

CAPE PFM Conference 2007 –Concept Paper

“Tales of the Unexpected: PFM Reforms in difficult environments”

14th & 15th November, 2007

Introduction and Outline of Workshop Objectives

Public Financial Management is the process by which governments raise revenues and allocate, spend and account for public funds. In its broadest sense, PFM encompasses fiduciary concerns as well as the use of public resources to achieve public policy objectives. The performance of PFM systems critically affects the capacity of governments to fund and deliver high-quality public services that are affordable and responsive to the needs of the population. An effective PFM system that produces sound PFM outcomes is therefore considered an important requirement for a well-functioning and accountable government. The reform of PFM systems and processes is everywhere now held as central to the development of more effective states, but the results have been mixed and significant challenges remain.

International experience of PFM reform shows that some countries, notably within the OECD, have succeeded in transforming quite rapidly the quality of their PFM systems. In contrast, PFM systems remain weak in many other countries despite substantial domestic reform efforts and high international investment in those reforms. There is an apparent correlation between countries considered to have a high quality of governance and those that display successful PFM outcomes. Yet, successful PFM reforms have also occurred in the context of relatively poor governance environments, including many low income and transition countries. The reforms in these countries are typically more modest in their pace and scale, and the impact upon PFM outcomes less strongly pronounced, but positive reforms have nevertheless been initiated, pursued and sustained despite an apparently unfavourable governance context.

The CAPE conference will investigate the relationship between PFM reform and governance. It will look at experience of PFM reform in countries where features of ‘good governance’ are weak or absent, yet where positive changes in PFM systems have occurred or appear to be occurring. The conference will explore what types of PFM reforms have taken place in such ‘unfavourable environments’ and will seek to draw out lessons for how to pursue successful reform. It will consider what factors motivate and sustain PFM reform progress, drawing upon theoretical frameworks and country case studies to advance explanations for the appearance of successful reform in unexpected contexts. The conference will explore whether attempts to understand and address such factors more widely across other countries without apparent reform “pre-conditions” would also make it possible to contemplate an acceleration of improvements in PFM systems and processes in those countries. The contribution of those reforms to broader improvements in governance and accountability will also be considered.

Governance is a sophisticated concept and attempts to define it remain contentious. Standard measures typically include some element related to public financial management quality, but the nature and direction of the relationship between PFM and governance is highly ambiguous. The current good governance and “good enough” governance agendas may not capture the factors that motivate and sustain

successful PFM reforms. Nor do the observed PFM reform achievements in a country necessarily offer a guide to the wider standard of governance. It may be that existing conceptualisations of governance exclude important contributory variables for improved PFM performance. Or the drivers of PFM reform may actually be independent of the quality of governance. Certainly, informal institutions and political economy factors may have a stronger motivating influence and impact than formal governance factors.¹

What is clearly apparent is the need to investigate further the complexity of these relationships and reduce the uncertainty over the direction of causality. A broader view of governance may be required to explain why PFM reforms succeed, allied with a deeper understanding of the interaction between technical reforms, organisational context, institutional setting, and political economy incentives (ODI 2005). In particular, a greater awareness of the influence of political economy factors may be central to the success of PFM reforms and the achievement of improved PFM outcomes.

13 November

19.00 – 21.30 – Speakers’ dinner with CAPE

Venue: RSJ, Coin Street, Waterloo

14 November

9.00 – 9.30 – Registration and coffee

9.30 – 10.00 - Introduction and presentation of workshop concept

Simon Maxwell - Director, ODI – Introduction to the CAPE conference 2007

Edward Hedger – Research Fellow, ODI

Topic: Conference agenda and rationale: CAPE position on PFM reform in challenging environments

10.00 – 11.00 - Session 1: PFM and Governance – How are they related?

The first session of the workshop seeks to grapple with the complexities of the governance concept and the measurement issues it presents. It will also address the relationship between governance and PFM. What do we really know about good governance? Where does PFM fit in the “new” governance agenda? What determines good governance and how does this affect the development of sustainable and effective reform? If governance is bad, can PFM make a difference?

The definition of governance that is commonly used has come to be closely associated with the ‘good governance’ agenda and its emphasis on lowering costs of transacting and limiting the wastage associated with rent seeking. In turn the application of this agenda has become embedded in efforts to inspire growth and reduce poverty in developing countries.

¹ Political economy factors - or the system of actors, interests, and institutional and organisational constraints and incentives which come to bear on public policy making and implementation - are increasingly seen as a fundamental driver of PFM reforms (ODI 2005; DFID 2005; World Bank 2005; Holmes and Evans, 2003).

However, there remains a significant amount of uncertainty surrounding the ‘good governance’ paradigm and its particular conceptualisation of favourable governance. A key critique has been on its push for a standard package of reforms when there remains ambiguity as to which institutions matter most to development and which kinds of governance interventions are most likely to promote development in individual countries and regions. Recent work has proposed several alternative interpretations of this agenda to improve governance in developing countries arguing that significant structural differences in developing country environments demand different governance requirements to promote growth and the standard governance prescriptions although desirable may not actually be implementable in the short turn (Grindle, 2004; Rodrik, 2004; 2006; Khan, 2006; North et al., 2006; Moore and Schmitz, 2007). Khan for instance, argues that the focus of governance conditions in challenging environments should actually be on achievable institutional ‘rules’ and in developing governance capabilities associated with these rules (Khan, 2006).

How we have come to define governance has important implications for how we view its relationship with reforms to PFM systems. The current debates around the good governance agenda signal a high level of uncertainty in both our understanding of good quality governance and the factors which contribute to it. As a result, there is little clarity on what types of governance factors have an impact on PFM reforms and in what ways. It is also not clear whether improvements in PFM systems, as part of the standard package of reforms proposed to improve governance, in turn drive improvements in governance environments. These ambiguities are worth investigating closely. This session will aim to refine our understanding of the relationship between governance and PFM.

Chair: Alison Evans – Director of Poverty and Public Policy Programmes, ODI

Speaker: Sanjay Pradhan - Director of Public Sector Governance, World Bank

Topic: Defining Challenges: What we mean by ‘good governance’ and how is it linked to PFM reform?

Plenary Discussion

11.00 – 11.30 - Coffee

11.30 – 13.00 - Session 2: What do we mean by successful PFM outcomes and performance? How do we measure aggregate PFM reform progress?

This session will try to reach some agreement on what we mean by good PFM outcomes. It will consider how we measure PFM performance and how we can compare them across countries and over time. Given the constraints on the availability of data and its comparability across countries, can we legitimately broaden the definition of PFM outcomes? Would a broader definition help us reach a better understanding of the relationship between PFM and governance?

In order to understand better the nature of the relationship between governance and PFM, it is necessary to define effective PFM outcomes and to measure the performance of the PFM systems that affect those outcomes. The classic stated objectives of PFM reforms are to achieve fiscal discipline, facilitate strategic prioritisation of expenditure, and promote operational efficiency or “value for money” (World Bank 1998; Campos and Pradhan 1999; Schick 1998). PFM reforms across the world have also been influenced by New Public Management reforms in many OECD countries, and their stress on greater public sector efficiency and bureaucratic responsiveness (Manning 2001). These definitions are helpful and are widely

accepted, but they present significant measurement challenges. Measuring and calibrating allocative efficiency and value for money in a way which is either definitive or which permits some sort of grading or ranking for comparative purposes is especially problematic. As a result, international comparisons of PFM performance rarely go beyond issues of fiscal discipline and budget sustainability

In order to overcome an excessively narrow conception of PFM performance, attempts have been made to benchmark the quality of PFM systems and processes. One initiative has focused on identifying those practices which are most likely to promote effective PFM outcomes and then comparing using this “model” as a point of comparison for assessing actual practices. The system of PEFA indicators is among the most developed applications of this approach, but some methodological and comparative challenges remain. These relate partly to difficulties of aggregating individual scores into broader categories of PFM performance and also to the lack of available data across a large number of countries or over a long period of time.

However, a more fundamental issue arises from the complexities involved in attempting to derive comparisons of budget outcomes. Assessment of PFM outcomes at a wider level are determined not only by the outputs of budget process but with the interaction of these outputs with the broader governance environment. The available data on budget processes and institutions tends to conflate outputs of budget processes in terms of the nature of the budget process and outcomes such as the effectiveness of budget accountability mechanisms (Mejia Acosta and de Renzio, forthcoming).²

Chair: Andrew Lawson - Associate, ODI

Speaker 1: Paolo de Renzio - Research Associate, GEGP, Oxford University

Topic: What do we mean by ‘successful’ PFM outcomes and performance? How do we measure aggregate PFM reform progress?

Speaker 2: Carole Pretorius, Independent PFM Specialist

Topic: What is a practical approach to identifying examples of ‘successful’ PFM reform?

Plenary Discussion

13.00 – 14.00 - Lunch

14.00 – 17.30 - Session 3: What kind of PFM reforms have succeeded and why? Reflections from country reformers

This session will use country case studies to explore the experience of PFM reforms, focusing on where successful reform has occurred in challenging environments. It will address a number of questions relevant to policy-makers and researchers. Which are the PFM reforms that have typically occurred in those countries exhibiting a challenging governance environment? In what sequence were the reforms pursued? Why were those particular reforms initiated and pursued? What factors enabled the specific reforms to proceed? What extent did those PFM reforms directly motivate

² This weakness is reflected in a number of assessments and other reviews. These include for instance CPIA indicators on the ‘Quality of Budgetary and Financial Management’ the ICRG indicator on ‘bureaucratic quality’; the Open Budget Index and the Global Integrity indicator on ‘budget process’.

wider-ranging PFM reforms and lead to improved PFM outcomes? How far did the reforms contribute to wider public sector reform and improvements in governance?

PFM reforms are at the centre of current international efforts to support the development of more effective states. Yet despite high and increasing levels of spending on support to PFM reforms, PFM systems are still very weak in many low-income and transition countries (Dorotinsky and Floyd, 2004). Although there has not been comprehensive cross-country comparative analysis of PFM reforms, there is at least a perception that outcomes have not in general been commensurate with the level of investment. A wide range of countries have faced the need to implement difficult PFM reforms in the context of challenging governance constraints. The experience that may be considered and the lessons that may be derived are therefore limited neither by geographical region nor by level of prosperity.

Chair: Malcolm Holmes, Independent PEM Specialist (formerly Department of Finance, Australia; World Bank; and IMF)

Speaker 1: Mario Marcel – Director, Politeia Public Solutions, Chile (formerly Director of Budget Office, Ministry of Finance, Chile; Executive Board Member, IADB)
Topic: Chilean PFM reforms – An example of success in a favourable governance environment

Speaker 2: Sok Saravuth – Manager, PFM Reform Committee Secretariat, Ministry of Finance, Cambodia
Topic: Cambodian PFM reforms using the “platform approach”

Speaker 3: Ranjit Chakraborty – Joint Secretary to the Government of Bangladesh / Project Director, Financial Management Reform Programme (FMRP)
Topic: Bangladeshi PFM reforms

15.30 - 16.00 - Tea

Plenary Discussion

18.00 – 21.00 – Drinks reception with canapés
Venue: Young Vic, The Cut, Waterloo

15 November

9.00 – 9.30 – Coffee

9.30 – 13.00 - Session 4: What are the key explanatory factors underlying successful PFM reform?

Country evidence suggests that successful PFM reform does occur in some environments which are considered to be unfavourable in terms of the quality of their governance. Despite the difficulties in measuring governance, it is possible that a sound governance environment is not necessarily a condition for the achievement of improved PFM outcomes. Drawing on the country experience presented during the first day, the morning sessions on Day 2 will explore the factors that motivate and contribute to successful PFM reform outcomes in countries characterised by unfavourable governance conditions. The sessions will use different theories of change to consider the respective roles and influence of actors both internal and external to the process of government financial management.

Part 1: The first part of this session will look at the role of the civil service and the executive in enabling or constraining PFM reform. It will also consider the relationship between PFM reform and wider public sector reform. What are the lessons and hypotheses for creating an internal dynamic of PFM reform? What factors are critical in which contexts? How can political incentives be harnessed in support of PFM reform? What is the role of institutions in enabling PFM reform to proceed in challenging contexts? Do the “institutional” and “management” perspectives offer competing or complementary explanations?

Political science and economic theory offer a number of possible frameworks for interpreting and explaining the emergence and progress of public sector reforms. It is now widely accepted that explanations of why PFM reforms do or do not occur in certain environments must consider not only the technical reform process, but also the organisational context, the institutional setting, and the wider politico-economic environment. The attitudes of individuals and groups within the government and the bureaucracy towards PFM reform will be powerfully influenced by these factors.

Research into the political economy of budgeting and financial management has found evidence of considerable divergence in some countries between the formal process of expenditure management and the real allocation decisions that underlie that process (Rakner et al 2004; DFID 2007). There are both formal and informal processes at work, with PFM outcomes often dominated by informal practices, which are at variance with the formal rules and yet go unchallenged. Attempts to explain why reforms succeed or fail must therefore look behind the “façade” and understand the factors motivating political decisions about public resource management (Killick 2005).

Other studies on PFM reform effectiveness have focused on the central importance of “strategic vision” and overall reform leadership by the executive, underpinned by an effective change management process (DFID 2005). This interpretation of the reform process places as central the pace and sequencing of change. Any attempts at PFM reform must take into account the political feasibility of the reform progress in the given country context and must address organisational issues alongside technical solutions.

A more theoretical approach to understanding the reasons underlying successful PFM reforms draws upon public choice theory to consider the institutional responses to collective action problems (Dunleavy and Rhodes 1990; Ostrom et al. 2002, Gibson et al., 2005). Where there is high asymmetry of information between governments and other interested actors about PFM performance, governments and bureaucrats may not be motivated to pursue reforms that would benefit the public interest. Political calculations by politicians are strongly influenced by the extent to which non-government actors have access to adequate information and by the level of political competition in the form of credible alternatives (Keefer 2004; Gray 2007). The right institutions or “rules of the game” may reduce this uncertainty and thus act as a countervailing force against state capture and clientelism (Booth *mimeo*). Political economy approaches that consider explicitly the role of institutions either in influencing action or affecting motivation may therefore be central to the success of PFM reforms (Keefer 2004; Chang 2002).

Mapping out the theories of change is not a simple exercise and many of the perspectives do overlap substantially. Two broad frameworks can be conceptualised as “management theory” and “institutional theory”. Although imprecise definitional constructs, they do allow entry points for analysis of country case study experience.

Part 2: The second part of this session will consider how other domestic actors can affect the progress and success of PFM reforms. It will seek to explore what impact domestic accountability mechanisms and institutional checks and balances may in sustaining reform progress and in preventing the quality of reformed PFM outcomes from regressing. How can pro-PFM-reform domestic political alliances seek to achieve greatest impact? What combinations of actors may be most effective in which contexts?

In addition, various domestic “political” actors external to the executive-bureaucratic PFM process may have the capability to influence the initiation and progress of PFM reforms in unfavourable contexts (DFID 2007; Lawson and Rakner, 2005). Depending upon their degree of dominance in the political economy, this could be a strong and positive influence. Key domestic actors that may engage or interact with the PFM reform process are: interest groups and pressure groups; the external audit office; “independent” inspectorates such as anti-corruption commission; opposition parties; the legislature and non-government parliamentarians; civil society and NGOs; business and the private sector; donors; and the media. Evidence from research suggests that such groups are capable of exerting a particularly strong motivating impact upon PFM reforms (Krafchik 2003; de Renzio and Krafchik 2007).

Chair: Andres Mejia Acosta – Research Fellow, IDS

Speaker 1: Nick Manning – Sector Manager, Public Sector Group, LAC Region, World Bank

Topic: The roles of the executive and the civil service in PFM reform

Speaker 2: Ian Lienert - Senior Economist, Fiscal Affairs Department, IMF

Topic: Influence of actors external to the government and civil service, and their importance for PFM reform performance and sustainability

Speaker 3: Carlos Scartascini - Senior Economist, Research Department, IADB

Topic: The political economy of PFM reforms: lessons from research in Latin America

11:00 - 11.30 - Coffee

Plenary Discussion

13.00 – 14.00 - Lunch

14.00 – 16.30 - Session 5: Implications for policy and research

The afternoon session will seek to draw out emerging conclusions from the workshop and to set out the policy implications for domestic reformers and the agenda for future research around PFM reform effectiveness in unfavourable environments. Can lessons be drawn from comparative experience across developing, transition and advanced countries?

Conference Discussant (14.00 – 14.20): Paul Smoke, Professor of Public Finance and Planning, New York University

The conference discussant will review the main arguments and conclusions from Sessions 1-4, refocus the proceedings on the opening questions posed in the concept note and CAPE position, and set the questions for the breakout groups.

Part 1: Breakout Groups (14.20 – 16.00)

Four breakout groups will discuss preset questions that focus on the implications for future policy and practice. The participants will be divided into groups based on their profile. An ODI facilitator will be assigned to each group to keep the discussions focused and to manage the time.

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| 1. Domestic reformers | (ODI Facilitator: Andrew Lawson) |
| 2. Donor community | (ODI Facilitator: David Booth) |
| 3. Consultancy/advisory community | (ODI Facilitator: Malcolm Holmes) |
| 4. Research community | (ODI Facilitator: Paolo de Renzio) |

Part 2: “The Way Forward”: Panel Perspectives (16.00 – 16.50)

Four panellists who are recognised specialists in their fields will be invited to offer short perspectives on next steps and the agenda for further work. The panellists will not act as rapporteurs from the break out groups or summarise the discussions from the groups. Instead they will offer personal perspectives that draw upon the conference proceedings and their own views and experience in relation to the conference topics.

Chair: Paul Smoke, Professor of Public Finance and Planning, New York University

1. **Domestic reform leader:** Anwar Shakhan – National Coordinator of PFM Reform Project, Ministry of Finance, Yemen
2. **Donor public finance specialist:** David Gray – Head of Financial Accountability and anti-Corruption Team (FACT), DFID
3. **Consultant / public finance reform adviser:** Tim Cammack – Senior Consultant, Oxford Policy Management
4. **Researcher / academic on public finance:** Chris Scott – Senior Lecturer, London School of Economics

16.50 – 17.00 - Workshop close – Simon Maxwell – Director, ODI

*Edward Hedger & Zainab Kizilbash Agha
Centre for Aid and Public Expenditure
16 November 2007*

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