships in governances and complementarities among institutions which are more important than any single institutions in bolstering development.

The author points to the possibility that "institutions matter" more in certain circumstances. For example when a critical mass of open rule based institutions exists, institutions may be more important in explaining development. Perhaps it is better to show progress in a range of institutions rather than reach some preset level of institutional excellence. Perhaps there is a neighbourhood effect, where the absolute level of governance matters less than that relative to neighbouring states.

The author warns that donors should avoid holding out unrealistic expectations for institutional change to lead to economic growth and poverty reduction. It is also crucial for donors to realize that the costs and benefits of institutional reform may change from one period to the next when expectations differ. Attitudes and expectations vary from country to country. Therefore different strategies, such as a comprehensive approach to reform or focusing resources on a few crucial institutions, may vary across countries.

Grindle, M. S. (2007) "Good Enough Governance Revisited"

This paper attempts to move beyond establishing the concept of good enough governance which questions the long menu of institutional changes and public capacity initiatives that are generally deemed important for developed public finance systems and tries to explore how this concept can be operationalised in real world contexts. The paper is divided into two sections. The first section reviews the lack of consensus on the relationship between governance and development. The second section looks at what the best ways are to move towards better governance in a particular country context. Development practitioners are often confronted with long lists about what they must do with little guidance on prioritisation. The author suggests they prioritise by using a number of existing analytical frameworks to improve decision making. In particular the context of the country, the content of reform and the reform process must be analysed. The author concludes that there are no 'magic bullets'. Therefore research and practice must both find opportunities to move in a positive direction, rather than seek to find a universal panacea for successful reform.

The debate on good governance is surrounded by discussions of definition, measurement and inference. The definition of governance itself is complex, and differs across organisations and academics. Defining good governance implies making a judgement about "what ought to be". Definitions often vary in the degree to which they imply particular policies. The consensus is that although measurement of governance is problematic and inexact, the effort is worth it to clarify thinking and set a basis for empirical work.

Studies using large cross country comparisons have tried to establish a relationship between governance and development. These studies tend to find a consistent positive correlation between development and good governance. Others such as that of Kaufman and Kraay (2002) find that this relationship is not just one of correlation: good governance causes development. The findings of these studies are repeatedly questioned on methodological grounds. Other criticisms include work by Hewko (2002), which suggests that broad generalisations of large cross-country comparisons ignore how countries are affected by the institutional, international, policy and leadership environment.

In contrast to large cross-country studies, country case studies tend to show that development is not fully dependent on having good governance. This literature concentrates on experiences of countries that have made economic progress without addressing governance deficiencies first. Rodrik (2003) suggests that growth can be stimulated by a small number of policy and institutional changes. In contrast, Chang (2002) suggests that some basic characteristics are needed but other governance factors emerge over time in with or as a consequence of growth. Other research, such as earlier work by the author (Grindle 2004), focuses on organisational and political factors that bring about governance reform. There is still considerable disagreement between researchers about which historical and political economy factors cause good or bad governance. Some case studies look at particular episodes of institutional or policy change and explore how issues got onto public agendas, how they were debated and negotiated and what factors contributed to whether changes were sustained. Contextual

issues appear to be important in explaining which reform initiatives were implemented. In particular domestic reform leadership seems almost essential.

There also exists a distinct literature that considers the challenges for governance in particular circumstances. These circumstances include the case of countries that have high levels of HIV and AIDS, are extremely dependent on aid or are deemed to be fragile states.

The author suggests ways in which the good governance agenda can be used to target fewer, feasible and more useful interventions. Organisations need to be aware of and incorporate into their policy recommendations the methodological and empirical ambiguities that are to be found in existing research on this topic. Grindle suggests using two existing analytical frameworks to improve decision making about which governance interventions are necessary. One framework focuses on assessing the strengths and weaknesses of states in terms of institutions, organisations and legitimacy. Practitioners must then assess where particular countries are on a continuum of state strength and capacity. By making an effort to assess pre-existing governance capacity in the country concerned, priorities for governance interventions can be more readily identified.

The second framework looks at the sources of change that may exist in particular governance environments. The DFID sponsored Drivers of Change (DoC) approach is based on this idea. In Grindle's opinion this approach provides a good foundation for strategic analysis by emphasising the importance of the local context as the point of departure and of a longer term perspective than is typically the case in planning for development interventions. It also encourages strategic identification of opportunities for effective interventions, how to negotiate and introduce change and how to consider difficult issues for institutionalisation.

Grindle proposes two ways in which practitioners can influence change that promotes governance reform. These are to assess both the context of reform and the content of the changes that are proposed. For practitioners who work at the level of specific policies and programmes, government objectives driving reform must be understood. In this way the time, complexity and potential conflicts of each activity can be identified and addressed. In addition to analysing the context and content, the process of a reform must be understood. This involves looking at how to bring the issue on the agenda, how to design the reform, what needs negotiating and the conditions that affect whether implementation of the reform and its sustainability are likely. By merging an analysis of both the content and context, practitioners can more effectively sort through the difficulties in making choices among the options for the investment of their time and resources.

Publisher: *Development Policy Review* 25 (5): 553-574

Key Themes: Relationship between governance and development, implementing institutional reform

Hudson, A. and Wren, C. (2007) "Parliamentary Strengthening in Developing Countries"

This report seeks to inform DFID on the best way to help to strengthen parliaments in developing countries. It reviews the current state of knowledge on the role of parliaments in improving accountability, responsiveness and state capability. It also reviews the work of organisations involved in parliamentary strengthening. The authors argue that it can be problematic to identify any lessons from efforts to strengthen parliaments, despite the large

number of organisations involved in this type of work, because only a small number of analytically robust assessments have taken place. However, the report does manage to provide several guidelines on how to strengthen the role of parliaments based on a small number of reviews and expert advice.

The authors posit that support to strengthen the role of parliaments needs to be focussed on democratic accountability so that it sets well within the context of the ‘good governance’ agenda. The authors recognise that effective parliaments are a key component of the national governance system. Consequently they highlight that it is essential for countries faced with challenging governance environments to strengthen their parliaments, despite other ways of improving accountability and governance. A strong parliament will increase the likelihood of a successful implementation of a public finance reform and sustain the quality of such a process.

The authors hold that parliaments in many developing countries are weak, because they have very little resources at their disposal. This leads to a low skills and knowledge base, a lack of institutional capacity and creates perverse political incentives. However, it is crucial to recognise that the context also plays an important role in parliamentary performance. Weak parliamentary performance can be explained by the nature of political systems, political climate, the wider social and cultural environment and relationships with donors.

The authors summarise lessons learnt from a Sida review (2005) of efforts to strengthen the role of parliaments, which supports their point of view. The review emphasises why donor efforts to strengthen parliament often fail. Donors should address the causes of weak parliamentary performance. These causes are so varied that donor must consider not just the local political context, but also the wider local context, which includes the influence of civil society. Moreover, seeing parliament as a self contained institutional entity rather than looking at the underlying causes of parliamentary weaknesses is likely to lead to a failure of attempts to strengthen parliament. Donors often give insufficient attention to the lack of political will to reform and the political incentives of parliamentarians. The review also highlights that donors’ methods are often not well suited to their objectives (e.g. conferences and workshops rather than long term capacity building).

Support from the country itself is required for a project to be successfully sustained. The authors advocate a demand-led parliamentary strengthening programme with long term support from donors and involving domestic actors (interest groups, the opposition, domestic organisations etc.). Furthermore the principles of the Paris Declaration on Aid Effectiveness should be followed. The authors also recommend that DFID works closely with UK based organisations, using their expertise and coordinating efforts.

Publisher: *Department for International Development (DFID)*

Key Themes: Parliamentary strengthening, role of donors

IMF (2007) “Fiscal Policy Response to Scaled-Up Aid: Strengthening Public Financial Management”

This paper cautions that fiscal institutions and public financial management (PFM) systems must be strengthened if effective use is to be made of budgetary resources. This is crucial given that the scaling up of aid is likely to impose additional pressures on PFM systems and

given that countries could benefit greatly from having their aid disbursed as budget support. The paper identifies challenges to the reform process and proposes a set of recommendations to improve the probability of successfully reforming public financial management systems in low-income countries.

Despite sustained efforts, which have been supported by international financial institutions and donors, progress on PFM reform has been uneven. This has been shown through various diagnostic statistics, which assess the quality of PFM systems.¹ The authors look at the HIPC-AAP (the first attempts to systematically assess the quality of PFM systems over time) and found that 19 of the 26 countries still needed 'substantial upgrading'. These assessments found that countries were particularly weak in the areas of budget execution and tracking poverty-reducing expenditures. The IMF's *Report on the Observance of Standards and Codes* (ROSC) assessments examined fiscal transparency in a sample of 28 countries that qualified for the Poverty Reduction and Growth Facility (PRGF) and concluded that country PFM systems were generally weak in many important areas (e.g. comprehensive and credible budget and effective auditing). PEFA assessments have also shown weaknesses in budget preparation and execution in most countries. The IMF attributes the lack of progress on PFM reforms to poorly prepared, unrealistic budget plans that do not take into account countries' limited capacity in this area. Civil conflict, corruption and evasion of formal rules have also been contributing factors.

This paper highlights several ways in which countries can strengthen key elements of their PFM systems:

- *First planning and budgeting must be integrated into a coherent framework.* This ensures consistency between policy priorities within government and between the government and donors.
- *A medium-term approach to budgeting is advised.* Reliable and consistent fiscal and macroeconomic projections are needed to set a realistic and comprehensive medium-term fiscal framework (MTFF) that can guide the planning and budgeting process. A medium-term expenditure framework (MTEF) also helps in this respect. However, designing and implementing an MTEF is challenging and needs to be done cautiously. An IMF (2006) study has concluded that MTEFs can be effective, but only where circumstances and capacity permit. When the preconditions are not right it is a burden on resources and distracts from areas that need more immediate attention.
- *Capacity must be built in budget execution and reporting.* For example by upgrading fiscal reporting systems, improving accounting and internal control and enacting procurement legislation.
- *Donor aid must be integrated into the budget process.*
- *Poverty-reducing expenditures should be tracked.* A subsequent step could involve movements towards a results oriented budget, which allows poverty reducing spending to be monitored. This would reduce fungibility of resources and increase accountability of governments to their commitments to reduce poverty.

¹ These include: HIPC Assessments and Action Plans (HIPC-AAP) prepared jointly by the IMF and World Bank on a range of LICs; the IMF's fiscal transparency ROSC; World Bank assessments, including Public Expenditure Reviews (PERs), Public Expenditure Management and Financial Accountability Reports, Country Financial Accountability Assessments (CFAAs), and Country Procurement Assessment Reports (CPARs); and reports prepared by the multi-partner Public Expenditure and Financial Accountability (PEFA) programme.

The paper also emphasises the importance of a prioritised, well-sequenced plan. Several factors are identified as critical to the success of such a plan: diagnostic studies must be used to identify weaknesses in existing systems that can be addressed in the plan; donors should play a role in coordinating their actions with policy priorities and the budget cycle; political economy factors must be considered; champions or leaders of the reform process within government or public sector agencies must be identified; the main constraints to reform should be identified as early as possible and attempts made to eliminate them or reduce their impact. The paper advises that the platform approach is one way in which reforms can be structured, but care must be taken in implementing it. Furthermore technical assistance is seen as critical to the success of PFM reforms, but such interventions need to be carefully coordinated. Technical assistance should not underestimate political economy obstacles and should place an emphasis on country ownership.

Publisher: *International Monetary Fund (IMF)*

Key Themes: PFM reforms, diagnostic statistics

Krafchik, W. (2003) “What Role Can Civil Society and Parliament Play in Strengthening the External Auditing Function?”

This paper examines the contribution of civil society budget groups in different circumstances. The increasing trend of budget work is a relatively recent phenomenon. However, the evidence points to the potential for budget work across a wide range of countries, including those in difficult environments. The paper emphasises that budget groups operate in countries that are very different in circumstances. It is important to note that budget groups have been able to start even in countries where governance is weak (e.g. corruption in Nigeria, political turmoil in Indonesia and repressive regimes in Malawi). The scope of budget work appears to be wide and significant. The paper highlights that budget groups have not sufficiently exploited all the potential opportunities, especially those pertaining to the function of external auditing. However, the author does recognise that it is too early to provide any generalisations in the experiences to date.

The author points out that looking at separate stages of the budget process and the potential impact of budget groups at each stage appears useful. It is important to appreciate the diverse origins and work of budget groups. Often they monitor at all stages, but concentrate on a specific stage in the budget process. Budget groups can play a role in the budget process at the drafting, legislative, implementation and auditing stages. The author concludes that civil society groups are most effective at the legislative stage of the budgeting process. At this stage research, training and dissemination can build budget literacy and can help bring a pro-poor perspective to the budget. At the budget drafting and implementation phase it is likely that only a few organizations will be active on only a small proportion of the budget, because this phase is technical and requires many resources. At the drafting phase budget organizations can add new information and perspectives to the debate on citizen priorities and help build the capacity of communities to participate. At the implementation phase there is a limited role of collating information about programme impacts. At the auditing phase there is likely to be a greater role working with the legislature. A full state audit is likely to be too costly for budget groups, so their role is limited to checking the Auditor-General’s findings in specific areas or following up these findings, which often indicate problems in expenditures and procurement. However, civil society has typically played a limited role in this area, which is often due to the absence of effective legislative powers limiting the incentives to scrutinize

expenditures. Another reason is that current budget issues often confuse the findings in the audit report, because in developing countries the audit report is often presented about two years after the close of the financial year.

Overall, results indicate that budget organizations have had a positive impact in diverse settings despite significant political and data issues. The question remains, however, how the potential of budget groups can be maximised. The paper does not concentrate on complementary relationships between budget groups and other domestic actors. However, it does mention that budget groups can achieve a greater impact when the legislature has greater budget oversight and when the media covers budgetary issues extensively. Budget groups and the legislature can complement each other in their activities. For example budget groups can increase capacity and research expertise, whereas the legislature can provide access to key moments in the budget process.

In some circumstances budget groups can have greater influence than in others. The author provides several examples of when this might be the case. When countries are undergoing a democratic transition, budget work appears to have a large impact. Democratisation brings with it increased transparency and participation, which allows budget groups and the legislature to have a greater impact. In such an instance they can try to achieve even greater transparency giving rise to a virtuous circle with increasing transparency. Decentralisation also brings greater opportunities for involvement, training and analysis by budget groups. New public expenditure management systems rely on conditions that are important for budget work, such as greater transparency and access to timely and accurate data.

Publisher: *International Budget Project*

Key Themes: Civil society budget groups

Lawson, A. and Rakner, L. (2005) "Understanding Patterns of Accountability in Tanzania: Final Synthesis Report"

It has been recognised that sustainable policy and institutional reform require an in-depth knowledge of both formal and informal political processes and accountability mechanisms. In response to this, a study was commissioned to investigate patterns of accountability in Tanzania. This report is a synthesis of that study.

The study tried to capture both 'top down' and 'bottom up' perspectives. Interviews with elected representatives to National Parliament and analyses of recent land-mark political decisions were used to examine a more 'top-down' perspective while micro-survey and an ethnographic survey helped to understand expectations of citizens regarding the power-holders and their own entitlements and the local accountability environment. The report suggests that even in unfavourable governance environments, measures can be taken that are likely to successfully improve accountability mechanisms. However, in addition they note that the report does not provide a comprehensive picture of the accountability environment, as important areas such as the electoral or justice system are not examined.

It is clear that the good governance agenda is not firmly rooted in Tanzania. Overall a picture emerges of an inherently weak democracy with the structure of power being dominated by the executive. However, despite the lack of formal controls to keep the executive in check, informal controls exist that prevent the executive having excessive powers. These informal

controls include the discipline imposed by internal party rules of the dominant party (CCM) and to a lesser extent social and religious controls. The authors warn, however, that a reliance on informal rules and traditions alone can lead to a serious abuse of presidential powers. Despite the weaknesses in many important systems, such as the police and justice systems, Tanzania does have established democratic and parliamentary processes. This implies that although many systems remain weak, the institutional building blocks are in place. Consequently domestic actors can play a role in greatly improving the accountability environment.

The framework that this paper used distinguishes between different types of accountability. Looking at horizontal, vertical and external accountability separately allows the authors to identify where Tanzania's accountability systems are weakest and suggest how these might be improved. Vertical accountability is defined as methods by which non-state agents hold the state to account. According to the authors these mechanisms are weak in Tanzania. Horizontal accountability is defined as the intra-governmental control mechanisms between the legislature, the judiciary, the executive and between the executive's sub-entities (i.e. the Cabinet, the line ministries and lower-level agencies). Interviews suggest that formal and informal mechanisms lead to weak horizontal accountability. A low level of transparency, limited evidence of accountability and little understanding of the budget process by parliamentarians imply that parliament's role of holding the executive accountable is ineffective. External accountability involves the relationship between the government and international entities and is also deemed to be unsatisfactory.

Despite these weaknesses in accountability mechanisms the report optimistically concludes that the country can improve its balance of power with small changes over a range of areas, rather than radical reforms that may be controversial to implement. The authors recommend that to tackle the weak vertical accountability, the rules controlling presidential power must be strengthened and formalised. Allowing independent candidates to stand at local and later at national level would lead to new voices in Parliament and local government. Moreover, decentralisation is seen as crucial in improving accountability. Hence the authors recommend increasing the power and resources of local governments. The simultaneous improvement of access to budget information and to decision making processes at the local level will greatly increase transparency. However, when making recommendations, the authors warn that the particular unfavourable circumstances of the accountability environment must be identified. For example simply advocating an increase in transparency is unlikely to have a large positive impact. Efforts, such as participation in Public Expenditure Reviews, are likely to become tokenistic if the formal budget does not adequately reflect actual budget execution. The causes of the lack of transparency must be taken into account. In Tanzania these causes are not just the weak capacity, but also the hierarchical view of authority.

Additionally, technical and administrative factors can play a decisive role in increasing the capacity for budget oversight. For example improving the technical capacity of MPs through training, increasing the time span to analyse budget and providing more user-friendly information about the budget at earlier stages in the budget process can have positive impacts. Civil society, including the media, could have an influence in improving horizontal accountability, but their influence is still likely to be limited. The report recommends that donors could help with information dissemination to improve external accountability. Finally the authors caution against simplifying the lessons that emerge from their research. This is

because the overlap between different actors and the range of informal rules imply that lessons that work in one area may not do so in others.

Publisher: *Oxford: Oxford Policy Management and Bergen: Christian Michelsen Institute*

Key Themes: Accountability, formal and informal budgetary institutions

Lienert, I. (2005) “Who Controls the Budget: The Legislature or the Executive?”

The author examines differences in the authority which legislatures have over budget formulations in 28 countries with five different forms of government. The sample includes Nordic countries and a few Asian and Latin American countries. The aim of the paper is to investigate whether the legislature’s budgetary authority is linked to the degree of separation of powers between the executive and the legislature. A link is found between the *political* powers of the legislature and degree to which these are separated from the Executive’s. The author finds that the legislature’s authority to affect the shape and size the annual budget is strong in presidential systems, but weak in parliamentary monarchies. However, he finds that differences in budgetary powers within a particular form of government in the spectrum between these two extremes are as great as those between different forms of government. Country specific factors that emanate from electoral systems, political systems, legal frameworks, and cultural traditions, appear to be more important than the particular form of government.

This paper adds to existing research on the relative power of legislatures in individual countries. Recently, Wehner (2005) has developed an index of the legislature’s budgetary powers that can be used for a large number of countries. The literature has also discussed the relative roles of the legislature and the executive. One strong conclusion that emerges in the literature is that a strong central budget authority and constraints on legislature’s budgetary power is necessary to maintain fiscal discipline (e.g. von Hagen, 1992, 1994).

This paper looks at the budgetary powers of the legislative under different forms of government. The paper distinguishes between five different forms of government: presidential system (e.g. US), semi-presidential system (e.g. France), parliamentary republics (e.g. Germany) and Westminster-type parliamentary systems (e.g. UK). In presidential systems there is a strong separation of power, with elections for the legislature and for the executive being separate. The legislature has strong decision-making and agenda-setting powers. In contrast, in a Westminster-type parliamentary system, there is no clear cut separation of powers. The head of the executive branch is a Member of Parliament and leader of a major political party. Executive powers are strong within government and if the government has a majority in parliament, the government alone determines the budget. The other three forms of government have legislative powers that lie between these two extremes.

The degree of separation of powers depends on a number of factors. For all five forms of government there appears to be a broadly linear relationship between the degree of separation of power and the extent to which the legislature can control the executive. However, the question is whether separation of powers is also linearly related to budgetary control rather than political control of the legislature over the executive. An index of the legislature’s budgetary powers is constructed based on criteria that are important in determining the allocation of revenues, expenditures and the overall balance. The author finds there is no broad one-to-one linear relationship between separation of powers and average budgetary

power of the legislature. The shape of the relationship seems to change when the sample changes, suggesting that country specific factors are likely to be important determinants of the budgetary power of the legislature.

The author considers other variables that are likely to influence budgetary powers. Potential political determinants include: political parties and the voting system; whether the government is a majority or a minority government in parliamentary systems; whether a presidential system has a multiplicity of political parties; whether there is a second chamber of the legislature (e.g. bicameralism in Germany) and the existence of “veto players”. Furthermore in some countries there are certain legal and constitutional constraints on executive power, such as fiscal rules to avoid economic crisis. Coalition and annual budget agreements can constrain legislative budgetary powers. Country specific factors can also determine budgetary powers. For example, royal prerogative powers (e.g. UK) or the role of cultural factors in reaching a consensus on the budget (e.g. Japan).

Publisher: *International Monetary Fund (IMF) Working Paper*

Key Themes: Forms of government, balance of power between the legislative and executive

Marquette, H. and Scott, Z. (2005) “Getting to Grips with Politics: Political Analysis at the World Bank and DfID”

The latest thinking on how to introduce reform to public sectors suggests that public sector reforms based solely on technical solutions, which ignore political realities, are unlikely to succeed. This paper compares and contrasts the new approaches of political analysis at the World Bank and DFID: Expected Utility Stakeholder Model (EUSM) and Drivers of Change (DoC) respectively. While their methodologies differ substantially, they both seek a more in-depth understanding of political factors and seek to address the increasingly political nature of their work. Despite several flaws the authors conclude that DfID’s approach is commendable in its consideration of institutions and politics. However, they argue, that while the EUSM is a step in the right direction, some important concerns remain. They believe the Bank is unlikely to question the underlying reasons behind their findings or question the desirability for reform in the first place. The authors also argue that due to costs and lack of qualified experts in a country, a more qualitative method may be preferable.

The World Bank advocates a move away from qualitative analyses, which it refers to as “soft and intuitive methodologies”, towards quantitative methods. It claims that it has found an operationally useful way of apply political analysis through its EUSM. The preferences of key stakeholders are analysed using game theory, decision theory, spatial bargaining and risk management models. The authors are not able to provide an in-depth analysis of the EUSM as it was only piloted in 2002 and access to the pilot report is restricted. They therefore only review the World Bank’s PREM note (2004).

The authors outline some benefits and limitations of the EUSM. The model is useful in assessing what level of reform is likely to succeed, rather than simply ‘blaming’ politics and can be applied to a wide range of issues. However, an empirical model is only as good as the quality of its data. In this case the data relies on expert opinion and there is a shortage of experts in some countries. Furthermore these experts must possess not only country specific knowledge, but also in-depth technical knowledge of procurement. Furthermore there are always caveats in relying on elite opinion. Some aspects of how this model can be

implemented continue to be unclear. For example, the authors are unsure how the experts were chosen or how the weighting for the level of influence was calculated. There is also no mention of the public in the list of stakeholders and it seems unlikely that public opinion does not play a role in a democratic country. The method also seems quite time-consuming and costly. It is unclear how often analysis will be conducted and it may not even be feasible to do it routinely. In addition the sensitivity of the findings raises questions about the ability to share findings and use outside experts. However, more fundamental is the criticism that this analysis does not provide any information on how and why certain stakeholders are obstacles. These issues must be addressed to understand the lack of political will.

In contrast to the ESUM, DFID developed the Drivers of Change approach, which is used to understand the political context of any reform. The framework involves three levels: agents (political elites, civil society, donors etc.), structural features (natural resources, trade, investment etc.) and institutions (i.e. formal and informal rules). All these three levels are inter-dependent on each other: agents affect and are affected by structural features of the economy through institutions, and therefore the DoC approach highlights the central role the quality of institutions play reform processes. A key benefit of the DoC approach is its flexibility - it can be used at national, sub-national or sectoral levels. Furthermore it places importance on donors understanding the historical and political country context.

However, in the authors' opinion the DoC approach also has several limitations, which the authors describe as flaws rather than inherent problems. The approach is not concerned with a country identifying its own problems. The authors highlight that different people in different contexts always perceive realities in a different way. This can, however, be dealt with by widening participation. DFID recognise that operationalising the approach is difficult as few guidelines exist on how to deal with 'obstacles' to change, how to differentiate strong drivers from less strong ones, what to do if no strong driver emerge and how to prioritise. This is the opposite problem that the ESUM faces. Furthermore institutional change requires longer time frames than are often available for the analysis to be carried out. As with the ESUM, the DoC approach is limited by not identifying why particular institutions are likely to be pro change. A concern of the authors is also that DoC studies might in future slip into the trap of treating particular actors as homogenous, for example treating all media as pro-reformers. The ESUM's pilot model highlights that this is not always the case. It might be necessary to further disaggregate findings in the DoC approach.

Publisher: This paper was presented at the IDD Seminar Series, International Development Department, University of Birmingham, 25th October 2005

Key Themes: Methods of political analysis, Drivers of Change approach, Expected Utility Stakeholder Model

Meisel, N. and Ould Aoudia, J. (2007) "Institutions, Governance and Long-term Growth"

This paper argues that the relationship between good governance and growth is not confirmed. They use an original database, '2006 Institutional Profiles', to show that 'good governance' measures may not be a priority for countries that have not yet begun the phase of economic catch-up. The authors advocate that diverging developing countries should prioritise the acquisition of converging country characteristics, while converging countries should prioritise governance reforms.

Long-term economic growth is partly explained by the mobilisation of factors of production. However, this mobilisation is only made effective over time by institutions. New institutional economics suggest that institutions are instrumental in this process as they reduce the uncertainty in economic, political and social relationships. The 'good governance' agenda provides suggestions on which tools can be used to reduce this uncertainty. However, the existence of a positive causal relationship from 'good governance' reforms to long-term growth rates is disputed. Furthermore it remains an open question as to whether 'good governance' is the only way to generate confidence in countries that differ in their resources, history and growth dynamics.

The 'Institutional Profiles' database uses North's definition of institutions as the formal and informal rules that govern the behaviour of individuals and organisations. It covers 85 countries, including a range of developing, transition and developed countries that cover 90% of the world's population and GDP. It considers institutions under nine functions (political institutions, safety, law and order, public governance, markets' operating freedom, co-ordination of actors and strategic vision, security of transactions, regulations, openness to the outside world and social cohesion). These functions are then cross-tabulated between four sectors (public institutions, civil society, the market for goods and services, the capital market and labour market). The survey considers the effectiveness rather than the existence of institutions, i.e. de facto rather than de jure approaches to institutional arrangements.

The authors show that as countries become more developed, their institutional profiles move towards the direction of growing formalisation. They note that there exist two systems for the 'production of confidence' that is required for the foundation of economic activity. Developing societies have a system based on interpersonal and informal systems of regulation, while in developed countries regulation is impersonal and based on law and written agreement. Impersonalisation of systems depends on factors that are exogenous to institutions, such as population growth (increases number of stakeholders), increasing urbanisation (reduces importance of interpersonal relations) and enlarging the space of economic relations (weakens relationships based on personal ties). The evolution between systems is complex, non-linear and does not occur spontaneously. It is a source of instability and insecurity, involving periods of reduced confidence. For the adoption of formal rules to be successful, adequate precautions must be taken by public institutions. If these are not taken, corruption will result. However, the authors caution that modernisation can lead informality and economic and social shocks can reverse the process of institutional transition.

The 'Institutional Profiles' show that 'good governance' indicators are just the advanced stage in the formalisation of rules or an ideal system of regulations. The authors criticise Kaufmann et al (1999) and Arndt and Oman (2006) for confusing the importance of income levels with income growth. The authors suggests that not only the very long term growth rate should be analysed, but the medium and long term growth rate should be considered. Furthermore they criticise the assumption of the virtual fixity of governance over the long term. The authors argue that although the level of formalisation of rules is strongly correlated with the level of development, this is not the case for the speed of development. They suggest that there may not be a simple linear relationship between GDP per capita growth and the formalisation of rules and that multiple trajectories of this relationship might exist given specific features of different societies. The 'Institutional Profiles' database also makes a distinction between 'grand corruption', which is less perceptible to the public as a whole, and 'petty corruption', which affects everyday relations. The fact that all possible combinations of relations between

corruption (both petty and grand) and economic performance exist, points to a more complex explanation of corruption than is generally supposed. The scarcity of fiscal resource is often regarded as the main structural factor driving corruption. However, moves towards the formalisation of rules do not necessarily imply a reduction in the diversion of public resources. This is because a transition between systems may require large and permanent transfers to groups and individuals. The database shows that 'institutional core' variables are closely linked to the level of income, but the configuration of other variables depends on the country context. These core variables include institutions dealing with public governance, co-ordination and strategic visions, regulation and social cohesion. Other variables include: political institutions, safety, law and order systems, markets' operating freedom and openness to the outside world.

The paper concludes that the role of the state depends on whether the country is a diverging or a converging economy. North argues that the traditional explanatory variables of long-term growth are not growth factor, but manifestations of growth. The causes of growth are institutions that preserve long-term confidence or address factors that threaten collective confidence. Transaction costs and expectations are the two channels through which confidence is related to growth. The authors use the database to support their hypothesis that the production of confidence is needed for long-term growth. This confidence results from the combination of state capacity to reduce transaction costs and improve expectations and the formalisation of rules that ensure efficient public governance and security of transactions. They conclude that the function of co-ordination and strategic vision could explain the rapid growth in some countries with little formalisation of rules. In countries that are converging, efforts should concentrate on formalisation of rules. In countries with low growth rates, priority should be given to the functions of co-ordination and strategic vision, improving the quality of public goods and legal and property rights.

Finally the authors link these conclusions to the framework developed by North et al. (2006). This framework distinguishes between open social orders (founded on impersonal relations based on laws) and closed or limited-access social orders (relations are interpersonal and not based on laws, thus limiting productivity growth). In closed social orders, installation of a legal framework is essential for transition. The authors suggests that dynamics could be introduced into North et al's framework by allowing for exogenous destabilising factors, such as population growth, urbanisation, increasing education.

Publisher: Unpublished

Key Themes: 'Good governance', institutional reform, corruption, open and limited access social orders

Mejía Acosta, A. and de Renzio, P. (2007) "Aid, Resource Rents and the Politics of the Budget Process"

This paper develops a general equilibrium framework to analyse the politics of the budget process. It differs from previous literature, because it goes beyond partial associations of the relevant variables and offers a dynamic approach to explaining interactions and interdependence of variables that affect budget outcomes. The authors use available measures to empirically test the implications of this framework. Their main recommendations are, firstly that more comprehensive data must be collected on budgetary institutions and budget processes. Measures must come from good quality data and be methodologically robust.

Second, more work is needed on the modelling of budget politics. The causal mechanisms and political dynamics that lead to good budget governance must be disaggregated, in particular the influences of informal practices. More detailed insights can result from country case studies. The authors suggest that countries could be analysed before and after PFM reform.

The literature has recognised that politics is an important consideration in the budget. However, most authors have only concentrated on specific aspects of the budget process, such as budgetary institutions on budget accountability. There have been no satisfactory analyses into the political determinants of the weaknesses in budget processes in aid-dependent or resources-rich countries. The authors look at what variables affect budget outcomes. They consider not only variables explaining these outcomes, but also at factors that influence the quality of these budget outcomes. More specifically they consider not only fiscal discipline, but also allocative and operational efficiency of the budget.

Budget outcomes are a result of the interaction between three factors: the wider socio-economic environment, relevant political actors and exogenous forces (including resources rents or aid flows). However, the way in which these factors interact within the formal and informal budget processes remains unclear. Political institutions create incentives for implementing and enforcing policy agreements over time. Several important results have emerged from the literature. Relatively strong executive power tends to be associated with fiscal discipline. Electoral rules and government regimes that lead to coalitions tend to have higher fiscal discipline and more sustainable outcomes, as the bargaining costs of assembling coalitions is high and they are less susceptible to electoral cycles. State capacities also impact the nature of the budget process. Budget institutions are a subset of political institutions and are thus influenced by the same factors. However, they are also influenced by uncertainty in the economic environment, informality and weak institutional capacity. Furthermore Campos and Pradhan (1996) have found that donors have a strong influence on budget institutions because they impose spending cuts that undermine prioritisation and are aid is often fragmented. Exogenous factors affect budget outcomes too. This paper focuses on aid and resource rents. Aid can have a negative impact on the budget due to the “Dutch disease” effect, limits on accountability, funds kept off-budget and it can undermine institutional capacity through fragmented assistance. Resource rents also diminish the need for accountability and have been found to create disincentives for good budget governance and increase political instability.

The paper does identify some possible and concrete measurements to assess the extent to which political, technical or exogenous variables affect budget outcomes. It uses two simple indicators for budget performance. These are the fiscal balance, which proxies for budget sustainability and the Human Development Index, which proxies for budget efficiency. Categorical variables were used to measure the degree of political competition, electoral rules, constraints on executive authority and citizen participation in political activities. Budget quality is measured by the CPIA indicator on the “Quality of Budgetary and Financial Management”, which rates countries on several variables. Seemingly sound indicators for budget transparency and accountability are also available. The authors conclude that more detailed and better quality data is needed to measure the impact of budgetary institutions on budget processes. The deployment of the PEFA (Public Expenditure and Financial Accountability) methodology to assess PFM systems is useful for country studies, but does not easily allow for cross country comparisons due to the qualitative nature of the data.

The theoretical implications of the framework are tested empirically. The combined impact of political institutions, aid and resource rents on a country's fiscal balance is investigated. The authors find that strong executive power leads to a positive fiscal balance, but only if the level of political competition is strong. Unchecked executive authority may produce the opposite effect. In a country with a strong, but rule-bound executive, aid flows are unlikely to have a significant effect on fiscal deficits. Aid is found to have a negative effect on fiscal balances, in contrast to non-renewable resources rents having a positive effect. Furthermore they find a small negative impact of aid on development outcomes. However, this is a result that requires further analysis to consider possible reverse causality, different aid modalities and the effects of donor fragmentation. They also find the apparent result that the quality of budgetary procedures significantly prevents fiscal deficits. However, many countries are inconsistent with this result. The authors suggest that there are non-institutional factors that may partly determine the budget process, but are not captured in cross country data.

Publisher: Unpublished

Key Themes: Political determinants of the budget process, aid and resource rents, measuring budget outcomes

Nunberg, B. and Abdollahian, M. (2005) "Operationalizing Political Analysis for development: An Agent Based Stakeholder Model for Governance Reform"

Understanding the underlying political factors that form the incentives of key stakeholders is crucial, because reforms can face much opposition from agents that stand to lose from it. Although this line of thinking is now accepted in the reform debate, it is less clear how an operationally useful political analysis can be applied. This paper reviews the World Bank's approach to addressing this problem. It looks at how an agent based stakeholder technique could systematically be used by donors to make decisions about priorities and the design of intervention. The paper highlights that it is particularly well suited to operational policy because it is a dynamic model. Analysts are able to change the agents involved or their preferences to model various scenarios. This gives donor organizations a way of determining their optimal policy positions.

The paper describes a model which is more rigorous in its approach than previous efforts to analyse the politics of reform. These analyses have typically used broad country reviews of political economy, intuitive methods of stakeholder analysis or at the behaviour of stakeholders with respect to specific reforms. Typical stakeholder analyses have qualitatively assessed the preferences of stakeholders to determine which ones will form coalitions to oppose the reform. The analyses normally categorise the identified stakeholders according to their ability to influence outcomes and how important the reform is to them. However, these analyses have lacked a dynamic component and thus not been able to answer what the following step should be. Agent based models focus on individuals, who are interdependent, interact with little central authority, follow simple rules and are adaptive and backward-looking. However, these models are very complex when there are many agents and multiple reform issues. This new approach combines traditional stakeholder approaches with agent based modelling. In contrast, the combined model allows simulation of stakeholders in the reform context. It simulates iterative round-by-round negotiations amongst stakeholders. It can predict how bargaining dynamics play out over time with considerable accuracy.

The paper looks at a pseudonymous centralised country 'Anyland' to show how the approach works. Corruption has become a high profile issue in Anyland. It is particularly pervasive in the procurement process. Therefore procurement reforms are advocated. Many stakeholders have important political clout due to their control over the procurement process. The analysis begins with rigorous data collection through interviews with experts, donors and government officials who have extensive knowledge of the policy issues involved. The interviews asked for explanations and characterisations of the context of reform and the relevant players, rather than opinions and predictions. Numerical values were assigned to each stakeholder, taking into account their interests in reform, their veto power, their policy stance, their relative influence and the importance attached to the issue outcomes. This information is mapped along a continuum of options for the degree of reform in order to display likely coalitions and their distribution of power. The model is operationally useful because it can predict how a change in a particular stakeholder's initial policy stance can affect the behaviour of others. Simulating the negotiations among stakeholders in a series of iterative interactions provides a picture on which level of reform is most feasible politically. Analysis in Anyland shows that a position by the World Bank advocating full reform of all government agencies dealing with large procurement issues would be less likely to win stakeholder support than an initially scaled back position.

The model has several additional operational uses, but also suffers from limitations. It can analyse the trade offs involved in reforms that have interrelated, but conflicting policy priorities. It can also combine macro-level and micro-level analysis. Macro-level analysis enables policymakers to not only look at the political difficulties of individual measures, but to assess if it is feasible to attack the agenda as a whole. Micro-level analysis shows where resources are most effectively invested. However, there are some limitations that policymakers should be aware of. First accurate results are dependent on timely and accurate information. Second the approach requires qualified experts with an in-depth knowledge of the technical and political aspects of the country. It should also be integrated into ongoing programmes to be most effective.

Publisher: Prepared for the International Studies Association annual meeting, Honolulu, Hawaii, March 2-6, 2005

Key Themes: Political obstacles to reform, agent based stakeholder analysis

Rakner L., Mukubyu, L., Ngwira, N. and K Smiddy Schneider, A. (2004) "The budget as theatre – the formal and informal institutional makings of the budget process in Malawi"

This report seeks to understand the process of political will in understanding the budget process in Malawi. It attempts to explain why previous studies have concluded that Malawi lacks the political will to formulate, implement, evaluate and reform the budget process. In particular it considers a broad range of institutions and stakeholders in the budget process, recognising that interests of a particular group must be regarded as variable over time. The authors collected the data from focus group discussions and conducted interviews to examine how formal and informal institutions interact to determine the roles of the government, civil society and donors in the budget process. The study emphasises why reforms that are technically feasible do not appear to work. It also highlights the importance of understanding the country specific factors that resist or do not facilitate PFM reform.

The budget process is described as a theatre to emphasise that the informal incentives and bargaining process, for a large part, circumvent the formal budget process. Informal decisions often undermine formal institutions and civil society is not represented to the extent that it would be in the formal budget process. Therefore despite the PRSP, budget outcomes are largely shaped by the interests of politically powerful actors. Accountability institutions are ineffective because they are undermined through subversion, under-funding and political patronage. There are formal provisions to oversee the budget process, but these are not enforced effectively and financial reporting deadlines are often missed. Another problem in the process of budget oversight is weak capacity, which reduces the effectiveness of the oversight players. However, the question of why these institutions are not given adequate resources is linked to the issue of stakeholder interests. It is the powerful political interests and informal incentives that allow the weak capacity in the oversight institutions. The authors draw the link between the lack of resources and the consequent demoralisation of the civil servants that give rise to perverse incentives.

The authors examine the causes of the lack of demand for accountability. The political capture of the private sector partly explains this, as the weak business sector finds that their interests are protected by individual negotiations with the government. However, the lack of demand for economic accountability from civil society can be attributed to cultural factors, as the citizens do not consider themselves to have ownership to the budget.

Another reason given by the authors for the failure of technically feasible reform agendas is due to donor conditionality and the relationship of the government with donors. Donor conditionality linked to economic accountability has produced unintended consequences. Aid that is brought into the system despite poor financial management and accountability can exacerbate poor PFM. Donors do not reward or punish performance in poverty reduction outcomes and the timing and amount of aid pledged does not usually meet its targets. Furthermore, government commitment to PFM reform is undermined by the perceptions about donors, whose activities are not regarded as legitimate. Unless the government-donor relationship is improved, reforms funded by donors are unlikely to succeed.

The report also provides suggestions for improving the budget process in light of the weak accountability. It is clear from the findings that political actors will feign their attempts to reform in light of their vested interests. Therefore the authors claim that only by strengthening actors outside the executive branch and increasing their demand for accountability, can long-term positive change ever occur. It is necessary to use qualitative indicators to measure progress in the budget process and strengthening the demand for accountability from parliament, the media, the private sector and churches. Civil society could play a role if the budget were written in a way that includes informal processes and that could be more easily understood by citizens. Moreover, changes in donor assistance can improve political incentives. Despite the unfavourable environment of Malawi, measures can still be taken by civil society and by donors to provide demand for accountability and eventually create the pressure to make reform feasible.

Publisher: *World Bank*, Washington, DC

Key Themes: Political will of budget reform, formal and informal institutions, demand for accountability, donor involvement in budget reform

Robinson, M. (2006) “Budget Analysis and Policy Advocacy: The Role of Non-Governmental Public Action”

The author reviews the evidence on applied budget work to assess the impact that civil society may have on the budget process. Using case studies and comparative analysis of independent budget groups, Robinson investigates which activities have a positive impact in particular circumstances. Scepticism from academics about the potential influence of civil society on the budget process and the need for civil society practitioners to learn from past experiences implies that this line of research is significant. This paper is useful in the detail it provides of the precise nature of the activities of civil society groups.

The goals of applied budget work are identified as not only ensuring that government budget priorities are consistent with policy objectives and that resources are efficiently used in priority areas, but also contributing to democracy building in a wider sense. By enhancing the accountability of decision makers and the transparency of the budget process, civil society can help achieve these goals. The author recognises that the reluctance of governments to open the budget process to scrutiny can hamper the efforts of civil society budget groups. Two mechanisms that can increase information on the budget process is civic pressure to introduce legislation and international pressure through budget transparency surveys.

Robinson emphasises that budget groups can be influential in some activities and settings but less so in others. For example opportunities for citizen engagement can be higher where local governments have more power due to fiscal decentralisation legislation. The case studies show how impacts on changes in budget policies and in the budget process can be achieved. For instance, success has been noted in tracking expenditure outcomes leading to improved efficiency and reduced corruption (e.g. the UDN used community based monitors to identify teacher absenteeism and a lack of quality in building materials used for schools). Improving budget awareness and literacy through training and capacity building have also been very successful (from interview responses – hard to quantify) and using the media as a budget outlet can be an important strategy in some countries. While the success of budget groups in improving information about the budget process and improving transparency is evident, not all budget groups have been able to influence budget policies. The author highlights that it is particularly important that budget work is able to strengthen democracy outside the immediate sphere of the budget by promoting voice, participation and greater transparency.

However, Robinson argues that it is unrealistic to expect that there could be substantial changes in budget priorities due to civil society groups, as constitutional provisions hamper changes in expenditure priorities. In addition the structure of the budget process limits legislative review in many countries. Thus minor changes can be regarded as a large success. Other strategies can be used to scale up and replicate such successes, for example improving legislative checks and influencing the executive. Robinson’s review recommends that for a successful campaign in changing budget implementation and monitoring, a wider coalition of interests is required. Moreover linkages are needed between budget groups in civil society and the legislatures.

Publisher: *Institute of Development Studies* Working Paper 279

Key Themes: Civil society budget groups

Santiso, C. (2006) "Banking on Accountability? Strengthening Budget Oversight and Public Sector Auditing in Emerging Economies"

This paper is a review of recent developments in assistance provided by the international financial institutions (IFIs) to parliaments and external audit agencies in Latin America. It argues that despite an increasingly broader view of governance in PFM reforms, efforts must seek to move beyond a focus of the influence that the executive has in the PFM process. They must also consider how the demand for financial accountability can be strengthened through both formal and informal institutions. The author emphasises that not only does the balance between executive discretion and legislative oversight need to be addressed, but informational asymmetries between the state and society must be tackled. Consequently the role of civil society and the media is of great importance in the process of PFM reform.

Empirical evidence shows that centralisation of budgetary systems and relatively strong executive power is more likely to enforce fiscal restraint. However, the author argues that recent experiences have shown that there are also risks in allowing the executive to have excessive budgetary powers. In this case a lack of checks and balances by parliament has often led to corruption and state capture. The literature acknowledges that greater transparency and accountability improve the quality and legitimacy of fiscal governance. However, the unavailability of comparative data implies a lack of empirical evidence of the impact of legislative oversight or external scrutiny on fiscal outcomes. The author does, however, produce some comparative statistics showing a positive correlation between external auditing and a fiscal governance indicator (corruption control using the Corruption Perception Index of Transparency International 2004).

The author documents the change in assistance strategies of the IFIs, whose activities have broadened as a result of the introduction of the governance agenda. Although the World Bank has supported public sector reforms and sought to strengthen accountability institutions such as financial management, legal and justice systems in Latin America, their approach to strengthening parliaments and external audit agencies remains less clear. In contrast the Inter-American Development Bank has less political restrictions and is therefore able to actively engage in strengthening the role parliaments can play in the PFM process. The author also notes that the IMF's *Code of Good Practices on Fiscal Transparency* (1999) 'tends to restrict itself to fiscal governance within the executive', whereas the OECD do consider the role of parliament in the budget process. Therefore the author argues that IFIs are yet to view the budget cycle in a comprehensive manner.

The review highlights several important policy implications. First the author emphasises that IFIs must recognise which instruments are more effective at reforming institutions and which are more effective at strengthening institutions. For example conditionality attached to policy based loans is likely to belong to the former category, while investment lending and technical assistance to the latter. Clearly some instruments, such as policy dialogue or analytical work fall into both categories. The author emphasises that synergies must be found between these. A central lesson regarding political economy is that assistance must not solely rely on technical capacity. To reform successfully it must be understood that a reform must be politically viable as well as technically feasible. For example increasing the technical capacity of agencies is futile when politics implies that independent agencies are likely to become captured by the state. Thus multilateral institutions could greatly improve their effectiveness in supporting budgetary reforms if they take into account the structure of incentives that

influence institutional change, such as electoral rules, the role of political competition and party systems. Finally more research is needed into why governments choose to restrain themselves by strengthening the institutions that oversee them.

While the focus of the paper is on multilateral support to formal budgetary institutions, the author highlights that finding effective synergies between formal and informal accountability institutions, including civil society and the media, is crucial. A deeper understanding of the dynamics of PFM reform is required. Furthermore it must be acknowledged that although governance factors can explain the performance of the budgetary systems, political factors are crucial to understanding the reform of budgetary institutions. Therefore it seems entirely plausible that by using the relevant instruments, which use a country's political factors to their advantage, PFM reform has the potential be successful even in the context of poor governance.

Publisher: *Public Budgeting and Finance* 26(2): 66-100

Key Themes: Multilateral support, lending to budgetary institutions, parliamentary strengthening

Scartascini, C. and Filc, G. (2007) "Budget Institutions and Fiscal Outcomes: Ten years of inquiry on fiscal matters at the Research Department"

This paper reviews Inter-American Development Bank (IADB) research on budgetary institutions and fiscal outcomes. In the paper, the authors construct a new database on fiscal rules and budget procedures and use it to test whether budgetary institutions can affect fiscal outcomes. They find that countries with more hierarchical procedures and more stringent and enforceable fiscal rules are associated with higher fiscal balances than those with more collegial procedures and less enforceable fiscal rules. The IADB research has been prompted by unsuccessful policy reforms, ineffectiveness of governments since the 1990s and a lack of clarity in the literature on how to move forward. IADB have developed a new framework based on an analysis of policy making which considers a more in depth actors, incentives, the rules of interaction, and capacity in influencing reform processes.

There have been two main strands of literature regarding fiscal deficits: 'electoral' and 'budget' institutionalists. Electoral institutionalists look at how electoral systems shape the incentives of politicians who make choices about government expenditure (e.g. Persson and Tabellini, 2000, 2003). This literature focuses on the problem of 'tragedy of the commons' i.e. the tendency to fund expenditures through deficits, because the benefits of these expenditures accrue to the current administration, but the costs to future ones. By contrast, budget institutionalists argue that what matters to budget discipline is budget transparency and a more hierarchal/centralized budget system. Cross country evidence (e.g. von Hagen, 1992) shows that more centralized budget institutions (i.e. where the executive branch has relatively strong decision making powers) tend to have smaller fiscal deficits.

Literature on the effectiveness of institutional arrangements shows that to reduce deficit levels, the autonomy of legislatures and spending ministries to decide their own spending levels must be limited. One of the most frequently cited papers in this line of IDB research is the Alesina et al (1999) paper, which finds that countries with more stringent and hierarchical fiscal rules, and more transparent budget processes have lower deficits. Stein et al. (1999) combine both strands of literature to find that both budgetary institutions (hierarchical procedures and fiscal rules) and electoral institutions are significant determinants of fiscal

performance in Latin America. However, the literature has not provided many recommendations for policymakers. Furthermore, a number of countries in Latin America have been adopting fiscal responsibility rules. Therefore there seem to be good reasons to look at new evidence.

The authors follow the methodology of Alesina et al. (1999) and construct a new composite index and new individual indexes of fiscal rules, hierarchical and transparent procedures. They classify an increased number of questions within these three indices, giving answers values on a scale of 0-10. The dependent variables are the average primary deficit of the general and the central government. Results are insignificant for the world sample. However, the sample of developing countries shows that countries with more hierarchical and transparent budget processes and restrictions on the freedom to run large deficits and/or accumulate debt have a significant association with lower present primary deficits. Results for Latin American countries are similar to those of the developing country sample.

The introduction of procedural rules has led to many disappointing results in Latin America. In many cases the failure of these policies has been due to policymakers not considering the country specific features of the policymaking process. Therefore the authors argue that the determinants of fiscal outcomes should be analysed within a framework that recognises the importance of the policymaking process. It is this process that provides information on the incentives of actors to comply with the budget rules and procedures. The advocated framework (based on work by Spiller, Tommasi, and others) takes its methodology from the IDB Research Network project 'Political Institutions, Policymaking Processes, and Policy Outcomes' (PMP). It applies this to budget processes in the project 'Who decides on Public Expenditures? A Political Economy Analysis of the Budget Process' (BMP).

The features of the budget that result from complex intertemporal exchanges between political actors depend on their incentives, their interactions and their ability to achieve cooperative outcomes. If intertemporal cooperation can be achieved, public spending becomes less volatile, more responsive to changes in the economic environment and allows long-term investment in projects and capabilities. Whether the budget process will allow or hinder cooperation depends on certain key features of the process. These include the extent that political actors can benefit from deviating from cooperation, the number of political actors, the number of times they interact and enforcement mechanisms. All these key features depend in turn on the country's history and institutions (e.g. political regime, electoral system, judiciary and civil service, etc.)

Using this framework the paper provides some examples of how reasonable reforms that are generally recommended for Latin America can have unintended effects because of the policy environment they are inserted into. However, there may also be cases where the institutional arrangements allow fiscal rules and budgetary procedures to have benefits above what the policy is intended for (e.g. IDB work on Uruguay).

Publisher: Office of Evaluation and Oversight: Inter-American Development Bank
Key Themes: Budget institutions, fiscal outcomes, budget reform, institutional context

Schick, A. (1998) "Why Most Developing Countries Should Not Try New Zealand's Reforms"

In the author's opinion developing countries should first undertake basic reforms, rather than trying to adopt "best practice" models. Far-reaching reforms introduced in New Zealand could lead to significant gains in the operational efficiency of its government departments and agencies. However, the author cautions that applying such advanced innovations to developing countries where institutional environments are underpinned by both formal and informal mechanisms is very risky.

New Zealand has implemented a range of management reforms. Public managers are given the discretion to operate within an accountability framework that specifies what results they must produce. Performance is closely monitored. It is based on the idea of "new contractualism". Implicit or relational contracts are replaced by explicit contracts, which are enforced by transparency and accountability mechanisms. However, New Zealand's extensive efforts to create conditions under which formal negotiations and contracts are enforced, must not be underestimated. Many departments have been reformed to separate policymaking from service provision. Ministers can purchase services from private or public providers, thus encouraging competition. Policy advice can also be contracted out to consultancies or external sources. Departments must produce detailed annual reports specifying the outputs that have actually been produced. Operational efficiency has been significantly enhanced, but there remain some concerns. Outputs can be specified in contracts, but insufficient attention is given to the importance of measuring outcomes. 'Contractualisms' can weaken traditional values of public service and lead to a lack of attention to tasks which are not specified in the contracts. Furthermore it entails enforcement and negotiating costs and the 'exit option' to make contracts effective is not always available.

A formal public sector is an essential condition for adopting New Zealand-type reforms. In New Zealand contracts and internal markets were feasible only because the country had a robust market sector and enforcement mechanisms. These conditions are typically absent in developing countries, which are often characterised by weak specifications of formal processes that regulate the economy. Informality implies that many civil servants are not assigned through merit and that there is an informal budget that deviates from the formal one. Informality has a positive side, as it can cut through bureaucratic obstacles and maintain fiscal discipline despite unrealistic budgets. However, it is also characterised by widespread evasion of civil service rules and corruption. The author warns that it is too risky for a country with a public sector characterised by such informality to one where managers have high levels of discretion. New Zealand did not make this leap either.

An informal public sector is unsatisfactory and contract based management is beyond the reach of many developing countries. They should therefore take a number of steps that proceed in a logical sequence to reduce the scope of informality and build management capacity. The author outlines what some of these steps might entail. First countries must typically formalise the market sector. This does not necessarily ensure the public sector will formalise too, but a culture of informality is likely to lead to corruption or mismanagement. Second, reliable external controls are needed. This is essential to build the skills of line managers to manage, instil a public ethic of honest behaviour, build trust between central controllers and line managers and build confidence in the government. However, the controls must be fair and realistic, otherwise they will be circumvented. Next politicians and officials must focus on the basic principals of public management, controlling inputs before they control outputs. Only once internal control has been established, should countries proceed onto New Zealand-type arrangements. The author highlights that Singapore can provide a

good model for developing countries, as it followed a logical progression of steps before several elements of the New Zealand model were implemented. It showed that progression can be rapid, but short cuts are inadvisable.

Publisher: *World Bank Research Observer*

Key Themes: PFM reform, budget basics, informality

Schwartz, H. (1994) “Public Choice Theory and Public Choices: Bureaucrats and State Reorganization in Australia, Denmark, New Zealand and Sweden in the 1980s”

This paper examines the reorganization of public sectors that took place in four countries: Australia, New Zealand, Denmark and Sweden in the early 1980s. The reforms were predominantly efforts to reduce both the size of the public sector and the fiscal deficits it was generating. The author notes that in all these four countries reform to public sectors was led by bureaucratic (and extra bureaucratic) actors who tried to replace existing bureaucratic methods with market-driven ones. They did this by separating policy-making from policy execution, along with introducing changes within and between agencies that enabled them to react to market pressures. This approach was unusual for that time in that it introduced the market into non-commercial state operations and in particular into welfare states.

The paper highlights the importance of the political context in which the reforms took place, but notes that the reform was primarily led by the ideas, arguments and participation of fiscal bureaucrats, which created the plans that the politicians executed. They were helped by the fact that political coalitions arose that favoured a reorganisation of the public sector in each country. Politicians in new governments entering power after long periods of opposition sought to consolidate a majority by attacking an inefficient or unresponsive public sector. In general, however, the more fiscal bureaucrats were willing and able to provide detailed policy advice to governments, the greater the degree of change was in the country.

What motivated the fiscal bureaucrats to push for reform? Fiscal bureaucrats saw themselves as ‘guardians of the money supply and as overseers of public spending in general’. The more likely that their efforts would lead to changes, the more motivated fiscal bureaucrats were in coming forward with reform ideas. The author identifies four problems that fiscal bureaucrats sought to resolve. The first two problems were associated with rent-seeking. Basing their beliefs on the public choice and rent-seeking literature of the 1980s, they believed that rent seeking led to uncontrollable public spending and employment. First state agencies were subject to capture by special interest groups with demands for excessive levels of spending or employment. Second state agencies behaved in a self-interested way. Furthermore the principal-agent problem led to state agencies being unresponsive to the needs of clients, as employees were maximizing their own interests. Finally politicians pressurised agencies to provide services that were not cost effective to further their own motives. Fiscal bureaucrats realized that the only way of resolving these problems was to eliminate the moral hazard problem, i.e. to align the interests of agents with those of citizens.

Fiscal bureaucrats tried to use institutional changes to constrain the future behaviour of state agencies. They wanted to decrease the power of public sector workers to seek rents and eliminate the moral hazard problem. To do this they changed the mix of incentives that govern individual and agency behaviour. This involved increasing competition by separating policy-

making and service provision through four key institutional changes. The paper analyses how the four countries approached each of these four changes.

1. Private sector style *wage discipline* was imposed on public sector labour.
2. There was a *focus on results* with a measurement of outputs and outcomes, rather than inputs.
3. Government was changed to more closely resemble the *model of a private sector holding company*. Reorganization separated planning and implementation stages of resource allocation.
4. *Competition* was encouraged. Agencies' monopolies over service provision were abolished. This was done by a combination of contracting out, privatization and deregulation.

Evidence showed that the reforms were successful. Public sector growth in the four countries slowed, the fiscal deficit decreased and efficiency increased. This suggests an indirect connection between reorganization and an elimination of rent seeking. The shift to market pressures within the public sector did impose discipline on public servants and thus constrained rent seeking activity. Creating a connection between personal taxes and service provision meant that consumers no longer relied on expressing their views through politicians but could protect their interests by switching to other firms or providers. However, the core activities of the old state (e.g. taxes, central bank) were not affected by the introduction of market type reforms. In fact the markets protected these core functions by insulating them from demands for more resources from other parts of the public sector.

Publisher: *Administration and Society* 26 (1): 48-77

Key Themes: Public sector reform, competition in public services, political context for reform

Sida (2006) "Power analyses – Experiences and Challenges"

This position paper draws on Sida's experiences to explore what lessons have been learnt so far about conducting power analyses. Power analyses are an approach by donors to take the political context into account. The paper explains what a power analysis involves and what core issues should be considered as part of the analysis. It appears that there are many benefits to conducting a power analysis. However, Sida has learnt that some limitations remain and should be addressed in future work. It is important to recognize that conducting power analyses may be more difficult in some countries than in others. For example political sensitivity will lead to fewer opportunities for promoting public discussion and involving local experts.

The aim of power analyses is to look at the political landscape in more depth and to consider how political factors are affected by and affect development cooperation. This involves analysing which stakeholders in the reform process have a large degree of power, the purpose of this power and the associated consequences on the development process. This implies knowing if power is generated through formal or informal agreements, if the power within the political system is characterised by strong leadership or stable institutions and the relative dominance of actors, interest groups and structures. Sida is cautious not to develop a fixed framework, because the precise actors, processes and structures to be included are country specific. However, the paper does highlight some core issues that should be included in the analysis. These include looking at how formal and informal power is distributed in society, how

power is distributed in the private and public sphere, the role of gender issues, the impact of cultural and belief structures on power relations and identifying the major conflicts of interest related to power and politics. Linking poverty to governance must be considered along the following dimensions: the ability of the poor to articulate and voice their concerns, the responsiveness of the state to those concerns and how agents can be held accountable for their decisions.

The paper explains why there is a need for power analyses and how they can be beneficial. The studies conducted across five different countries have contributed to improving the quality of engagement. Moreover they facilitated a deeper understanding of formal and informal social, political, economic and institutional dynamics. Power analyses also highlighted the risks and opportunities present in the process. Heightened awareness of the risks involved in the programmes led to the adoption of alternative approaches in place of traditional technical interventions that ignored elitist opposition. Furthermore the analyses led to a more rigorous understanding of the process of change. In particular formal and informal power relations and the incentives of relevant actors were considered in greater depth. Creating a dialogue with donors appeared useful in challenging donor assumptions about pro-poor reform and considering a range of perspectives. A common understanding by donors of the political economy challenges also facilitated harmonisation.

Challenges in conducting power analyses remain, but the paper makes certain recommendations to address them:

- Synergies can be made by facilitating discussion between groups that do not normally interact.
- Donors should invite local actors to scrutinize the implications of their decisions. The value of promoting public discussion deserves greater attention. Active dissemination and engagement can create opportunities for constructive dialogue.
- Designing diagnostic tools remains a challenge. Sida suggests that operational recommendations are specifically asked for in the terms of reference.
- There should be clearer incentives for staff to implement power analyses.
- Links should be made between human rights based approaches and power analyses, as the latter can explain why some groups may be discriminated against.
- Challenges for harmonization remain, because power analyses often conflict with donor aims to demonstrate a short-term impact. Sida suggests that a starting point in the challenges facing donor harmonization attempts may be to have a discussion based around the state dynamics of PFM. This could bring together donors and creditors with an interest in PFM as well as donors who highlight civil society as a driver of change.

The paper identifies some difficulties in conducting such analyses. First local experts and researchers are needed to examine deep rooted structures within the community. The complex nature of the analysis also requires the commitment of senior management. Second the concept of power is fundamentally contested. For example, power can be interpreted as the ability to do something, as capacity (i.e. who is the winner who has power over others), as a relational phenomenon or looked at in terms of how productive it is. Third, if the discussion of power is not linked to poverty, issues such as the political culture and political will in addressing the plight of the poor will be missing from the analysis. Finally the effect of international aid transfers may change the dynamics of power in poor aid recipient societies and have not yet been considered in the analyses.

Publisher: *Swedish International Development Cooperation Agency (Sida)*

Key Themes: Power analysis, drivers of change, structure of power

Stapenhurst, R. (2004) “The Legislature and the Budget”

This paper examines the legislature’s role of financial oversight of the budget and considers the lessons that have emerged from a decade of legislative development and reform. It highlights the importance of legislative involvement in the budget. The paper also suggests how the role of legislatures can be strengthened in the budget, both ex ante and ex post. Although much of the legislature’s influence depends on institutional arrangements, strengthening the research and technical capacity of the legislature can increase its role in the budget ex ante. Improved follow-up procedures, good relationships with auditing institutions and participation of civil society can all strengthen the role of the legislature ex post. However, donor efforts to assist in these measures often fail due to a lack of political understanding.

Ex ante legislative involvement in the budget has been debated in the literature. On the one hand it can hinder fiscal discipline, but on the other hand it provides a crucial way of incorporating the preferences of the public and reflecting national consensus. Legislatures may seek public input and can therefore be the entry point for influence from business groups, academics, civil society groups and the media. Therefore the author argues that legislative involvement in the budget process ex ante is desirable. The degree of legislative involvement in the budget ex ante can depend on many factors. The form of government is one of these factors, i.e. whether the state has a presidential or parliamentary system. Budgeting is ultimately an expression of power and thus the de facto influence the legislature has depends on political party majorities, as coalitions provide legislatures with more power. Furthermore the existence of a legislative research capacity can lead to more meaningful contributions to budget formulation. Specialised budgetary committees involved in in-depth technical analysis and debate, can also provide the legislature with a more important influence in budget formulation.

The desirability of legislative involvement in the budget ex-post is less controversial than ex ante involvement. If the legislature’s role in the budget ex-post is effective, their recommendations based on audit findings will be reflected in future budgets. Often the auditors report to parliament and to a specialised committee (Public Accounts Committee or PAC). The interaction between the legislature, the auditor and the committee differs substantially between countries. In general, however, financial oversight is greater if there is a good relationship between the auditor general and the PAC, as the PAC requires timely auditing and the auditors need the PAC to ensure audit outcomes are taken seriously. Recent survey findings show that obliging governments to give a formal response to committee reports or allowing the public and the media access to meetings can improve financial transparency. The author notes that provisions for an effective PAC include: having a broad scope and mandate; having the power to undertake effective analysis and publish the conclusion; effective follow-up procedures and strong support from the auditor general and parliamentary research staff. However, the effectiveness of the PAC can be constrained by a lack of willingness of the executive to respond to criticism, lack of public or media attention and weakness in the ethical culture within the executive and legislature. Therefore follow-up procedures and the supporting role of civil society can increase the effectiveness of the role of the legislator in the budget ex post.

However, donor assistance that aims to strengthen the legislature has provided mixed results. The author argues that the primary reason for this is that donors often do not consider the political context. Political will is a prerequisite for legislative strengthening. Therefore reformers must acquire an in-depth knowledge of the political environment. Furthermore legislative strengthening should be seen as complementary to governance improvements. It must be part of broader agenda to improve the PFM system, enhance government accountability and train participants in various interest groups and stakeholder organisations. Legislative strengthening is a long term process, but political time constraints imply that visible short term results are also important.

Publisher: *World Bank Institute*

Key Themes: legislative oversight of the budget, reform of the legislature's role in the budget, accountability

Stevens, M. (2005) "Effective States and Engaged Societies: Capacity Development for Growth, Service Delivery, Empowerment and Security in Africa"

This paper provides an analysis of public financial management (PFM) capacity building in Sub-Saharan Africa (SSA) in order to draw lessons for the Capacity Building Task Force. The paper does not attempt to provide a comprehensive assessment of all the broad areas of public financial management (PFM). Rather it aims to identify the central issues in SSA that affect all parts of government. The author emphasises that PFM capacity building is not just skills training, but includes a focus on processes, institutions and incentives involved in budgetary processes. Therefore there is a great overlap with PFM reform more generally. If donors can help countries be more successful in PFM reform, PFM capacity will grow as a result. Some suggestions are provided for successful PFM reform.

Countries in SSA have on balance improved their PFM performance since where they were in the 1980s. However, major governance challenges still remain. Donor studies have provided both countries and development partners with a framework for capacity building. Public Expenditure Reviews (PERs) have increasingly recommended that countries adopt Medium-Term Expenditure Frameworks (MTEFs) as a basis for budgeting. They have also pointed to the need for a deeper understanding of country PFM systems and led to the development of specific diagnostic statistics. Efforts to build PFM capacity have included creating independent revenue agencies and debt management offices, installing management and information systems, making the audit process more independent through training and laws, updating financial law and regulations and public procurement reform.

Results so far show that there have been upward trends in PFM performance indicators. Comprehensive measures of PFM performance such as the HIPC-Expenditure Tracking indicators have shown this, although they have not existed long enough to confirm any long-term trends. However, broader measures, such as CPIA indicators have shown PFM improvements over a longer time frame. Budget capacity, aggregate control and the revenue side seem to have mostly improved. However, the efficiency of spending is still undesirably low. It is unclear whether capacity building in audit and passing of new procurement laws have led to improvements. The introduction of new legal frameworks has had mixed effects in different countries, showing some success, but being undercut in others. Experiences with the

installation of integrated financial management systems and MTEFs have also included success and failures.

Informality still remains a critical challenge to PFM reform. Proponents of reform must understand these informal rules and ultimately seek to bring them in line with formal rules. The World Bank has found that most countries have performed well in the area of aggregate fiscal discipline. There has also been much progress in allocating resources to priority sectors. However, the area in which progress is less clear is the efficiencies and effectiveness of public goods provision. Low public sector salaries have led to staff augmenting their income on budget and off budget. A lack of investment in improving the work environment has exacerbated the low levels of efficiency. Therefore informality and opportunism continue to weaken budget execution.

The author suggests some ways of building a strong PFM structure in governments. As a first step he advocates putting in place a robust measurement framework to provide a basis for dialogue between development partners and governments. Using the 28 indicators of the PEFA performance framework is a promising way to do this. Country ownership is also important and it is now widely recognized that conditionality cannot drive a reform programme. Donors have been concerned about aid fragmentation, which undermines the unity of the budget. A response to this is aid harmonization, which seeks to reduce the transaction costs of aid. Budget support is a powerful way to achieve this. This has spurred the debate about whether PFM should reach a certain standard before budget support is provided. It seems likely that a flexible threshold is necessary. Much PFM dialogue has emphasised that the priority should be on establishing 'budget basics'. The author also recommends that the ministry of finance be strengthened and the legal framework re-examined. PFM reform must be synchronised with wider civil service reform, because a pay reform is needed to improve the incentives of staff. Finally legislative scrutiny and transparency must be improved. Capacity building outside government dimensions is also worth supporting; even in very corrupt countries where short run change is unlikely.

The author also highlights the need to pay more attention to design and sequencing issues and cautions against technically over-ambitious reforms. An example is the introduction of an Integrated Financial Management and Information (IFMIS) when the required expertise is lacking. Different countries will have different entry points. Brooke's 'platform approach' to PFM reform provides some suggestions for sequencing reform. The adoption of a properly developed MTEF is undisputed. However, cases of MTEF failures show that it is important to understand the prerequisites for successful MTEF development. Basic governance conditions may be absent in some countries. The design of MTEFs and the sequencing of development activities are crucial for the success of MTEFs.

Publisher: World Bank (Draft)

Key Themes: PFM capacity building, PFM reform, measuring PFM progress

Von Hagen, J. (2005) "Political Economy of Fiscal Institutions"

This paper strongly argues that the design of fiscal institutions has important consequences for budgetary outcomes (deficits, levels of spending and composition of spending). The argument rests on the theory that different decisions will be made under different institutional arrangements of the budget process. Therefore institutional reform can improve fiscal

efficiency, under the right circumstances. However, the paper shows that different political and constitutional environments appear to demand different institutional solutions to these problems. Historical evidence shows that because changing institutional arrangements requires an extraordinary effort, policy makers will only reform if there is an acute fiscal problem.

The paper looks at three institutional mechanisms that deal with the principal agent problem and the common pool in public finance. The principal agent problem arises between voters and elected politicians arises because the complex and uncertain nature of the economic and political climate implies only incomplete contracts can be written. Thus opportunities for rent-seeking arise. The common pool problem arises because targeted policies are funded by a tax fund that everyone contributes to. Therefore while costs are incurred by everyone, the benefits only accrue to a particular segment of society. This leads to excessive spending. Fiscal institutions can mitigate these problems. This paper reviews the effects of three kinds of institutions: fiscal rules, electoral rules and the design of budget processes.

Ex ante fiscal rules are numerical constraints on certain budgetary aggregates that aim to control politicians. The empirical evidence reviewed in this paper suggests that the effectiveness of fiscal rules is limited as they are usually circumvented. Ex ante limits on sub-national government deficits can be problematic if they do not own a sufficiently strong tax base. There is mixed evidence of their effect on macroeconomic stability and efficiency of fiscal policies.

Electoral rules can promote accountability and competition, which can help mitigate the principal-agent problem. They can also determine how profitable it is for politicians to favour majority or minority groups, thus affecting the common pool problem. Countries have different combinations of electoral rules, electoral formula that translate votes into seats and ballot structures. However, empirical analysis has identified some broad trends, which show that electoral rules matter for public spending. Persson et al. (2000) find proportional representation is associated with higher levels of corruption than plurality rule. Persson and Tabellini (1999) find that plurality rule elections and presidential government are associated with lower levels of general public goods than proportional representation and parliamentary government.

The design of the budget process can induce politicians to internalize all their decisions. Thus it can help mitigate the common pool problem. Centralization of the internal organization of the budget process will help to do this by ensuring competing claims on public resources are resolved within scope of the budget process. It is well established empirically that centralization of the budget process leads to lower government deficits and debts (Stein et al. 1999, Hallerberg and von Hagen, 1998 1999), as the common pool problem suggests. However, this can be compromised by a lack of transparency, off-budget funds, decisions that depend on developments exogenous to the budget process, non-financial laws that make expenditures compulsory and unreported contingent liabilities.

The author distinguishes between two approaches of centralization: delegation and contract-based. Delegation involves giving authority to a central agent who determines broad parameters of the budget and then enforces penalties for spending ministers who consistently defect. The contract approach involves binding budgetary agreements on a set of fiscal targets which are negotiated by all members of the executive at the start of the planning stage. The

author suggests that the institutional choice between the two approaches depends on the political context, in particular on the number of parties in government. He advocates the delegation approach for single-party governments, because spending minister and the finance minister must have the same set of basic spending preferences. In contrast the contract approach is more suited to multi-party coalition governments, because adherence to fiscal targets is less credible for a single party government who can walk away from them with no further consequences. Elections based on plurality rule are more likely to have a one party majority, whereas those based on proportional representation are more likely to yield coalition governments. Therefore the electoral rules of a country may determine which institutional design of the budget process is more effective. More research is needed on the interaction between the budget process and constitutional arrangements.

Publisher: Governance and the Efficiency of Economic Systems (GESY) Discussion Paper

Key Themes: Institutional design of the budget process, electoral rules, influences on fiscal outcomes

Wehner, J., Brösamle, K., Dimsdale, T., Mathiesen, M. A., Merz, T. and Mondo, E. (2007) “Strengthening Legislative Financial Scrutiny in Developing Countries”

There is an increasing trend to moving to direct budget support as a form of aid. This implies that there is a great need for effective legislative financial scrutiny of the recipients’ PFM systems. This report provides recommendations for DFID on how to work with legislatures to improve financial accountability and strengthen recipient countries’ public financial management systems. It also suggests how donor harmonisation and co-ordination on legislative strengthening can be improved. The report builds on Hudson and Wren (2007) and has also been commissioned by DFID.

Using survey data and specific case study materials, the authors outline the challenges to effective legislative scrutiny. These arise from both formal restrictions and informal ones. Formal restrictions on the legislature’s ability to scrutinise the budget can arise constitutionally, such as limited powers to amend the budget or the timing of the budget process. In some developing countries, budget secrecy is a tradition and the legislature is typically not involved in setting strategic priorities. It is not only the institutional and constitutional environment that impacts the effectiveness of the legislature, but also the political context. For example only when conditions such as free, fair elections and freedom of speech exist, are legislators likely to be independent. Clientelism, patronage and using the position of legislator as a stepping stone to the executive position can all hamper legislative duties. Therefore the authors recommend that both the institutional and the political context of a country must be understood to enable successful legislative strengthening work. Other obstacles include lack of transparency and access to sound fiscal data, lack of auditing skills in the public sector and perhaps most importantly divergence between budget plans and execution.

Past and present projects are described and provide some lessons for donor involvement in financial scrutiny. These experiences imply that the political context of a country does not predetermine the success of DfID’s efforts to strengthen legislative oversight. For example in Vietnam, despite the political system being based on a single party, a project aimed at strengthening the budgetary process and the legislature’s oversight capacity, was successful. This success was underpinned by the commitment of key stakeholders including that of the

executive. It is also interesting to note that the project coincided with wider PFM reform, so that the budgetary capacity was simultaneously built at a crucial moment. In contrast the experience of a project in Bangladesh provides evidence of how confrontational politics can hinder the progress of a legislative strengthening project. A project in Sierra Leone was also unsuccessful as issues such as patronage, lack of resources and the de facto subservience of parliament to the executive were not considered. Thus experiences show that the political context of a country does not imply success or failure. However, what does influence the success of a project is ownership and taking the political context into account.

The survey research identifies several broad areas in which donors can help improve legislative strengthening (e.g. technical assistance in legal reform, improving access to information, psychical and technical infrastructure development, budget training, network building and research). The report recommends that DFID should significantly scale up parliamentary strengthening with a long-term view of the reform process. Additionally DFID should seek to enhance coordination on the overall approach to financial scrutiny and to invest in analytic work on effective financial oversight. In particular this report highlights that DFID should consider the wider political context in its legislative financial scrutiny projects and avoid replicating formal institutional models. For fundamental change to result there needs to be a comprehensive approach to legislative strengthening throughout the budget process. Furthermore the authors argue that legislative financial scrutiny strengthening can complement other reform measures. As such, collaboration with other donors to introduce a range of measures may prove most successful.

Publisher: *Department for International Development (DFID)*

Key Themes: Legislative financial scrutiny, donor recommendations

World Bank (2004) “Operationalizing political analysis: the Expected Utility Stakeholder Model and governance reforms”

Identifying technical solutions to public sector reform has proved relatively easier than identifying how the reform can be implemented in a way that makes sense politically. The World Bank’s Expected Utility Stakeholder Model (EUSM) seeks to address this problem. The EUSM identifies the relevant stakeholders and their preferences, simulates possible bargaining dynamics between them and then predicts which groups will form coalitions and support what degree of reform. The note concludes that the EUSM offers “*a comparatively rigorous methodology for analyzing the effects of political incentives on the feasibility and sustainability of policy reforms*”. It is a flexible model as it can be used as a tool for a range of issues where politics and stakeholder interest play a decisive role.

The EUSM goes further than previous stakeholder analyses, which have relied on qualitative assessments of stakeholder preferences to forecast the likely behaviour of stakeholders. It is able to provide an empirical assessment of the likely extent of reform and the accompanying degree of stakeholder support. It does this by using expected utility forecasting techniques at each round of negotiations to simulate bargaining dynamics.

This note illustrates how the EUSM works by applying it to a fictitious middle income country, ‘Anyland’. Pressure from civil society and the media are making corruption in ‘Anyland’ a high profile issue. The procurement process is subject to much corruption and control over this process gives the government significant political clout. Hence stakeholder preferences must

be considered in the design of a politically feasible reform. First rigorous data collection is needed. Interviews with country experts lead to an assignment of numerical values to the value each stakeholder places on reform, the policy stance and relative power of each stakeholder. This information is mapped along a policy continuum to identify the coalitions that support different levels of reform. Sophisticated software then iterates a series of games. It predicts the most likely level of reform, which is the point where no stakeholder can gain from challenging the reform. Repeating the iteration with a change in a stakeholder's stance or power shows how supporting a stakeholder can alter the outcome of the reform process. This helps donors to decide where targeting their efforts would be most effective.

The authors claim that the EUSM, which has been applied to thousands of cases, has a 90% accuracy rate of real-time predictions. However, this refers to a wide range of issues such as corporate mergers and political elections and the note does not clarify what proportion of cases refer to countries with a higher information density. Advantages of the EUSM over a traditional approach include: a structured data collection format, the dynamic nature of the model and the ability to analyse the change in any stakeholder's policy position. However, there are limitations to the EUSM. Most important is the dependence on accurate, timely information. The extensive contextual knowledge required to apply the methodology and interpret the results can also severely limit the use of the EUSM.

Publisher: Washington DC: *World Bank*, PREM Notes

Key Themes: Expected Utility Stakeholder Model, political economy of implementing reform