

Tales of the unexpected: PFM reform in difficult environments

14 – 15 November 2007

Overseas Development Institute, London, UK



Tales of the unexpected: PFM reform in difficult environments

Session 3

Reflections from country reformers

14 – 15 November 2007

Overseas Development Institute, London, UK

Tales of the unexpected: PFM reform in difficult environments

Mario Marcel

Politeia Public Solutions

14 – 15 November 2007

Overseas Development Institute, London, UK

PUBLIC FINANCIAL MANAGEMENT REFORM IN AN EXPANSIONARY ENVIRONMENT – THE CASE OF CHILE

Mario Marcel

Consultant, Politeia Soluciones Publicas

Budget Director of Chile 2000-2006

CAPE PFM Conference 2007

Tales of the unexpected: PFM reforms in difficult environments

ODI, London, 14-15 November, 2007

COUNTRY BACKGROUND: THE ECONOMY

- ❑ Upper middle income country: per capita GDP at US\$ 15,000 ppp
 - ❑ Small economy in Latin American context: overall GDP US\$ 140 bn, 4th in the LAC region after Brazil, Mexico and Argentina
 - ❑ Strong growth over last 20 years: 6% p.a.
 - ❑ Open market economy, highly competitive, low sovereign risk
 - ❑ Poverty rate: 13,7%
 - ❑ Highly unequal: Gini monetary income before government transfers 0.53
-

COUNTRY BACKGROUND: POLITICS AND GOVERNMENT

- ❑ Presidential system
 - ❑ Returned to democracy in 1990, under Constitution passed by the military
 - ❑ Continuity in governments: last four governments from the same coalition
 - ❑ Unitary state
 - ❑ Relatively small government: general government expenditure 25% GDP
 - ❑ Tradition of honest, disciplined civil servants
 - ❑ Reliance on public-private partnership: infrastructure PPPs, DC pillar with private management in pensions, privatized utilities
 - ❑ Effective government: good record in social indicators, human development, policy effectiveness
-

COUNTRY BACKGROUND: PUBLIC FINANCE

- ❑ Copper revenues important source of funding (10% of fiscal revenues); tax burden 18% GDP
 - ❑ Prudent fiscal management: overall surplus in 16 out of 20 years
 - ❑ Hierarchical budgetary institutions
 - ❑ Emphasis on stabilisation due to volatile revenues: copper stabilization fund from 1986, followed by structural surplus fiscal rule since 2001
 - ❑ Public revenues, expenditure growing at 7% p.a. for 17 years
 - ❑ Net public debt 2007: -5% GDP
 - ❑ Surplus for 2007: 8% GDP, due to high copper prices
-

DRIVERS FOR PFM REFORM

- ❑ Gap between development needs and public resources: education, demographic transition, environment, gender equity
 - ❑ Unsatisfactory outcome of increases in public funding: national health service, quality of education, inequality
 - ❑ Expansionary environment as a threat to fiscal discipline
 - ❑ Fiscal policy under socialdemocrat president 2000, scandals 2003
 - ❑ Rising international standards, pressure from investors, shifting standards from population, media
-

WHAT MAKES GOOD PFM?

1. Macro effectiveness
 2. Efficiency in allocation of resources
 3. Efficiency in use of resources
 4. Transparency
-

MACRO EFFECTIVENESS

- Structural balance fiscal rule (2000)
 - Builds on studies on fiscal policy indicators
 - The rule: annual structural surplus of 1% of the GDP (changed to 0.5% of GDP for 2008)
 - Strict monitoring, transparency, compliance to secure credibility
 - Improves on European convergency criteria on stabilization, monitoring
-

EFFICIENCY IN THE ALLOCATION AND USE OF PUBLIC RESOURCES: PERFORMANCE-BASED BUDGETING

□ Chilean views of PBB:

- Performance information: M&E systems
 - Adapt budget process to use PI
 - Build incentives to performance management in agencies
 - Flexibility for managers to achieve results
-

PBB TOOLS: FACTS AND FIGURES

TOOL	DESCRIPTION	2007
Project appraisal (1975)	Investment projects appraised on the basis of cost-benefit analysis	<ul style="list-style-type: none"> -Appraisals performed by Ministry of Planning on the basis of shadow social price system -Minimum social return required for funding -Online Databank with 300.000 entries --15.000 projects submitted every year
Performance indicators (1994)	Indicators of effectiveness, economy, efficiency, quality of service with goals in budget process	<ul style="list-style-type: none"> -1,600 indicators of economy, efficiency, effectiveness -Adequate size, still need to balance dimensions -Performance reported to Budget and Congress in budget process and CPRs
Program evaluation (1996)	Programs selected annually for evaluation by independent panels, conclusions and recommendations reported to Congress	<ul style="list-style-type: none"> -240 evaluations performed or in progress, 2/3 of gov program spending -Growing share of Impact and comprehensive evaluations -Ministry-Budget agreements assessed and reported to Congress in CPRs
Management Improvement Programs (MIP) (1998)	Annual bonus paid on basis of agency's progress against goals in seven key management areas, benchmark-based approach	<ul style="list-style-type: none"> -Supports institutional performance pay system covering 100% of employees of Central Government -Annual bonus up to 10% of salary, paid quarterly -MIP results reported to Congress in CPRs -75% of staff on maximum bonus -External ISO 9000-type certification -Devolution of financial authority to top performers
Comprehensive Performance Reports (CPR) (1996)	Annual report prepared by every agency on performance against budget, targets, institutional commitments	<ul style="list-style-type: none"> -200 agencies send CPRs to permanent Budget Committee of Congress -CPRs basis for President's report and review by permanent Budget Committee of Congress
Bidding Fund (BF) (2000)	Pool of funds allocated to innovative programs on basis of quality and consistency of bids from ministries	<ul style="list-style-type: none"> -10% of gov expenditure allocated through BF -BF suspended for last half of administration; replaced by standardized template for budget programs

EFFICIENCY IN THE ALLOCATION AND USE OF PUBLIC RESOURCES: PERFORMANCE-BASED BUDGETING

- Some features of Chilean PBB system:
 - Multi-tool
 - Common methodological framework
 - Fully operative
 - Routinized processes
 - Government-wide
 - Mostly centralized
 - Open to public scrutiny
-

TRANSPARENCY

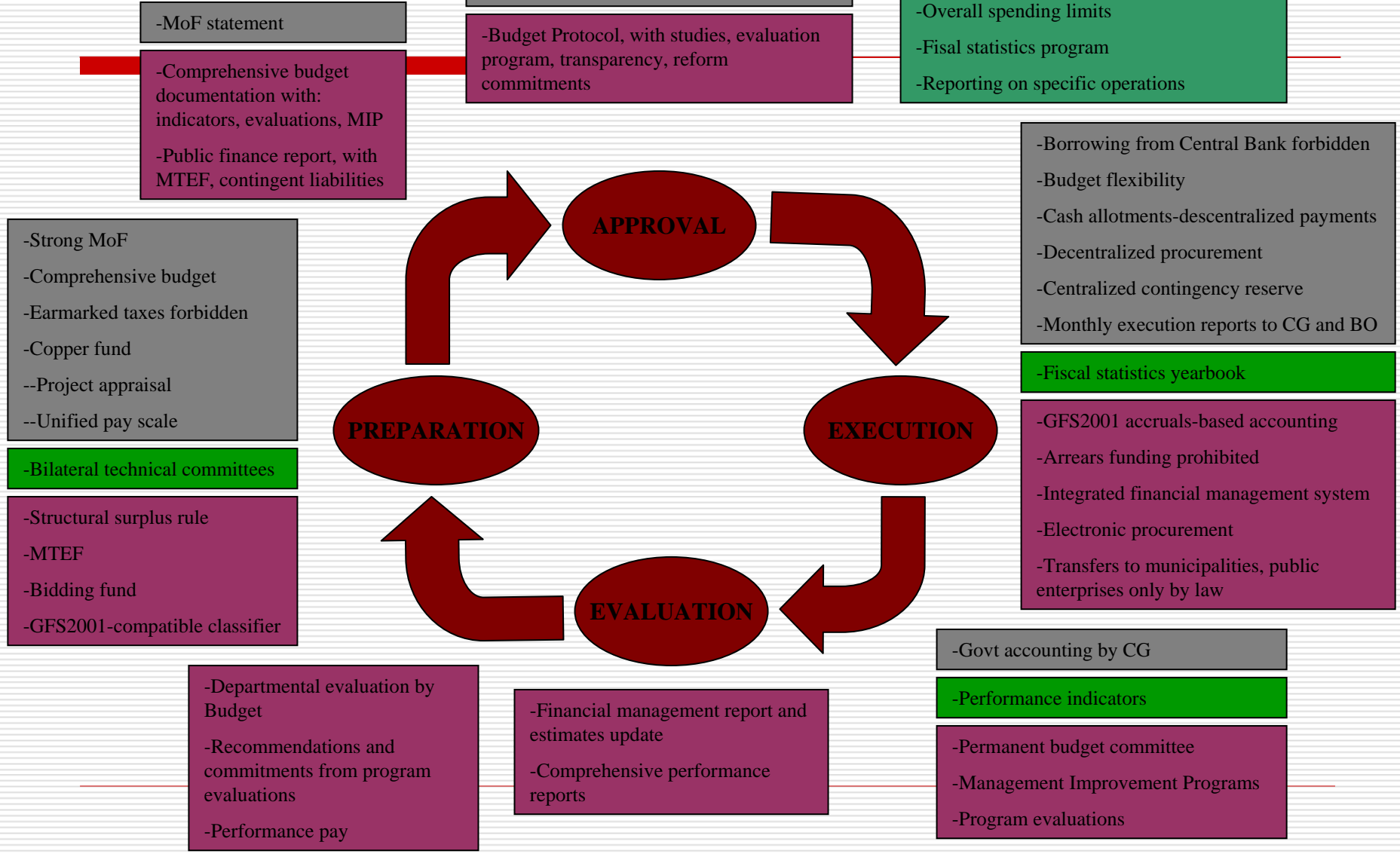
- Adapting budget classifications to ad-hoc program structure
 - Fiscal statistics (2003)
 - Adoption of GFS FMI 2001 standard, accruals accounting
 - Adoption of IMF-UN to functional classification
 - Coverage extended to off-budget central government
 - Publication on monthly, quarterly, annual series starting 1987, semi-annual government debt report
 - Integrated Financial Management Information System-SIGFE(2000)
-

OTHER INITIATIVES

- Medium-term financial outlook
 - Asset and Liability Management
 - Public Finance Report
 - Control of “secret” spending
 - Performance-based pay
 - Civil service reform
 - Government procurement
 - Internal audit
-

BUDGET SYSTEM IN CHILE

- PRE-1990
- 1990-95
- 1996-2004



SUCCESS MEASURES

- Reforms fully operational across central government (60% of government expenditure subject to some form of evaluation)
 - Fiscal policy as an asset in country risk assessments
 - Fiscal policy objectives reconciled with sector policies/goals
 - Orderly expansion of government expenditure at 6% p.a. since 2000
 - Expenditure reallocations: US\$ 1.5 billion 2001-2005
 - Use of PBB by managers, ministers, BO; change in managerial culture
 - Overall effectiveness measures
 - New PFM framework helped to respond to unforeseen restraints, scandals, without loss on consistency
 - Positive external assessments by multilaterals (IMF Fiscal ROSC, CFAA IDB-WB, OECD)
-

THE B-SIDE

□ Failures

- Using indicator-based performance pay
- Sub-institutional team-based performance pay

□ Obstacles

- Outdated external control
- Limited ministerial involvement

□ Pending challenges

- Extend evaluation to policies, subnationals, SOEs, tax expenditures
 - Overall strategic planning
-

SOME KEY ISSUES

- ❑ Is growth and normality more favourable than crisis environment?
 - ❑ Graduality vs. shock treatment
 - ❑ Constructive vs. inquisitive approach
 - ❑ The importance of social dividend
 - ❑ Purpose and timeliness of legislation
 - ❑ Building constituencies and bringing politicians on board
 - ❑ The importance of building a virtuous circle
-

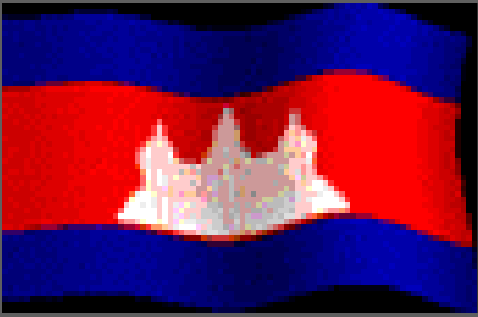
Tales of the unexpected: PFM reform in difficult environments

Sok Saravuth

Ministry of Finance, Cambodia

14 – 15 November 2007

Overseas Development Institute, London, UK



Public Financial Management Reform Program (PFMRP)

*Cambodia Experience:
Four Platforms Toward International Standards*

Kingdom of Cambodia
Ministry of Economy and Finance
London, 14-15 November 2007



Outline

1. Background
2. Achievements and Challenges
3. Next Step and Conclusions

1. 1. Background: Problem Statement

1. Technical issues

- **Fiscal Sustainability:** Medium term sustainability depends on improved domestic resource mobilization and adequate, effective public sector expenditure in economic services to finance the poverty reduction and growth agenda
- **Prioritization of Resource Allocation:** Weakness in both the budget formulation and execution process undermine locative efficiency
- **Efficient and Effective Use of Resources for Service Delivery:** Weakness in treasury operations, cash management, expenditure management, and monitoring and reporting, making the public expenditure and financial management system a source of fiduciary risk

1. 2. Background: Previous Efforts

2. Reform Efforts and Assistances

- Some separated and uncoordinated reform efforts have been undertaken since 1995
- Some individual technical assistances have been provided since 1995
- Technical Cooperation Assistance Program (TCAP) was the first comprehensive and integrated program with better coordination
- No common understanding of problem, unclear objective and strategic plan, short term focus
- Low ownership and low effective/efficient of the reform efforts and assistances

1. 3. Background: Platform approach

PFMRP

International standards of PFM system by 2015

Stage 1(2005-2007)	Stage 2 (2008-2010)	Stage 3 (2011-2013)	Stage 4 (2014-2015)
<u>Platform1:</u> Credible Budget	<u>Platform2:</u> Effective Financial Accountability	<u>Platform3:</u> Affordable and Prioritized Policy Agenda	<u>Platform4:</u> Effective Performance Accountability

2. 1. Platform 1 Objectives

A More Credible Budget

Revenue Policy & Forecasting:

- **Strengthen Macro-Fiscal Framework & Forecasting**
- **Improved Revenue Administration & Collection**

Budget Formulation:

- **Budget process**
- **Comprehensiveness & Integration of Budget**
- **Debt Management**
- **Post Budget Supplementary**

Budget Execution:

- **Streamline Process**
- **Use Banking System**
- **Cash Management**
- **TSA/Bank Accounts Consolidation**
- **Arrears Reduction**
- **Procurement**

2. 2. Platform 1 Achievements

Budget Credibility

key objectives to achieving platform 1

Preparation for later platforms

Revenue
Administration
and
Collection
Has
Improved
Significantly

Budget
Formulation
Has
Improved
Significantly

Budget
Execution
Has
Improved
Significantly

Substantial
Preparation
On
Fundamental
Areas for
Later
Platform
Has
Been Made

Minimum
Requirement
For Capacity/
Institutional
Development
& Motivational
Measure
Has
Been Achieved

2. 2. Platform 1 Achievements (cont.)

Revenue Administration & Policy

Revenue Administration and Collection Has Improved Significantly

- Revenue achieved 114.7% in 2005 and 105.4% in 2006.
- Tax revenue increased by 20.4% in 2005 and 20.2% in 2006.
- Non-tax revenue increased by 6.6% in 2005 and 9.3% in 2006.
- Collection through bank: 46%
- Laws/regulations have been strengthened
- Revenue forecasting has been improved and further improvement on macro-fiscal and revenue forecasting model is under construction.
- Trainings/workshops have been conducted
- Revenue policy framework has been drafted and is under consideration.

2. 2. Platform 1 Achievements (cont.)

Budget Formulation

Budget Formulation Has Improved Significantly

- Budget cycle/process: 3 stages/start from March
- BSP has been used as a vehicle for comprehensive and integrated budget
- New budget classification
- Salary budgeting process has been improved through better coordination and arrangement among LMs, CSS, CAR, and MEF
- Post budget supplementary credit has been cap within contingency fund.
- Mid-year review has been introduced since 2005
- Rev-Exp plan has been introduced in 2006
- Partial amendment of Budget law has been made and full amendment has been drafted.

2. 2. Platform 1 Achievements (cont.)

Budget Execution

Budget Execution Has Improved Significantly

- Expenditure profile

	<u>2005</u>	<u>2006</u>
1 st Qtr	14%	15%
2 nd Qtr	37%	40%
3 rd Qtr	64%	63%
4 th Qtr	95%	95%

- Expenditure by types

Salary	98%	104%
G/S	103%	108%
Capital	95%	82%

- Arrears reduction: 10% in 2005 and 38% in 2006.
- First phase streamline done
- 21 internal audit Departments
- Payment by check: 67%
- Procurement decentralization has been implemented
- Quarterly Expenditure plan has been used for disbursement

2. 3. Preparation for later platforms

Later Platform Preparation

Substantial Preparation On Fundamental Areas for Later Platform Has Been Made

- New COA and Budget classification has been implemented
- Initial design of FMIS has been started
- Internal audit has been introduced
- Expenditure tracking has been piloted
- Partial amendment of Budget Law has been made

- Program budgeting has been piloted
- Full amendment of Budget Law has been drafted and is under consultation
- Fiscal decentralization study and options have been conducted/proposed
- Initial design of state asset register has been started
- Minimum ICT capacity has been achieved

2. 4. Capacity development and Motivational Measures (CD&MM)

CD&MM

Minimum Requirement For Capacity/ Institutional Development & Motivational Measures Have Been Achieved

- Some institutional changes have been made within MEF
- Motivational measures have been undertaken (PMG/MBPI)
- Some training courses, workshops, and study tours have been conducted
- Initial step of functional review and establishment control have been undertaken

- Short/long term training strategies have been developed
- New recruitment has been made for CED, TD, NTRD, and NT
- Minimum ICT capacity has been achieved (computer equipments, networks, database, and some basic computer training)

2. 5. *Challenges*

- Sequential and interrelated works:
 - Macro-fiscal model and time series data availability and reliability
 - Comprehensive/integrated budget and institutional regulation/unpredictable nature of finances
 - Technical change and institutional/human resource management changes (program budgeting/FMIS)
 - Fiscal decentralization and D&D

2. 5. Challenges (cont.)

- Complexity and time consuming:
 - Accrual accounting in the new COA
 - Functional classification in the new budget classification
 - Program budgeting
 - FMIS needs new business process and capacity
 - Institutional/Motivational measures need overall civil service reform policy

3.1. Next Step From Platform /Stage 1 to platform/Stage 2

16 Objectives	63 Activities
- 5 objectives of platform 1 to be continue monitoring in stage 2	- 15 activities to be implemented in order to ensure the sustainability of budget credibility installed during platform/stage 1
- 8 objectives of platform 2 to be implemented in stage 2	- 39 activities to be implemented in order to improve and strengthen financial accountability
- 3 objectives for later platforms to be implemented in stage 2	- 9 activities to be implemented in order to prepare for later platforms

3.2. Next Step

From Budget Credibility to Financial Accountability

Platform 2 Goal	Objectives
Effective Financial Accountability	<ol style="list-style-type: none">1: Improved lines of accountability2. Further improve the implementation of new budget classification and new chart of account3. Introduction of Financial Management Information System4. Improved reporting and transparency5. Improved auditing/inspection and response to/use of audit/inspection findings6. Improved instruments for encouraging responsible financial management and enforcing accountability7. Develop and implement fiscal decentralization policy8. Implementation of the second phase of capacity development plan

3.3. Next Step

Works to be prepared for later platforms in Stage 2

Goals for later platform	Objectives
Program Budgeting, Fiscal decentralization, and long term Capacity Development	<ol style="list-style-type: none">1. Improve and expand the pilot implementation of Program Budgeting2. Develop and implement fiscal decentralization3. Review and further develop the overarching capacity development plan

3.4. Performance Indicators for Stage 2 (PIs)

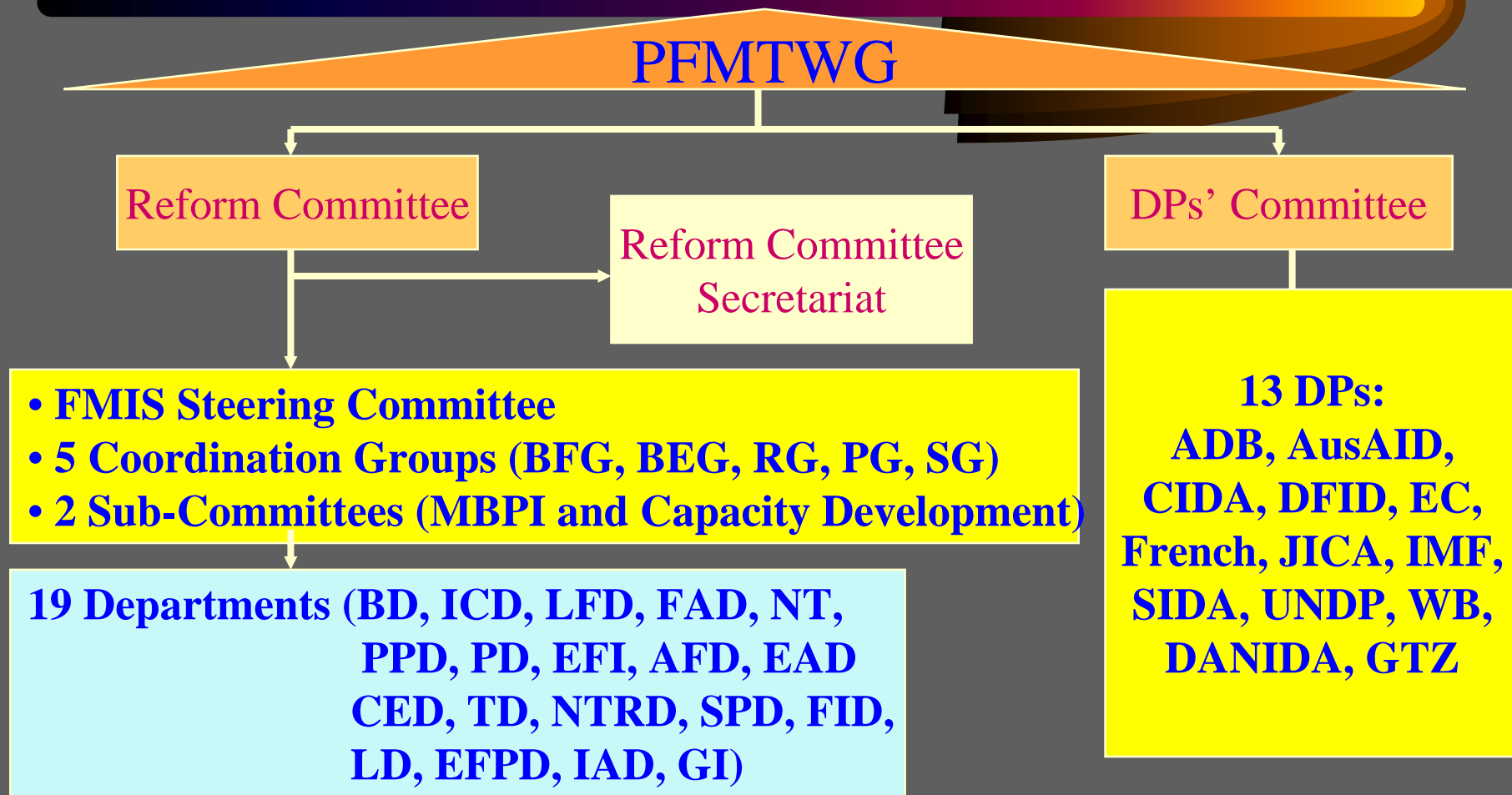
7 indicators from platform 1:
(to continue measuring against the 5 objectives from platform 1 to ensure budget credibility)

(1) Revenue out-turn close to target, (2) no accumulation of new arrears, (3) expenditure profile, (4) Reduction of bank accounts to be closed, (5) composition of expenditure, (6) better tax yield to GDP, (7) single budget process.

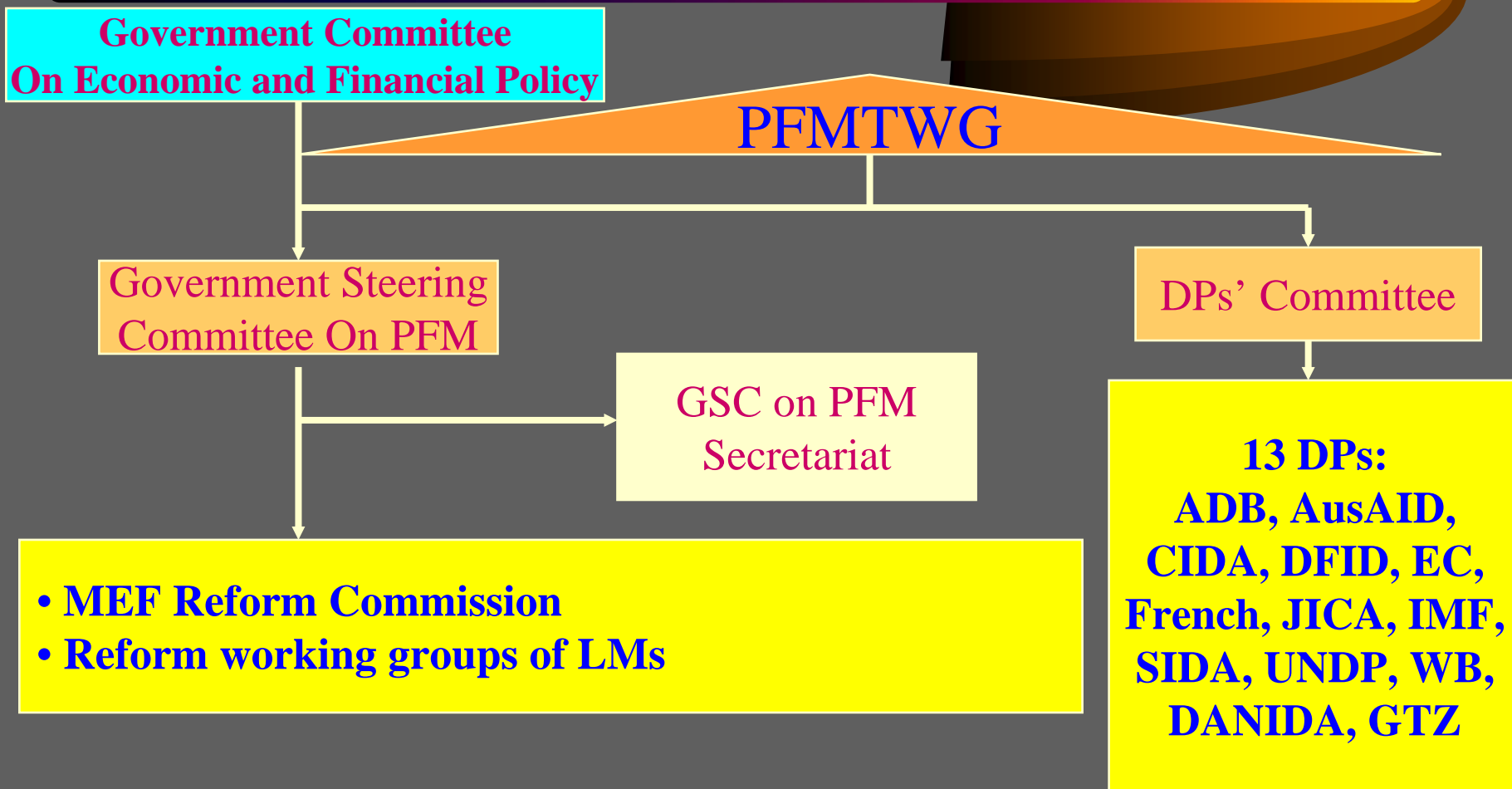
10 additional indicators from PEFA: (to measure against the 8 objectives of platform 2 to ensure financial accountability)

(1) clear rules for both responsibility and empowerment of all budget managers, (2) Core FMIS in place, (3) implement an alignment of COA and budget classification, (4) Taxpayer obligations and liabilities transparency, (5) Transparency in reporting to parliament and to public, (6) clear and transparent fiscal relationships between central and locally based public bodies, (7) clear sanctions in place, (8) clear rewards in terms of trust; freedoms and flexibility, (9) Strong post audit arrangements in place, (10) Minimum capacities established in key line ministries with regards to skill set required for exercising of effective accountability.

3. 5. Implementation Arrangements for Stage 1



3. 6. Implementation Arrangements for Stage 2



3.7. *Conclusions*

- PFMRP is the first most comprehensive reform program with clear objectives and strategic plan
- PFMRP is the first SWAp with effective/efficient coordination and implementation arrangements
- PFMRP has achieved significant results and gained more and more supports
- PFMRP is proving and promising in building Cambodia PFM system towards an international standard through a platform/stage approach
- PFMRP success depended on sustainable commitment, leadership, ownership, capacity development, and motivational measures



Thank You

**Tales of the unexpected:
PFM reform in difficult environments**

Ranjit Chakraborty
Ministry of Finance, Bangladesh

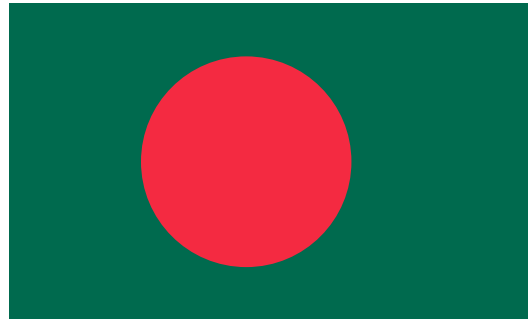
14 – 15 November 2007

Overseas Development Institute, London, UK

2007 CAPE Conference

Overseas Development Institute

Tales of the Unexpected: PFM reform in difficult environments *Experiences from Bangladesh*



*Ranjit Kumar Chakraborty
Joint Secretary to the Government of Bangladesh
Project Director, Financial Management Reform Programme (FMRP)*



Agenda

- The “guiding principles” behind PFM reform in Bangladesh;
- Background, timeline and sequence;
- The Financial Management Reform Programme;
- Achievements in Bangladesh;
- Constraints and Challenges;
- Future PFM Reforms

The Background to PFM Reforms in Bangladesh

Two guiding principles of PFM reform in Bangladesh are:

- It is a “home-grown” initiative, led by Finance Division with a strong champion for change;
- “Evolution not revolution”;



The Background to PFM Reforms in Bangladesh

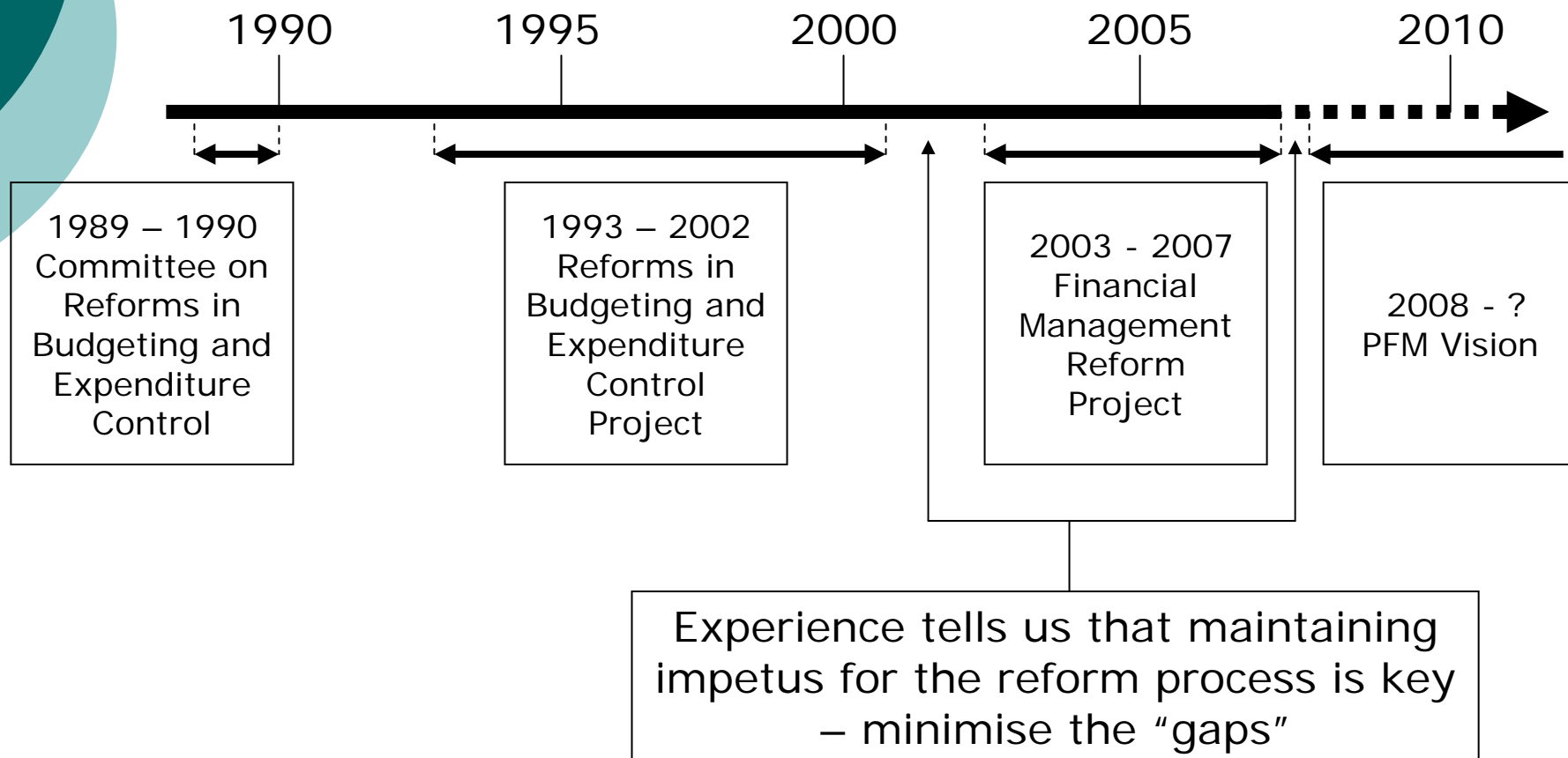
PFM Reforms have been ongoing since the “Committee on Reforms in Budgeting and Expenditure Control” was formed in 1989 ...



The Background to PFM Reforms in Bangladesh

... and a follow-on project will be launched when the Financial Management Reform Programme ends in June 2008

Background and Timeline of PFM Reforms in Bangladesh



Sequence of reform

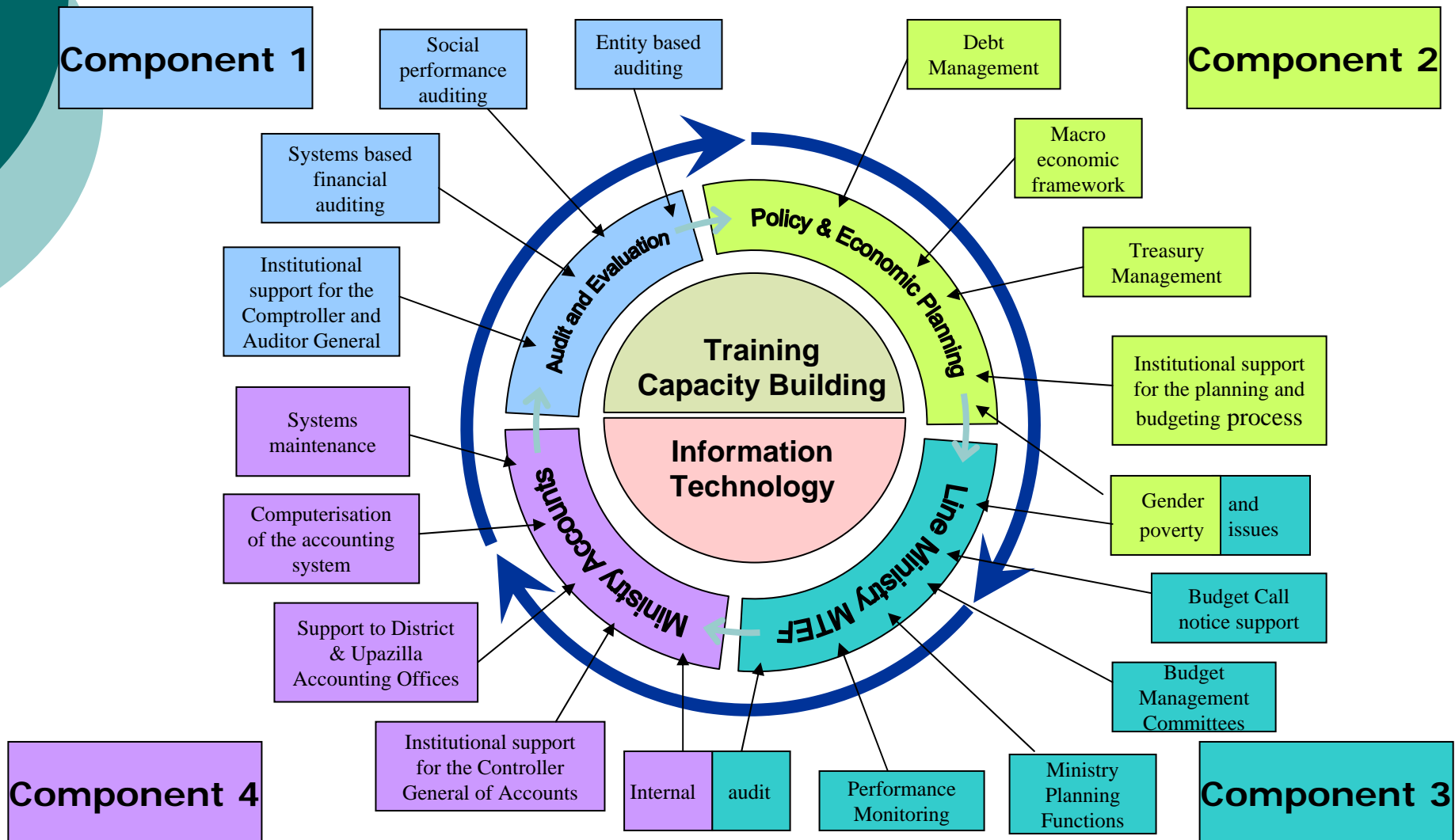
- The 1st phase of reforms focused on technical improvements, including:
 - Consolidation of financial data;
 - Streamlined budget administration;
 - Effectiveness of external audit;

Sequence of reform

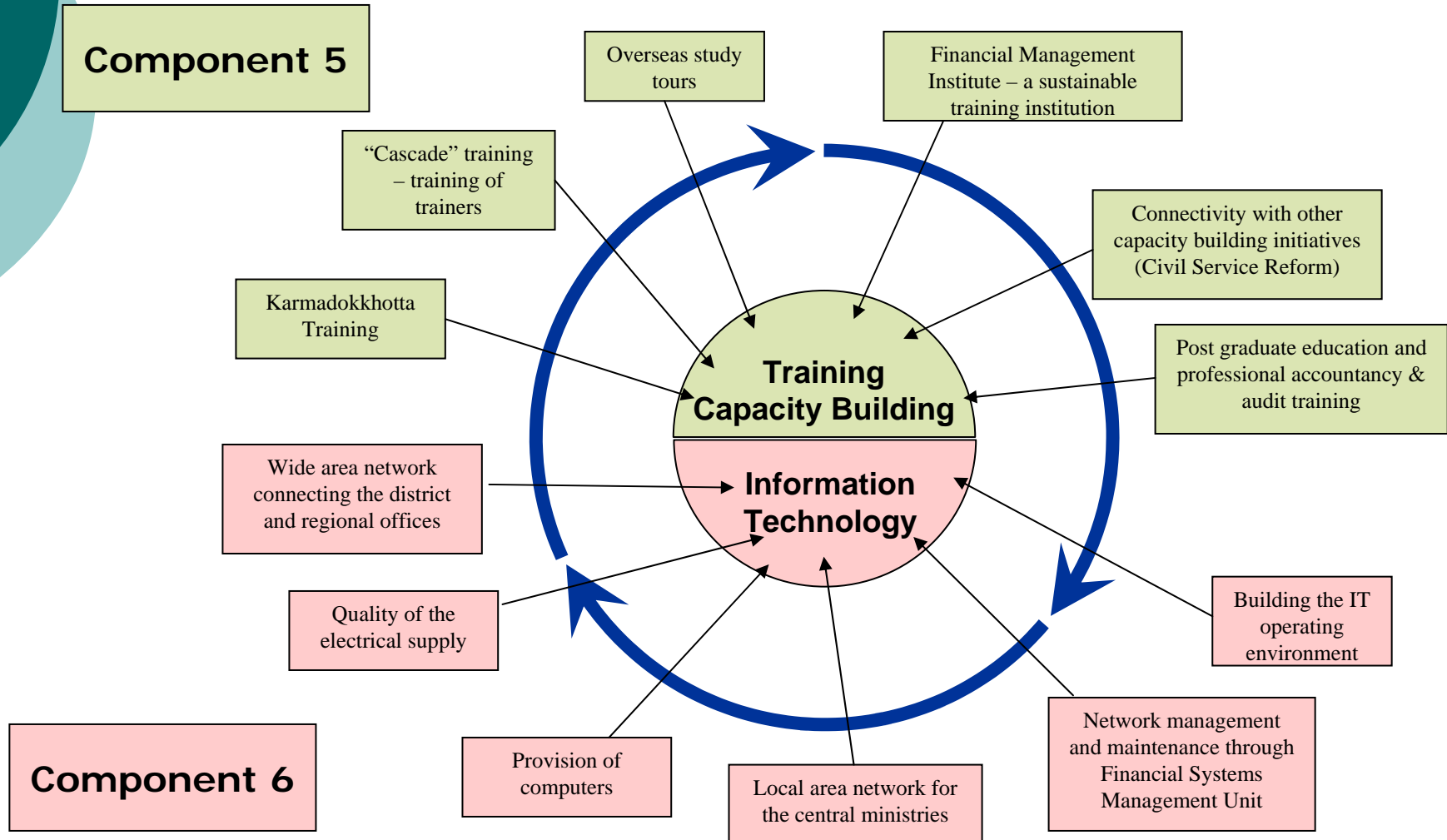
The 2nd phase focused on improvements to resource management, brought about largely by the MTEF:

- Macro modelling, debt management;
- Strengthening the linkage between policy planning and budgeting;
- Devolution of responsibility for planning and budgeting to the line ministries;
- Increased focus on monitoring and evaluation;

Operational Components of the Financial Management Reform Programme



Cross Cutting Components of the Financial Management Reform Programme



Achievements in Bangladesh

- **Computerisation of budget and accounting processes alongside a new classification system;**
- *Impact:*
 - *Improvements to the consolidation and presentation of financial information;*

Achievements in Bangladesh

- **Establishing a macro-fiscal modeling and Resource and Debt Management capability;**
- *Impact:*
 - *Provides more robust data for fiscal planning leading to fiscal stability;*
 - *Enables strategy creation and debt policy;*

Achievements in Bangladesh

- **Systems based auditing and improved level of professional qualification;**
- *Impact:*
 - *The ability to audit a ministry as an “entity” aligns the audit approach with budgetary responsibility;*
 - *The ability to undertake performance and social audits;*

Achievements in Bangladesh

- **Implementation of an MTEF approach to budgetary control;**
- Impact:
 - *Builds linkages between the policy planning and budget setting functions;*
 - *A tool to “operationalise” the poverty reduction strategy at the line Ministry level;*
 - *Builds effective monitoring and evaluation, including the capacity to report more effectively on Gender and Poverty expenditure;*

Achievements in Bangladesh

- **Establishing one of Bangladesh's biggest Wide Area Networks;**
- *Impact:*
 - *Allows the exploitation of modern technology;*
 - *Faster, more accurate and more comprehensive data collection;*
 - *Electronic data links to the banking system;*



Achievements in Bangladesh

- **Enhanced regulatory control through the dissemination of a Public Expenditure Manual, Internal Control Manual and Procurement Act & Regulations**
- *Impact:*
 - *Better operational financial management control;*

Achievements in Bangladesh

- **Setting up a Financial Management Academy to provide training:**
- *Impact:*
 - *A focal point for professional education and ongoing financial management training, (conceptual and operational) – an essential component of ensuring sustainability;*



Constraints over Reform

- A regulatory framework which in many areas goes back decades;
- A base of largely manual accounting systems;
- Large numbers of staff to train;
- High transaction volumes;
- Poor infrastructure, especially in rural areas;



Constraints over Reform

- The Controller General of Accounts' Department:
 - Employs over 6,000 people;
 - Processes approximately 3 million transactions a month;
 - Operates out of more than 500 locations;

Key challenges in implementing reform in Bangladesh

- *The Human Resource implications:*
 - *High levels of staff transfer erode the impact of the capacity building – significant levels of training are necessary just to stand still;*
 - *There is still not full buy-in from some institutions whose processes are affected by changes to the planning, budgeting and evaluations systems brought about by MTEFs;*
 - *Restructuring of Bangladesh Civil Service;*

Key challenges in implementing reform in Bangladesh

- *The roll-out of the computerised accounting systems, particularly to the rural treasury offices:*
 - *The continuity and quality of the electrical supply;*
 - *Appointing staff with the requisite technical skills;*
 - *Carrying out system maintenance, managing upgrades etc;*
 - *Establishing robust reciprocal systems in the banks which interact correctly;*



The Future Direction of PFM Reform

GoB PFM Vision and Goals:

- *Maintain fiscal discipline, macroeconomic stability and pro-poor growth;*
- *Promote the efficient use of public resources in accordance with the government priorities,*
- *Encourage better budget execution and enhanced transparency and accountability;*
- *Strengthen democratic accountability in budget planning and formulation and strengthen independent, external scrutiny;*



Thank You for Your Attention

Tales of the unexpected: PFM reform in difficult environments

14 – 15 November 2007

Overseas Development Institute, London, UK

